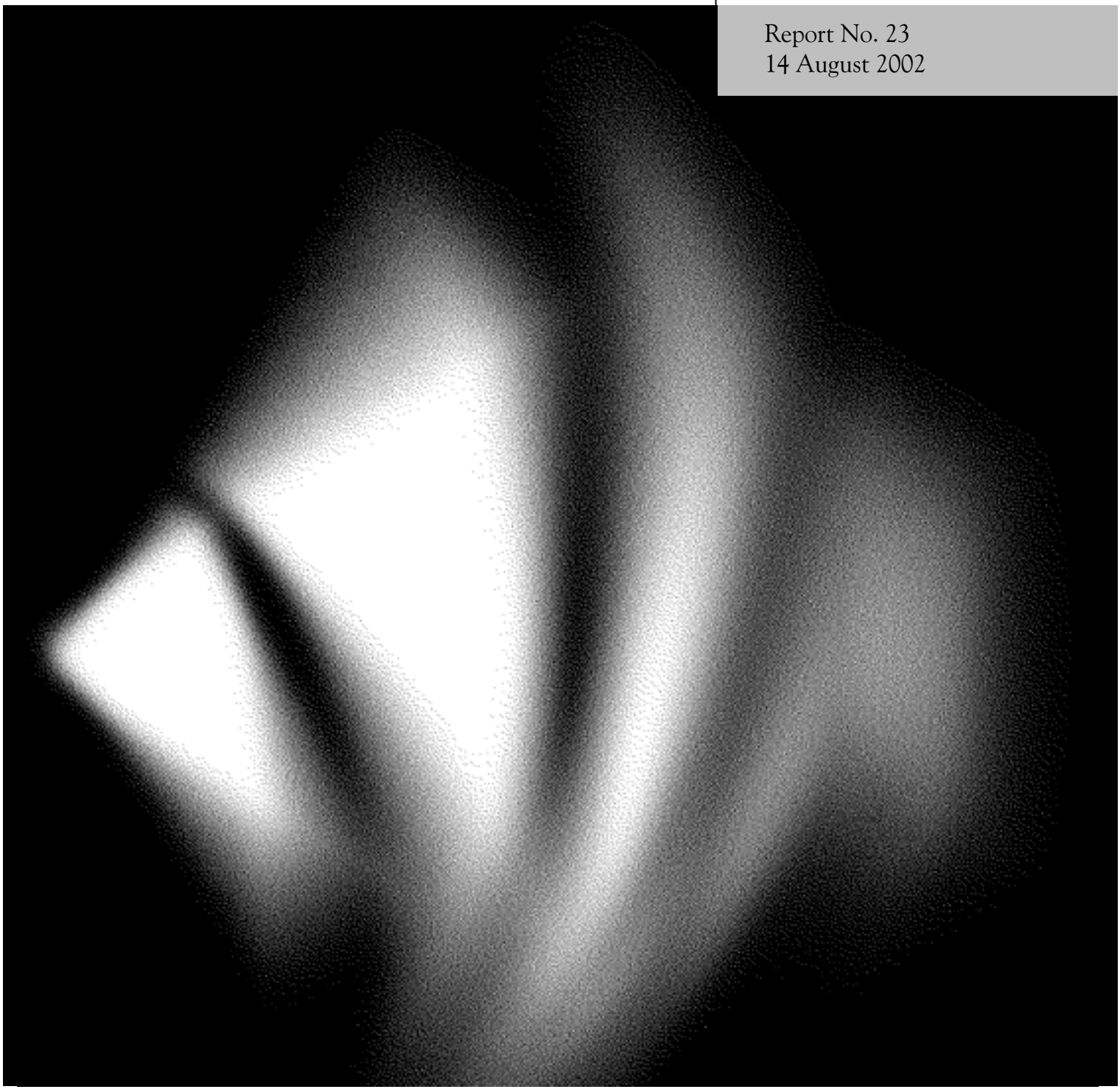
PRODUCTIVITY COMMISSION

Review of Section 2D of the *Trade Practices Act 1974*: Local Government Exemptions

Inquiry Report

Report No. 23
14 August 2002



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PRODUCTIVITY COMMISSION

14 August 2002

The Honourable Peter Costello MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, I have pleasure in submitting to you the Commission's final report on the *Review of Section 2D of the Trade Practices Act 1974: Local Government Exemptions*.

Yours sincerely

Helen Owens
Commissioner

Terms of reference

I, ROD KEMP, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, and in accordance with the Commonwealth Government's Legislation Review Schedule, hereby refer section 2D of the *Trade Practices Act 1974* to the Commission for inquiry and report within twelve months of receipt of this reference. The Commission is to hold hearings for the purpose of the inquiry.

Background

2. Section 2D of the *Trade Practices Act 1974* (TPA) exempts the licensing decisions and internal transactions of local government bodies from Part IV of the TPA. Part IV of the TPA regulates restrictive trade practices.

Scope of Inquiry

3. The Commission is to report on the appropriate arrangements for regulation, if any, taking into account the following:

(a) legislation/regulation which restricts competition should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation/regulation can be achieved only by restricting competition. Alternative approaches which may not restrict competition include quasi-regulation and self-regulation.

(b) in assessing the matters in (a), regard should be had, where relevant, to effects on the environment; employment, social welfare, access and equity; occupational health and safety; economic and regional development; consumer interests; the competitiveness of business including small business; and efficient resource allocation; and to identifying the likely impact of reform measures on specific industry sectors and communities, including expected costs in adjusting to change.

(c) the need to promote consistency between and within regulatory regimes and efficient regulatory administration, through improved coordination to eliminate unnecessary duplication. Particular attention is to be paid to the need for the consistent regulation of the licensing decisions and internal transactions of the Commonwealth, the States and Territories, and local government bodies.

(d) compliance costs and the paper work burden on small business should be reduced where feasible.

4. In making assessments in relation to the matters in (3), the Commission is to have regard to the analytical requirements for regulation assessment by the Commonwealth, including those set out in the Competition Principles Agreement. The report of the Commission should:

(a) identify the nature and magnitude of the social, environmental or economic problem(s) that the exemption seeks to address.

(b) clarify the objectives of the exemption.

(c) identify whether, and to what extent, the exemption restricts competition.

(d) identify relevant alternatives to the exemption, including non-legislative approaches.

(e) analyse and, as far as reasonably practical, quantify the benefits, costs and overall effects of the exemption and alternatives identified in (d). Consideration should be given to the compliance costs and paper burden on small business of the exemption and alternatives.

(f) identify the different groups likely to be affected by the exemption and alternatives.

(g) list the individuals and groups consulted during the review and outline their views, or reasons why consultation was inappropriate.

(h) determine a preferred option for regulation, if any, in light of objectives set out in (3).

5. In undertaking the review, the Commission is to advertise nationally, consult with key interest groups and affected parties, and produce a report.

6. The Government will consider the Commission's recommendations, and will consult with States and Territories prior to making its response, which will be announced as soon as possible after the receipt of the Commission's report.

ROD KEMP

[reference received 22 October 2001]

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Key points

- This inquiry is concerned with section 2D of the Trade Practices Act (TPA) which exempts the internal transactions and licensing decisions of local government from Part IV. Part IV regulates restrictive trade practices.
- There is a universal view that the internal transactions of a local government could not infringe Part IV and that the exemption for them is redundant.
- There are opposing views as to whether, in practice, Part IV would apply to the statutory and regulatory functions (including licensing decisions) of local government.
- The practical effect of section 2D depends on which of the two views is correct:
  - were Part IV not to apply to licensing decisions, an exemption under section 2D would have little, if any, effect and provide limited (mainly intangible) benefits to local government;
  - were the decisions subject to Part IV, then section 2D would provide more substantial benefits to local government and, importantly, to the wider community.
- Irrespective of which view is correct, there are potential costs to the community were a local government both to regulate and compete in the same market. However, there is little evidence of any such anti-competitive behaviour. It would, in any case, be subject to State and Territory competitive neutrality provisions and administrative review mechanisms.
- While retaining section 2D would ensure any existing benefits are maintained, it would not overcome the underlying uncertainty as to the application of Part IV to the regulatory activities of local government.
- In the Commission's view, a provision directly limiting the application of Part IV to the business activities of local governments should be inserted into the TPA. A direct provision would:
  - remove any uncertainty as to the application of Part IV to local government. This would reduce the risk of a local government body's legitimate regulatory decisions being challenged under Part IV and the associated costs of defending such decisions;
  - be consistent with the original intention of the NCP reforms to extend Part IV to all business activities irrespective of their ownership; and
  - define the application of Part IV to local government in a manner similar to that of the other tiers of government.
- Under this approach, section 2D should be repealed, as both exemptions would be redundant.

Overview

Section 2D of the *Trade Practices Act 1974* (TPA) exempts the licensing decisions and internal transactions of local government from Part IV of the TPA. Part IV regulates restrictive trade practices.

Background to section 2D

Section 2D was included in the TPA as part of the introduction of the National Competition Policy (NCP). This policy resulted from an agreement between the Commonwealth, State and Territory governments in 1995 to implement a package of measures to improve economic performance by enhancing competition in the delivery of goods and services.

The general intention of the NCP reforms, as noted in the second reading speech of the Competition Policy Reform Bill 1995, was to extend Part IV of the TPA to all business activities, irrespective of ownership. It was also recognised that while governments undertake both commercial and non-commercial functions, these reforms were 'not designed to affect the non-commercial functions undertaken for governments'.

Thus an important component of the NCP package was that the restrictions on anti-competitive behaviour in Part IV apply to all sectors of the economy, including unincorporated business enterprises and the business activities of State, Territory and local governments. Prior to this, constitutional limits on the Commonwealth's power had confined the application of the TPA to financial and trading corporations and the business activities of the Commonwealth. The relevant section, 2B, was specifically inserted to define the application of a number of parts of the TPA, including Part IV, to the business activities of the State and Territory governments. This has the effect of removing the 'shield of the Crown' from such activities.

In addition, section 2C was inserted to provide a list of certain 'non-business' activities of the Commonwealth, State and Territories that are outside the scope of Part IV. The non-business activities listed include licensing decisions, internal transactions and the collection of taxes, levies or fees for licences.

Local government, of itself, has never had the 'shield of the Crown'. Following representations from local government interests requesting equivalent treatment, section 2D was inserted in the TPA to specifically exempt the licensing decisions and internal transactions of local government bodies from exposure to Part IV. However, local government was not provided with all the exemptions it called for — including for collecting taxes, levies or fees for licences and from prosecution and financial penalties. Unlike the other tiers of government, there is no specific provision defining the application of the TPA, including Part IV, to local government or its business activities.

As part of the NCP package, the Commonwealth, States and Territories also agreed to review regulations which have the potential to restrict competition. This inquiry into the section 2D exemptions for local government is occurring in accordance with that legislation review process.

Approach to the review

The guiding principle under the legislation review process is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.

As both criteria must be satisfied, the onus is placed on those seeking to retain legislative restrictions on competition to 'build a case' as to their wider community benefit. Specifically, in regard to section 2D, the Commonwealth Government has asked the Commission to examine:

- the objectives of the exemptions and the nature and magnitude of the problems that they seek to address;
- the extent to which the exemptions restrict competition;
- the benefits, costs and overall effects of the exemptions; and
- any alternatives to the exemptions, including non-legislative approaches.

In undertaking its assessment, the Commission has been directed to take account of various matters, including the likely impacts of any changes to the current arrangements and the need to promote consistency in regulatory arrangements between the different tiers of government.

What is the impact of section 2D?

The two exemptions from Part IV provided by section 2D differ in their impact. The exemption for the internal transactions of local government has no real effect as it is not legally possible for an individual entity to carry on a business with itself. A transaction that is entirely internal to a local government therefore cannot infringe Part IV. This exemption is redundant.

The effect of the licensing exemption is unclear as there are opposing views as to the application of Part IV to the licensing activities of local government.

One widely held view of participants, including most State and local governments, was that in the absence of section 2D, licensing activities would be unlikely to be actionable under Part IV because they are considered to be part of local government statutory and/or regulatory functions and would fall outside the scope of the TPA. The other view was that Part IV applied to all the regulatory activities of local government, including licensing, in so far as they result in anti-competitive conduct.

The Commission sought advice from the Australian Government Solicitor as to the application of Part IV to local government in the absence of section 2D. The Australian Government Solicitor's view was that with the introduction by the State and Territory governments of the Competition Code in 1996, the Part IV provisions would apply to local government 'according to their tenor', irrespective of whether the activities were characterised as statutory or regulatory functions of government.

The practical effect of section 2D on the application of Part IV to local government depends on which view prevails and, to date, this has not been tested in the Courts. If Part IV does not apply to the licensing activities of local government, then section 2D would have little, if any, effect.

Conversely, if Part IV does apply, then the effect of section 2D would be to enable local government to undertake licensing activities without the risk of action under Part IV.

Are there benefits provided by the exemptions?

Were Part IV not to apply to licensing decisions, then section 2D provides no real benefit. However, many participants — the majority of which were local government bodies or associations representing local government — considered that section 2D provided the benefit of overt legal certainty. As such, it removed any possibility that their licensing decisions would be subject to frivolous and vexatious legal challenges which could be costly to defend. They acknowledged any such legal action would be unlikely to succeed. Local government participants also drew

comfort from the formal recognition provided to local government in the legislation and from the partial consistency with Commonwealth, State and Territory governments provided by the exemptions. Such benefits are mainly intangible.

In contrast, were Part IV to apply to licensing decisions, the benefits of the section 2D exemptions would be more substantial. By making these decisions, after due process, local governments fulfil legitimate statutory and regulatory functions which provide community benefits not otherwise obtainable. While any anti-competitive effects should be considered when licensing is undertaken, they should not be the sole criterion for determining community benefit.

Without section 2D, local government bodies could incur litigation costs in defending their licensing decisions. More importantly, to the extent that local government bodies might adapt, and possibly compromise, their licensing activities to avoid litigation, there may well be a consequent loss of benefits to the wider community.

Are there costs attached to the exemptions?

Despite little evidence to date, there is the possibility that the section 2D exemption of licensing decisions could create costs for the community by permitting local governments to impose unjustified restrictions on competition. In particular, this could occur where a local government body is both regulating and competing in the market for a particular good or service (for example, a local government may operate a child care centre and licence private child care centres).

If Part IV were to apply to licensing decisions, then the section 2D exemptions would sanction any anti-competitive licensing behaviour. In contrast, if Part IV were not to apply, then it would be this lack of applicability per se, and not the section 2D exemption of licensing, which would permit any such anti-competitive behaviour.

However, irrespective of the application of Part IV, there are other existing provisions preventing the misuse of regulatory activities for such anti-competitive behaviour. These include State and Territory legislative constraints on the use of regulation by local government, recourse to administrative review mechanisms and competitive neutrality requirements operating in each State and Territory which guard against government businesses being provided with a competitive advantage.

As a result of the interplay of all the provisions influencing local government licensing, the potential costs to the community from section 2D are unlikely to be realised. There would be, in effect, virtually no costs associated with the retention of section 2D.

In summary, the exemption of internal transactions contained in section 2D is redundant whereas that for licensing could provide net benefits to the community.

Options for the future of section 2D

The Commission has considered a number of options, including:

- retain the section 2D exemptions in their current form;
- retain section 2D, but with modifications;
- insert a direct provision into the Act; and/or
- repeal section 2D.

Retain section 2D in its current form

Continuation of the status quo is the simplest option. This would retain any community-wide benefits provided by the exemptions, the extent of which would depend on the view as to the application of Part IV to the licensing activities of local government.

Modify section 2D

A number of modifications were suggested, including clarifying the terminology and extending the range of exemptions included in section 2D.

Modifying section 2D to clarify terminology surrounding the concept of 'licensing' in respect to local government activities was raised by some participants. However, in the Commission's view it is questionable whether the effort needed to clarify key terms in the legislation would deliver any practical benefit, especially if it related to only one tier of government.

A further suggested modification was to extend the exemption for internal transactions to include transactions between local governments and their corporatised business units. It was argued this would ensure similar treatment to that provided to corporations in the private sector. However, there is little point in extending such an exemption, as local governments, being body corporates, are already in the same position as private companies.

Extending section 2D to encompass the non-business activities of the other tiers of government listed in section 2C (imposing or collecting taxes, levies and fees for licences and the acquisition of primary products) as specific exemptions for local

government was also suggested. This would provide local government with some unnecessary exemptions, such as the acquisition of primary products.

Based on the view that the regulatory activities of local government are not subject to Part IV, extending the exemptions would be unlikely to have any practical effect. As with licensing activities, other regulatory activities such as the collection or imposition of taxes, charges and licence fees by governments would not be subject to Part IV. Hence, while there are currently no formal exemptions for these activities, they would be at little risk from actions under Part IV.

Alternatively, were Part IV to apply to regulatory activities (except those exempted under section 2D), the imposition and collection of taxes, levies and licence fees by local government would be exposed to greater risk of actions. In this case, such an exemption (to reflect section 2C) could be of benefit to local government. However, since the inception of the current arrangements there have not been any legal actions to test which view is correct.

A further suggested modification was to extend sections 2A and 2B immunity from prosecution and financial penalties afforded to the Commonwealth, State and Territory governments (but not their authorities) to local government. Such an extension would constitute a more significant change to current arrangements. The immunity applies to all activities of Commonwealth, State and Territory governments and not just to the regulatory activities covered by the exemptions in sections 2C and 2D. This issue is outside the Commission's terms of reference.

Insert a direct provision

Another option was to insert a direct provision as to the application of the TPA to local government in the Act. The South Australian Government proposed that a local government body should be exempt from a number of provisions of the TPA, including Part IV, except where it carried on a business.

While the wider application of the TPA to local government is also outside the scope of this inquiry, a specific provision which exempted a local government body from Part IV, except where it was carrying on a business, could be considered. Such a provision would be similar to section 2B of the Act, which applies Part IV to State and Territory governments.

This approach would remove the legal uncertainty as to the reach of Part IV in relation to local government and avoids the need to specify an exemption for licensing. As such, section 2D could be repealed (as proposed by the South Australian Government).

Repeal section 2D

If the licensing exemption has little or no practical effect, then section 2D could be repealed.

Alternatively, repealing section 2D could result in a loss of community benefits, were local government licensing activities found to be subject to Part IV. Whether such a loss of benefits would be incurred is debatable. The view of the Australian Government Solicitor is that, if section 2D were to be repealed, local government bodies would be considered as authorities of the States and the Northern Territory for the purposes of sections 2B and 2C. As such, they would receive protection not only from Part IV, but also from other parts of the TPA. This may or may not be relevant or desirable, but is also outside the scope of this inquiry.

A number of other participants, including the Australian Competition and Consumer Commission and the NSW Department of Local Government, had a different view and considered that a local government body did not meet the definition of an authority of a State or Territory for the purposes of sections 2B and 2C.

Importantly, until such time as the applicability of sections 2B and 2C to local government was tested in the Courts, there would be considerable uncertainty as to whether a local government body was considered to be an 'authority' of a State or Territory.

The Commission's preferred approach

In the draft report, the Commission put forward two options for improving community welfare for further consideration. The first option was to retain section 2D and the second was to replace section 2D with a direct provision that limited the application of Part IV to the business activities of local government.

In comparing the two approaches, the Commission notes that the NCP reforms clearly intended to extend the regulation of trade practices under Part IV to all businesses irrespective of ownership. It also notes that while retaining section 2D would ensure that any existing benefits to the wider community and local government are maintained, it would not overcome the underlying uncertainty as to the application of Part IV to the regulatory activities of local government.

In weighing up the two options, the Commission considers that Part IV should only apply to the business activities of local government. Thus, a direct provision to this effect would be consistent with the original intention of the NCP reforms to extend

the restrictions on anti-competitive behaviour under Part IV to all business activities irrespective of their ownership.

Importantly, it would remove any uncertainty as to the application of Part IV to the regulatory activities of local government. Such a provision would remove the risk of litigation involving the legitimate regulatory decisions of a local government body and the administrative and legal costs of defending such decisions. It would, in effect, exempt all regulatory activities of local government, including the imposition of taxes, levies and fees for licences.

Moreover, it would avoid the need for specific exemptions such that both existing exemptions — not just for internal transactions — in section 2D would become redundant. Defining specific exemptions is in itself problematic and any omission, by inference, may lead to debate as to whether or not a particular activity was intended to be exempted.

There was broad support for the direct approach from participants, particularly from local government interests. However, there was some concern that changing the existing arrangements may raise definitional issues and other uncertainties in regard to the business activities of local government.

The Commission considers that, given the variety of circumstances that could arise, it would be counter productive to attempt to define a business activity. While the TPA itself provides a limited definition of a 'business', there is considerable legal precedent established as to what constitutes 'carrying on a business' in respect of the Commonwealth, States and Territories for the purposes of Part IV. The definition of a business activity for the purposes of Part IV in case law is considerably more substantial than that used to define the licensing activities of local government under the current section 2D arrangements. Also, there would be the question of whether any such definition should apply to all levels of government.

An area of uncertainty relates to the differential treatment with the other tiers of government if section 2D were to be repealed and section 2C, which lists certain non-business activities of the other tiers of government, were to remain in place. Erroneously, this might be interpreted to mean that any relevant activities listed in section 2C could be considered as business activities when undertaken by local government. Approaches to overcome any such uncertainty and promote consistency in treatment are discussed below.

In drawing on the views of participants, including the Australian Competition and Consumer Commission, there appears to be no 'technical' reason as to why a direct provision would not be feasible. However, as discussed above, there is the potential

that such a provision could be used to sanction the use of local government regulatory activities for anti-competitive purposes.

There has been, however, no evidence that local government has been engaging in such anti-competitive behaviour. Indeed, if a local government body were to use its regulatory functions in such a manner, there are other existing provisions such as competitive neutrality requirements in each State and Territory and, where local governments are regulating on behalf of a State Government, recourse under State Government legislation and administrative review mechanisms, which would address such behaviour more effectively than by providing for legal action to be taken for breaches of Part IV.

On balance, the Commission's preferred approach is to insert a direct provision limiting the application of Part IV to the business activities of local government and repeal section 2D.

Implementing the preferred option

A direct provision limiting the application of Part IV to the business activities of local government should be similar to section 2B, which limits the application of Part IV to the business activities of the State and Territory governments. However, it should not necessarily include exemptions from other parts of the TPA or from prosecution and fines. These exemptions may not be relevant or desirable for local government, but in any case, as noted above, are outside the scope of this inquiry.

Also, as noted, a direct provision removes the need to list exempt activities or provide examples of non-business or regulatory activities, enabling the repeal of section 2D. (A similar argument applies in regard to the other tiers of government, given that they have a direct provision and a number of non-business activities are listed in section 2C as being outside the scope of Part IV.)

Recommending specific legislative amendments to section 2C is outside the scope of this inquiry. However, a number of approaches could be considered to avoid any uncertainty and promote legislative consistency in the treatment of the different tiers of government. Consideration could be given to removing the non-business activities listed in section 2C which are also, in effect, redundant. Alternatively, a direct reference to local government could be included in section 2C or a reference to section 2C added to the direct provision.

To minimise any transaction costs, these amendments to the TPA could be included as part of any other changes arising from the wider (Dawson) review of the TPA currently being undertaken.

RECOMMENDATION

- ***A direct provision be inserted in the Trade Practices Act 1974 to ensure that Part IV of the Act does not apply to a local government body except in so far as the local government body, either directly or by an authority of the local government, carries on a business; and***
- ***section 2D be repealed.***

Summary of findings

FINDING 3.1

There was a universal view that local government internal transactions could not infringe Part IV and that this exemption is redundant. However, the opposing views as to the application of Part IV of the TPA to the regulatory activities of local government have resulted in some uncertainty as to the practical effect of exempting licensing from Part IV.

FINDING 3.2

The benefits provided by section 2D reflect the opposing views as to the application of Part IV to the statutory and regulatory functions of local government. If Part IV were to apply to the regulatory activities of local government, then the benefits would be more substantial.

FINDING 3.3

Irrespective of the application of Part IV to local government, potential costs could arise if a local government body were both to regulate and compete in the same market. However, if it were to use its regulatory powers to provide its business activities with a competitive advantage, any such anti-competitive behaviour would be subject to State and Territory competitive neutrality provisions and administrative review mechanisms. Any costs to the community of section 2D are likely to be insignificant.

FINDING 3.4

Section 2D provides a net benefit to the community, the extent of which is uncertain, reflecting opposing views as to the application of Part IV to local government.

FINDING 4.1

The Commission finds that the net benefits would be greater if section 2D were to be replaced by a direct provision limiting the application of Part IV to the business activities of local government. In addition to the benefits of the existing arrangements, a direct provision would:

- *remove any uncertainty as to the application of Part IV to local government;*
- *be consistent with the original intention of the NCP reforms to extend Part IV to all business activities irrespective of their ownership; and*
- *define the application of Part IV to local government in a manner similar to that of the other tiers of government.*

1 Introduction

1.1 Background

In April 1995, the Commonwealth and State and Territory governments agreed to implement the National Competition Policy (NCP). The policy embodied a package of measures to enhance competition in the delivery of goods and services and thereby to improve economic performance. An important component of the package was provision for the restrictions on anti-competitive behaviour in Part IV of the *Trade Practices Act 1974* (TPA) to apply to all business activities, irrespective of ownership.

At that time, local governments — in contrast to their State and Territory counterparts — were notionally subject to Part IV. However, there was some doubt as to whether aspects of Part IV would have applied directly to them, primarily because their level of business activity would not have been sufficient for them to have been deemed as 'trading or financial corporations'. Legislation subsequently enacted by the States and Territories to give effect to their commitments under the NCP means that the Part IV provisions now apply to the business activities of local governments, irrespective of whether or not they would be regarded as trading or financial corporations. There are opposing views as to whether the non-business activities of local governments, relating to their statutory and regulatory functions, are subject to the Part IV provisions.

The original intention under the NCP was that Part IV would apply to all business activities of government, other than those granted a specific exemption by a State or Territory pursuant to section 51(1) of the TPA. Section 2B was inserted to remove 'the shield of the Crown' and apply Part IV of the TPA to the business activities of the States and Territories. It added to section 2A which removed the Commonwealth's 'shield of the Crown'. No similar provision was inserted applying Part IV to the business activities of local government. In addition, section 2C was added, listing certain examples of the 'non-business activities' of the Commonwealth, States and Territories outside the scope of Part IV. These included 'licensing decisions' and 'internal transactions'. Following representations from local government interests requesting equivalent treatment, section 2D was also inserted in the TPA to exempt the licensing decisions and internal transactions of

local government bodies from exposure to Part IV. (A snapshot of local government is provided in box 1.1.)

Box 1.1 **A snapshot of the local government sector**

Local government plays an important role in Australia's economic and social life.

There are currently around 730 local government bodies in Australia. These bodies and the communities they serve are diverse in character. For example, the Brisbane City Council provides services for over 850 000 people and has an annual budget of more than $1 billion. In contrast, the Murchison Shire Council in Western Australia has an annual budget of just over $1 million and services a population of around 150 spread over more than 40 000 square kilometres. In a number of jurisdictions there are also local government bodies servicing self-contained Indigenous communities. Collectively, around 80 per cent of local government bodies are located in regional, rural and remote areas.

Local government bodies provide a range of services including:

- engineering services (roads, bridges, footpaths and drainage);
- community services (housing, aged care, child care and fire fighting);
- recreational and tourism services (swimming pools and caravan parks);
- waste collection and management and environmental protection;
- regulatory services (land use, buildings etc); and
- cultural services (libraries, galleries and museums).

Provision of water and sewerage services is also a local government function in Queensland, Tasmania and rural New South Wales.

While the majority of these services are provided 'in-house', contracting out of service delivery by local governments is increasing. The services most commonly contracted out include recycling, garbage collection, sanitation, cleaning of community facilities and maintenance of roads and bridges.

Australia-wide, nearly 50 per cent of the revenue to fund local government service provision comes from rates, with a further 25 per cent coming from user charges. Commonwealth and State grants provide a little under 20 per cent of local government revenue (CGC 2001). However, there are significant variations in funding sources across and within jurisdictions. For example, according to the National Office of Local Government (NOLG 2001), grants can constitute as much as 80 per cent of some rural and remote councils' total revenue.

Further information on the local government sector and its activities is provided in appendix B.

As part of the NCP package, the Commonwealth, States and Territories also agreed to review regulations which have the potential to restrict competition. Section 2D

was identified as one such regulation and this inquiry into the section 2D exemptions is occurring in accordance with that legislation review process.

1.2 The inquiry

As part of the review of section 2D, the Commonwealth Government has asked the Commission to examine:

- the objectives of the exemptions and the nature and magnitude of the problems that they seek to address;
- the extent to which the exemptions restrict competition;
- the benefits, costs and overall effects of the exemptions; and
- any alternatives to the exemptions, including non-legislative approaches.

In undertaking its assessments, the Commission has been directed to take account of various matters, including:

- the principle that legislation or regulation which restricts competition should be retained only if the benefits to the community outweigh the costs and if the underlying objectives can be achieved only by restricting competition. (This requirement underlies all reviews under the legislation review process.);
- the likely impacts of changes to the current arrangements on specific industry sectors and communities; and
- the need to promote consistency in regulatory arrangements, particularly in regard to the treatment of the licensing decisions and internal transactions of the Commonwealth, States and Territories and local government bodies.

The full terms of reference are set out at the front of this report. The Commission is to report to the Government by 2 October 2002. The Government has indicated that it will consult with the States and Territories prior to responding to the Commission's report.

1.3 Scope of the inquiry and the Commission's approach

The scope of the inquiry is relatively narrow. In essence, it is concerned with whether Part IV of the TPA should apply to some particular aspects of local governments' activities — namely, their administration of licensing requirements applying to the supply of particular goods and services, and transactions between

different parts of the same local government body. (The coverage of the section 2D exemptions is discussed in detail in chapter 2.)

As such, the inquiry is not concerned with the wider implications of competition policy for local governments' activities and the communities they serve. Nor does it review the implication of competitive neutrality requirements for the provision of goods and services by local government. These matters were canvassed extensively in the Commission's recent report on the *Impact of Competition Policy Reforms on Rural and Regional Australia* (PC 1999). Moreover, the inquiry is not a general review of local government contracting out practices. Also, it is not directly concerned with the application of Part IV to the Commonwealth, State and Territory governments in sections 2A, 2B and 2C.

In examining the section 2D exemptions and formulating its views, the Commission has taken an economy-wide view. That is, as in all of its inquiries, it has sought to identify what arrangements would be in the best interests of Australia as a whole and not just local government.

The Commission's reason for adopting an economy-wide view is that, in many cases, particular pieces of legislation or regulation can have ramifications extending beyond the activities and entities that are directly affected by them. For example, regulations which inappropriately restrict competition can increase the costs of doing business and thereby damage wider economic performance.

A broader review of the competition provisions in Part IV of the *Trade Practices Act 1974* is being undertaken by a committee of inquiry chaired by Sir Daryl Dawson. The Committee is to report to the Commonwealth Government by November 2002 (Costello 2002).

1.4 Inquiry processes

In preparing this report, the Commission has sought to provide the opportunity for a wide range of interested parties to contribute to its deliberations. To this end, the Commission advertised the commencement of the inquiry in the national press and in local government publications and invited public submissions. To help those preparing submissions, it released an issues paper in December 2001. It also established a website (www.pc.gov.au/inquiry/section2d) on which it has placed relevant legislation, inquiry material and submissions from interested parties.

A draft report was released in May 2002 outlining the Commission's options in regard to the future of section 2D.

Informal discussions and submissions

The Commission commenced informal discussions with interested parties soon after it received the reference. The Commission spoke to over 40 groups and individuals, representing a range of interests, including: local government associations; regional groupings of councils; individual councils; State government departments with responsibility for local government issues; a number of Commonwealth agencies, including the National Office of Local Government and the Australian Competition and Consumer Commission; and private contractors providing services to, or in competition with, local government. It also requested advice from the Australian Government Solicitor regarding the application of Part IV of the TPA to those local government activities covered by section 2D in the absence of the exemptions. (Appendix C contains the reply.)

The Commission has also had the benefit of commentary on the issues from 28 written submissions prior to the release of the draft report and 11 submissions commenting on the options proposed for the future of section 2D set out in the draft report. The submissions have come predominantly from local government. Further informal discussions were held following the release of the draft report with Mr Ray Steinwall, the South Australian Government and the South Australian Local Government Association. A full list of those who have made submissions and/or participated in informal discussions is contained in appendix A. The Commission wishes to thank participants for their input and involvement in the inquiry.

Public hearings

The Commission held public hearing in Sydney and Melbourne in June and early July to provide interested parties with an opportunity to comment on the draft report. A list of those participants that presented submissions at the public hearings is contained in appendix A.

1.5 Structure of the report

The remainder of this report consists of:

- chapter 2 which outlines the provisions in Part IV and describes the nature and history of the section 2D exemptions. It also details some other mechanisms that could be used to provide exemptions for the activities covered by section 2D were this particular provision not available;
- chapter 3 which looks at the purpose of section 2D and its benefits and costs; and

- finally, chapter 4 which assesses the possible options and sets out the Commission's recommendation in regard to the future of section 2D.

2 Legislative arrangements

Section 2D of the *Trade Practices Act 1974* (TPA) exempts the licensing decisions and internal transactions of local government from Part IV of the TPA. Part IV regulates restrictive trade practices.

This chapter outlines the provisions of Part IV, discusses the history to the section 2D exemptions and details the legislative arrangements involved and the nature of the conduct exempted. It also discusses other provisions in the TPA that potentially could be of relevance in the absence of section 2D.

2.1 Part IV of the Trade Practices Act

The purpose of Part IV has been described by the Courts as proscribing and regulating agreements and conduct to procure and maintain competition in trade and commerce (NCC 1999). To this end, Part IV restricts anti-competitive trade practices where they have the purpose or likely effect of substantially lessening competition in a market. It includes:

- section 45 which prohibits arrangements that exclude or lessen competition such as:
  - agreements which involve, for example, market sharing or which restrict the supply of goods or services;
  - agreements that exclude or limit dealings with a particular supplier or customer;
  - agreements that fix prices. This includes agreements which purport to 'recommend' prices, but which in reality fix prices; and
  - actions by a person in concert with another that hinder or prevent a third person from supplying or acquiring goods or services or engaging in trade and commerce (secondary boycotts);
- section 46 which provides that a corporation with a substantial degree of power in a market must not take advantage of that market power for the purpose of:
  - eliminating or substantially damaging a competitor;
  - preventing the entry of a person into a market; or

– deterring or preventing a person from engaging in competitive conduct in a market;

- section 47 which prohibits exclusive dealings (ie restricting a party's freedom to choose with whom, or in what, to deal) by a corporation in 'trade or commerce';
- section 48 which prohibits resale price maintenance involving suppliers, manufacturers or wholesalers from specifying a minimum price below which goods or services may be resold or advertised for resale; and
- section 50 which generally prohibits mergers or acquisitions which would have the effect or likely effect of substantially lessening competition in a substantial market for goods or services.

2.2 History of the 2D arrangements

Section 2D was inserted into the TPA as a result of the National Competition Policy (NCP) reforms adopted by the Council of Australian Governments (CoAG) in 1995. The reforms embodied a range of measures to enhance economic performance by facilitating effective competition in the delivery of goods and services. They were implemented through a number of intergovernmental agreements (see box 2.1), the *Competition Policy Reform Act 1995* passed by the Commonwealth Government and subsequent State and Territory legislation.

Extending the Trade Practices Act

An important component of one of the intergovernmental agreements was the Conduct Code Agreement which extended the competitive conduct rules in Part IV of the TPA to previously exempt sectors. Constitutional limits on the Commonwealth's powers had previously confined the application of the TPA to financial or trading corporations and the business activities of the Commonwealth. Unincorporated businesses, such as legal partnerships operating solely within one state, were not subject to Part IV. Furthermore, many State and Territory government businesses had enjoyed 'shield of the Crown' immunity from the Act. This immunity has never extended to local government.

To extend the provisions of the TPA to these previously exempt entities, the *Competition Policy Reform Act 1995* inserted Part XIA into the TPA to provide for the States and Territories to pass legislation to enact a modified (Schedule) version of Part IV, the Competition Code, in each of their jurisdictions. All States and Territories implemented the agreed legislation to take effect from July 1996 (NCC 1997).

Box 2.1 **The National Competition Policy reforms**

The NCP framework consists of three intergovernmental agreements. These are:

- The *Competition Principles Agreement,* which sets out principles for:
  - prices oversight of certain government businesses;
  - putting government businesses on a 'competitively neutral' basis with private sector competitors;
  - reform of government monopolies;
  - reviews of legislation which restrict competition;
  - allowing businesses (third parties) to gain access to some 'essential' infrastructure facilities; and
  - application of the Agreement to local governments.
- The *Conduct Code Agreement,* which establishes the basis for extending the competitive conduct rules of the TPA to all businesses in Australia, including the business activities of government. In this regard, it required each State and Territory to implement legislation to apply Part IV to all persons within a State or Territory.
- The *Implementation Agreement*, which specifies a program of financial grants by the Commonwealth to State and Territory governments — so-called competition payments — contingent on implementation of the agreed reforms.

The NCP also established two institutions — the Australian Competition and Consumer Commission and the National Competition Council.

The Competition Code incorporated in State and Territory legislation reproduces the rules set out in Part IV of the TPA, but modified to refer to 'persons' rather than corporations to enable all businesses and individuals to be covered. It is this reference to 'persons' in the Competition Code that applies Part IV to local government.

In contrast, the Commonwealth, States and Territories are subject to the TPA directly via specific sections in the Act, namely sections 2A and 2B respectively. The Competition Code in each State and Territory includes the Schedule version of Part IV provisions replicating sections 2B and 2C and other relevant regulations under the TPA (see box 2.2). While the Competition Code contains no equivalent of section 2D, it is intended to be interpreted as the TPA is interpreted (Hood 1998).

All enforcement actions are undertaken through a single agency, the Australian Competition and Consumer Commission (ACCC), and legal action is carried out in the Federal Court. This addresses concerns about regulatory overlap for those businesses that would potentially be subject to both the relevant State or Territory Competition Code and Part IV.

Box 2.2 **Amendments to extend the TPA under the NCP**

To extend the TPA in accordance with the intergovernmental agreements, the *Competition Policy Reform Act 1995* made amendments to the TPA and *Prices Surveillance Act 1983*. The amendments to the TPA included inserting the following sections:

- section 2B to apply specific parts of the legislation, including Part IV, to the States and Territories so far as they carry on a business, either directly or by a State or Territory authority, and to provide exemptions to the States and Territories, but not their authorities, from prosecution and financial penalties under the TPA;
- section 2C setting out a list of certain activities of the Commonwealth, States and Territories that are considered not to be business activities for the purposes of sections 2A and 2B and therefore exempt from Part IV. It includes:
  - imposing or collecting taxes, levies or fees for licences;
  - licensing decisions;
  - internal transactions; and
  - the acquisition of primary products; and
- section 2D setting out the exemptions for local government from Part IV of the Act in respect of:
  - licensing decisions; and
  - internal transactions.

Section 2A, which existed prior to the NCP reforms, applied the legislation to the business activities of the Commonwealth. However, section 2A was amended as part of the NCP reforms to provide exemptions to the Commonwealth, similar to those provided to the States and Territories, in respect of prosecution and financial penalties under the TPA.

Prior to these changes, the applicability of Part IV to local government business activities had been unclear. As the TPA only applied to financial or trading corporations (and the business activities of the Commonwealth), some local government business activities may have been subject directly to Part IV and indirectly through their dealings or transactions with trading or financial corporations. However, there was some doubt as to whether aspects of Part IV would have applied directly to local governments, primarily because their level of business activity would not have been sufficient for them to have been deemed as financial or trading corporations.

In addition to the amendments to the TPA, the NCP reforms provided a commitment, under the Competition Principles Agreement from the Commonwealth, States and Territories to implement competitive neutrality requirements for their government businesses and to introduce mechanisms to

investigate complaints about breaches of those requirements (see box 2.3). In the States and Territories, these arrangements also extend to local government business activities. The competitive neutrality requirements are relevant to this inquiry only in so far as those activities of local government referred to in section 2D are potentially subject to these requirements.

Box 2.3 **Competitive neutrality**

Competitive neutrality (CN) requires that significant government business activities should not enjoy any net competitive advantage over those of their competitors simply as a result of their public ownership.

Competitive neutrality does not extend to offsetting competitive advantages arising from factors such as business size, skills or location — factors which are independent of ownership.

Under the *Competition Principles Agreement*, designated government businesses are required to ensure that their prices take account of:

- full attribution of costs incurred in providing the goods or services;
- full Commonwealth, State or Territory taxes or tax equivalents;
- debt guarantee fees (directed at offsetting any competitive advantages provided by government guarantees);
- a commercial rate of return; and
- regulatory costs equivalent to those which their private sector competitors would normally experience.

While local governments were not parties to the agreement, clause 7 of the *Competition Principles Agreement* states that each State and Territory government is responsible for applying CN to local government.

Also, the agreement allowed Commonwealth, State and Territory governments the freedom to determine their own agenda for the implementation of CN principles. This has resulted in differences between jurisdictions in the speed with which the policy has been applied and in how the principles of CN are applied 'on the ground' (PC 1999).

Local government concerns over the extension of the Trade Practices Act

At the time the amendments to the TPA were being considered, local government raised various concerns in relation to the extension of Part IV to their activities. One concern was that the use of policies by local government giving preference to local suppliers in commercial dealings in the purchasing or tendering process could potentially breach section 45 of the TPA.

For example, an agreement, arrangement or understanding between a local government body and another person or firm as part of a 'buy local' or 'preferred supplier' policy may have the potential to prevent others firms or individuals interested in providing the goods or services from doing so and subsequently lessening competition.

In addition, there was concern that certain local government activities may raise issues in relation to the prohibitions on the misuse of market power under section 46 of the TPA. The ACCC (1996) canvassed such a scenario. For example, a decision by a local government to provide a service on an in-house basis, such as rubbish removal or road maintenance could arguably prohibit a potential supplier from being able to compete to provide that service thereby injuring the supplier.

Introducing the exemptions

The original intention in extending the TPA to State, Territory and local governments was that Part IV should apply to all business or commercial activities of government unless specific activities were exempted by a State or Territory pursuant to section 51(1) of the TPA. Section 51, a previously existing section, allows for exemptions for certain activities under specific Commonwealth or State and Territory legislation (see section 2.4). At the time Part IV was extended to local government, Pengilley said:

> The Act in binding local government entities merely provides that these entities, when engaged in commercial conduct, must play by the same rules as others. (1996, p. 202)

In the event, a range of specific exemptions from the TPA were proposed for the States and Territories. The *Competition Policy Reform Act 1995* — which made amendments to the TPA to include section 2B to extend the TPA to State and Territory governments (in respect of conducting a business either directly or through a State or Territory authority) — also provided immunity for a State or Territory, but not to their authorities, from financial penalties or prosecution. Section 2A, was amended at the same time to provide similar immunities from financial penalties and prosecution to the Commonwealth Government. The legislation also added section 2C, which provides a list of certain activities of the Commonwealth, States and Territories considered *not* to be business activities and therefore exempt from the legislation (see box 2.2).

Local government called for a similar range of exemptions to the other tiers of government. In voicing local government concerns, Senator Bell in the second reading speech of the Competition Policy Reform Bill 1995 said:

> The current provisions in the act will leave local government open to possible litigation under the competitive conduct provisions while state governments performing identical

> tasks will not be open to such litigation. Local government is clearly seen as the poor third cousin. This could leave it open for an unscrupulous business to try to use the Trade Practices Act to argue that local government fees were excessive or anti-competitive. It could severely restrict the ability of local government to use its full range of powers to protect the considered interests of local communities.
>
> … Buy-local programs by local governments could be regarded as anti-competitive as could arrangements for preferred suppliers to councils or councils being preferred builders for state main roads departments. Such arrangements ensure the integrity of some local communities and make sure they can maintain a strategic capacity to build or repair, or meet many of the needs that a local community needs to retain to call itself a community. (Senate Hansard 27 June, 1995, pp. 1880–1)

As it transpired, local government was not provided with the exemptions it called for regarding exposure to prosecution and financial penalties under the Act. It was also not provided with an exemption in respect of collecting taxes, levies or fees for licences which was provided as an explicit example of a non-business activity in section 2C and therefore outside the scope of Part IV in respect of the other tiers of government. In the section 2D amendments made to the TPA under the *Competition Policy Reform Act 1995*, the exemptions provided to local government were limited to licensing decisions and internal transactions in respect of Part IV of the Act.

In commenting on the reasons for the different treatment of local government, the House of Representatives Standing Committee on Financial Institutions and Public Administration, in a 1997 inquiry into aspects of the NCP reforms, observed that the differences in the exemptions provided to local government and the non-business activities of the State and Territory governments listed in section 2C were partly explained by 'differences in function carried out by the two tiers of government' (HRSCFIAPA 1997, p. 47). One example of such differences would be the acquisition of primary products by statutory marketing boards listed as a non-business activity of a State or Territory government, but not provided as an exemption for local government. More specifically, the Committee's understanding was that an exemption in respect of collecting taxes, levies or fees for licences was not provided to local government at the time because of a lack of a demonstrated need (HRSCFIAPA, 1997).

The current application of Part IV to local government

While the *Competition Policy Reform Act 1995* inserted section 2D to exempt certain activities of local government from Part IV, it did not define how Part IV was to apply to local government in general. In contrast, sections 2A and 2B define the application of Part IV to bind the Commonwealth, States and Territories so far as the Crown carries on a business. Section 2B was specifically inserted as part of

the NCP reforms to remove the 'shield of the Crown' and allow Part IV to apply to the business activities of the State and Territory governments.

Local government has never had the 'shield of the Crown' and the NCP reforms did not specify the application of Part IV to the business activities of local government.

Mr Steinwall considered that Part IV of the TPA now applies to local government, irrespective of whether or not it conducted a business:

> Section 2D is not couched in same terms of s2A and s2B. Sections 2A and 2B have the effect of applying Part IV to the Commonwealth and State Crown only to the extent that they conduct a business. A local government body on the other hand is subject to the Act irrespective of whether it conducts a business or not. (sub. 19, p. 8)

The Australian Government Solicitor (AGS) was of a similar opinion:

> It is to be noted that there is no general provision that limits the application of the Schedule version of Part IV to bodies that are engaged in business activity. (2002, p. 4)

Furthermore:

> … the individual provisions in Part IV are such that they are all capable, at least in theory, of being infringed by a council engaging in a non-commercial activity. (2002, p. 11)

According to the AGS, Part IV applies to local government through the application of the Competition Code which refers to 'persons' rather than corporations. As the AGS said:

> It [the Competition Code] is therefore not confined in its reach by the limits of Commonwealth constitutional power. It applies generally to 'persons'. Under State and Northern Territory laws relating to local government bodies, such bodies are incorporated and so are 'persons'. (2002, p. 4)

Also, apart from section 47 of the TPA which prohibits exclusive dealing, an entity is not required to be in 'trade or commerce' to be subject to the provisions of Part IV. As Mr Steinwall commented:

> … "trade and commerce" is not a separate ingredient of a Part IV contravention. (sub. 19, p. 6)

In contrast, a number of participants were of the view that, in practical terms, legislation which prescribes and regulates restrictive trade practices is by its very nature only ever likely to apply to business activities. That is, while Part IV, through the reference to 'persons' in the Competition Code, potentially applies to all legal entities, the entity would have to be undertaking a business activity to be subject to Part IV. As Pengilley noted:

> While the various sections of the Trade Practices Act covering restrictive trade practices do not expressly specify that they operate only in relation to "trade", "commerce" or "business", they do refer to akin commercial concepts such as "competition" and "markets" and predicate their operation on these concepts. For most practical purposes, the terms "trade or commerce" circumscribe the operation of the restrictive trade practices provisions of the Act and activities will have to be characterised as being engaged in "trade or commerce" for the Act to apply to them. (1996, p. 202)

Mr Steinwall noted that:

> The proposition that the regulatory activities of local government are not subject to Part IV is likely to be more a statement of practice than of the legal operation of the Part. (sub. DR32, p. 1)

The Law Council of Australia said:

> Part IV is concerned with the rules of competitive conduct in markets and is an inappropriate instrument for reviewing regulatory decisions. (sub. 23, p. 2)

These differing views indicate there is still some uncertainty as to the wider application of Part IV to the activities of local government. This is discussed further in chapters 3 and 4.

2.3 Section 2D of the Trade Practices Act

The legislative arrangements contained in section 2D of the TPA are succinct. They specify that the following two aspects of local government activities are exempt from Part IV:

- the refusal to grant, or the granting, suspension or variation of licences (whether or not they are subject to conditions) by a local government body; or
- a transaction involving only persons who are acting for the same local government body. (TPA, 2D)

The legislation sets out the meaning of a 'licence' and 'local government body' in the context of the exemptions. The concept of a 'licence' is relatively narrow. It relates to a right to supply goods or services. Examples include licences granted by local government bodies to operate a shop or caravan park, or the approval of buildings which are to be used for the supply of goods or services. The provision explicitly refers to licences 'whether or not they are subject to conditions'. This suggests that the exemption applies to licences that enables the licensee to engage in a particular activity as well as to licences that specify conditions regulating the behaviour of the licensee. It does not encompass other types of local government licences, such as licences to keep domestic pets or licences to use council property.

Importantly, section 2D does not prescribe the licensing powers of local government, but provides a narrow range of exemptions for local government activities from Part IV. Local governments' regulatory powers are derived from and circumscribed by their respective local government Acts or other State and Territory legislation. For example, licensing by local governments is often undertaken on behalf of State or Territory governments under specific State and Territory legislation (eg planning and building permits) or through the wider powers conferred on local governments under their respective local government Acts which allow them to regulate municipal type activities.

It appears that many of the licensing activities of local governments are undertaken under specific legislation on behalf of State or Territory governments. The Municipal Association of Victoria said:

> Councils predominantly issue licences when prescribed or authorised by [State Government] legislation ... (sub. 15, p. 5)

It is the circumscribed legislative power of local government and its creation and existence under State and Territory legislation that makes local government fundamentally different from the other tiers of government.

For the purposes of section 2D, 'local government body' refers to bodies established under State or Territory legislation for the purposes of conducting local government type activities. The exemption does not apply to those bodies established by a State or Territory solely or primarily for the purpose of providing a particular service, such as utilities to supply electricity or water. This definition would appear to apply to Indigenous councils providing municipal type services and those specific purpose councils operating under the New South Wales Local Government Act, such as noxious weed councils, not engaged in providing a particular service. The status of the special purpose councils operating in New South Wales is discussed further in chapter 4.

The legislation does not provide a definition or an example of an 'internal transaction'. However, these transactions clearly relate to dealings between departments or divisions of a single local government entity. For example, a council's parks and gardens department maintaining the lawns and gardens of community care centres operated by the same council would be considered as an internal transaction, not a business activity. As Mr Steinwall (sub. 19) notes, the intention of the exemption is that Part IV does not apply to transactions between persons acting for the same local government body.

2.4 Other relevant provisions of the Trade Practices Act

In the absence of section 2D, two other instruments could potentially be used to provide similar protection to local government from Part IV were this thought to be necessary. They are:

- authorisations under Part VII; and
- section (51) (1).

Also, the AGS has suggested that section 2C could apply to local government.

Part VII authorisations

Under the authorisations provisions in Part VII of the TPA, the ACCC is able to grant immunity from proceedings for some arrangements or conduct that might otherwise breach the anti-competitive provisions in Part IV of the Act. An authorisation is obtained by application to the ACCC from a party to an arrangement or a party engaging in the conduct in question.

The ACCC is able to grant authorisations for conduct such as anti-competitive agreements, price fixing arrangements, exclusive dealings and resale price maintenance that might otherwise breach sections 45, 47 and 48 of the TPA. However, authorisations cannot be granted for misuse of market power or conduct in breach of section 46.

In considering an application for authorisation, the ACCC applies the following tests:

- where an agreement or arrangement may substantially lessen competition, the applicant must satisfy the ACCC that the agreement results in a benefit to the public that outweighs any anti-competitive effect; and
- for resale price maintenance and actions taken by a person in concert with another that hinder or prevent a third person from supplying or acquiring goods or services or engaging in trade or commerce (secondary boycotts), the applicant must satisfy the ACCC that the conduct produces a benefit to the public such that it should be allowed to occur (ACCC 2000).

The ACCC's interpretation of the 'public benefit' is discussed in box 2.4.

Box 2.4 **The ACCC and the public benefit**

In assessing an authorisation to engage in anti-competitive conduct, the ACCC is required to determine if there is a net benefit to the public from such conduct. To determine this, the ACCC applies a 'public benefit' test. There is no standard test — each case is assessed with regard to the particular facts of the case in question. In general terms, the Australian Competition Tribunal has described a public benefit as:

> … anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principal elements … the achievement of the economic goals of efficiency and progress … (ACCC 1997, p. 37)

The factors which have been assessed as providing a public benefit by the ACCC include:

- business efficiency, especially if it results in improved international competitiveness;
- industry rationalisation resulting in more efficient allocation of resources;
- expansion of employment in efficient industries or employment growth in regions;
- industry cost savings resulting in lower prices at all levels in the supply chain;
- steps to protect the environment;
- economic development, for example, development of natural resources through encouraging exploration, research and capital investment;
- assistance to small business, for example, guidance on costing or pricing or marketing initiatives which promote competitiveness; and
- supply of better information to consumers and business.

However, an authorisation granted by the ACCC on public benefit grounds is not available for the section 46 restrictions on the misuse of market power under Part IV.

Authorisations are granted for a specified period of time, although the ACCC can initiate revocation of an authorisation. An ACCC authorisation determination is appealable to the Australian Competition Tribunal.

Section 51 (1)

In the absence of section 2D, section 51(1) of the TPA would still give the Commonwealth, State and Territory governments the option of exempting specific activities, including those of local governments from Part IV. In relation to the Commonwealth and States, sections 51(1)(a) and (b) state that:

> (1) In deciding whether a person has contravened this part [Part IV], the following must be disregarded:
>
> (a) anything specified in and specifically authorised by:

(i) an Act (not including an Act relating to patents, trade marks, designs or copyrights);

(ii) or regulations made under such an Act

(b) anything done in a State, if the thing is specified in, and specifically authorised by:

(i) an Act passed by the Parliament of that State; or

(ii) regulations made under such an Act.

Parallel provisions for the Territories are set out in sections 51(1)(c)–(e). Exemptions by regulation are limited to two years, while exemptions by legislation operate in perpetuity. The ACCC is required to report annually to the Parliament on the use and effect of such exemptions (ACCC 2000).

Local government utilised such an exemption in New South Wales until 2001 under previous waste management legislation. This enabled a group of local councils in southern New South Wales to agree to charge uniform waste disposal charges to stop cross-border tipping of rubbish.

Section 2C

Section 2C provides a list of certain 'non-business' activities of the Commonwealth, State and Territories. As sections 2A and 2B apply Part IV to the Commonwealth, States and Territories only in so far as they carry on a business, section 2C therefore provides examples of the 'non-business activities' of these governments which are outside the scope of Part IV. These examples of 'non-business activities' are wider than the explicit exemptions provided to local government under section 2D. As alluded to earlier, in addition to internal transactions and the issuing of licences, the other examples of 'non-business' activities include:

- imposing or collecting taxes, levies or fees for licences; and
- the acquisition of primary products by a government body under legislation.

Indeed, it appears that in many respects these examples were included in section 2C to provide additional certainty that the non-business activities of the Commonwealth, States and Territories were not subject to Part IV. As the then Assistant Treasurer said in introducing the Competition Policy Reform Bill:

> Certain forms of government activity such as taxing, licensing and compulsory acquisition of primary products are unlikely ever to be legally construed as 'business'. To avoid any doubt provisions have been included which expressly indicate that such activities do not amount to business. (Gear 1995, p. 2798)

Constitutional responsibility for local government lies with the States and Territories. As local government exists and operates under the auspices of State and Territory government legislation, there have been suggestions that sections 2B and 2C could provide a substitute for section 2D. For example, the AGS considered that in the absence of section 2D, local government bodies would be considered as authorities of the States and the Northern Territory for the purposes of sections 2B and 2C (see appendix C).

The possible roles for Part VII authorisations, section 51 exemptions and sections 2B and 2C as alternatives to section 2D are discussed further in chapter 4.

3 Benefits and costs of section 2D

The Terms of Reference require that the Commission take into account that regulation which restricts competition should only be retained where the benefits to the community outweigh any costs. Thus, the relativity between the benefits and costs of the exemptions to the community as a whole is a key consideration for the inquiry.

In undertaking the evaluation of benefits and costs, this chapter initially examines the rationales for the section 2D exemptions in the TPA. From this, it emerges that the practical effect of section 2D is unclear due to opposing views as to the application of Part IV of the TPA to the statutory and regulatory functions of local government. It examines the benefits of section 2D and finds that they reflect those opposing views. The chapter then examines the costs associated with section 2D and finds that any potential costs would be subject to other provisions of the National Competition Policy (NCP) arrangements as well as the relevant review mechanisms of the State and Territory governments. It concludes with the view that section 2D may provide benefits to the community which would outweigh the realisation of any potential costs.

3.1 Rationales for the exemptions

In looking at the practical effect and the benefits and costs more generally of section 2D, a useful starting point is to consider the rationales for the exemptions provided.

A range of arguments were put forward at the time by local government interests to obtain exemptions from Part IV of the TPA. These extended from maintaining local preference policies to parity of treatment with State and Territory governments. Since then, the need to maintain minimum standards by preventing litigation and the benefits to local government from restating accepted legal principles have emerged as further rationales for providing the exemptions contained in section 2D.

Maintaining local preference policies

As noted in chapter 2, at the time the NCP arrangements to extend the TPA to cover local government were being implemented, there were suggestions that an exemption for licensing decisions was necessary to ensure that local government bodies were not precluded from supporting local activity and employment when contracting out the provision of goods and services, even if a cost penalty was involved. Implicit in this argument was the view that, in the absence of an exemption, a lower cost out-of-area supplier that was unsuccessful in securing a contract because of a preference for local suppliers could take action against a council under section 45 of the TPA. In theory, were a local government body to link the contracting and licensing processes to provide local preferences, such arrangements, in particular the use of exclusive licences, would be protected by section 2D from any action under the TPA.

However, there is little evidence to suggest that the section 2D exemption for the licensing decisions of local government is likely to affect the capacity of councils to operate local preference regimes. Any licensing of providers by councils is usually considered separately from the process of contracting with particular licensed providers to supply goods or services. The Local Government and Shires Association of New South Wales said:

> … the licensing of goods and services providers (i.e provision of an approval or permit) is quite distinct from the contracting or tendering process. (sub. 6, p. 4)

That is, those that meet the minimum standards may be issued with a licence so that when a contract comes up for tender, all those with a licence to supply that particular good or service are eligible to tender for the contract. Consequently, the application of any local preference arrangement appears to be mainly relevant at the contracting rather than the licensing phase.

The Australian Local Government Association (ALGA) considered that the exemptions provided some protection if councils were to link the licensing and contracting processes:

> … it is important to keep the exemption in case licensing and contracting processes are connected, this would particularly be the case in smaller LGB's [local government bodies]. (sub. 8, p. 8)

However, permitting the direct linking of contracting and licensing poses one of the potential costs of the exemptions, namely the potential sanctioning of anti-competitive behaviour by local government. This is discussed further in section 3.3.

Ensuring consistency in treatment with the other tiers of governments

As discussed in chapter 2, the local government sector also argued at the time of the implementation of the NCP that without parity of treatment with State and Territory governments, local government would be exposed to possible litigation for government functions for which State and Territory governments would be exempt.

Consistency in treatment with the other tiers of government continues to be a concern to local government. As the ALGA said:

> Local government is the third sphere of Government in Australia. Local Government should not be treated in any different way to the other two spheres. Exemptions that apply to Commonwealth, State and Territory activities should also apply to Local Government activities. (sub. 8, p. 9)

The terms of reference ask the Commission to take into account the need to promote consistency between and within regulatory regimes. The exemptions provided to local government in section 2D can be seen as promoting some regulatory consistency between the different tiers of government. However, these exemptions provide only partial consistency between regimes as a number of the activities listed in section 2C as being examples of 'non-business activities' of the Commonwealth, States and Territories and therefore outside the scope of Part IV are not provided as exemptions to local government.

Given the fundamentally different role of local government from the other tiers of government, as noted in chapter 2, it may not always be desirable or appropriate to provide greater consistency between the tiers of government.

Maintaining minimum standards

A further rationale for the provision of an exemption for the licensing decisions of local government under section 2D (and as an example of a 'non-business activity' in section 2C for Commonwealth, State and Territory governments) would be to avoid the possibility that decisions required to enforce standards applying to goods and services could be challenged under the TPA on the grounds that competition was restricted.

Appropriate standards imposed by government through licensing arrangements can provide significant community benefits by protecting consumers from poor quality products, maintaining public health and safety or enhancing environmental amenity. However, the imposition of minimum standards can have the effect of lessening the number of firms or persons willing to supply a particular good or service and this may limit competition. For example, the licensing of certain occupations and

professions mean that only persons with the relevant qualifications are allowed to provide these services. Similarly, conditions attached to the licensing of retail premises, such as food outlets, may limit the number of such outlets in operation.

The Launceston City Council said:

> It needs to be emphasised that the licence and permit system exists primarily to maintain minimum adequate standards across the community as a whole. ...
>
> Compliance with the conditions of licences and permits will involve a cost either directly, or indirectly through curtailment of the degree of use of a property or business asset. (sub. 1, p. 1)

Whether section 2D protects the statutory and regulatory functions of local government, such as the licensing for minimum standards, from actions under Part IV or simply restates accepted legal principles is discussed below.

Restating accepted legal principles

Regulatory activities

If the view that the statutory and regulatory functions of local government are outside the scope of Part IV is accepted (as discussed in chapter 2), then the risk of successful action in the absence of section 2D would be negligible.

In accepting this view, the Local Government Association of Queensland considered that the rationale for including the exemptions was to make clear that the regulatory functions of local government were outside the scope of Part IV:

> The rationale for exempting licensing decisions is nothing more than a matter of express clarification, as a "matter of caution", that licensing decisions are not matters of trade and commerce and are therefore inherently outside the scope of the Competition Code [the State and Territory legislation that replicates Part IV of the TPA]. The rationale for exempting internal transactions of local government again does no more than clarify an accepted legal principle. (sub. 10, p. 2)

Likewise, the South Australian Government was also of the view that section 2D did not provide any real protection:

> … the advantage of section 2D is not so much that it provides any real protection for local government bodies, rather, that it acts as a beacon for the principle that regulatory and quasi-judicial activities of local government bodies are not (and should not be) subject to the TP Act. (sub. 25, p. 18)

Similarly the Australian Competition and Consumer Commission (ACCC) argued that:

> … it is unlikely that the presence of section 2D has, in reality, provided traditional non business local government activities with significant protection from the application of the TPA. The reason for this is that it is difficult to envisage many instances where the conduct described in section 2D would otherwise constitute a breach of the TPA given that in the main, local government activities have not been inconsistent with Part IV of the TPA. (sub. 3, p. 2)

Mr Steinwall commented that:

> If it does not apply it is not because it is incapable of applying but rather that in practice it is unlikely to apply. In practice it would be difficult to use a regulatory function to engage in anti-competitive behaviour. However, it is not impossible … (sub. DR32, p. 3)

He went on to note that as regulatory activities are undertaken unilaterally they would be unlikely to breach those sections of Part IV dealing with anti-competitive arrangements or agreements:

> The other reason that regulatory function may not attract liability under Part IV is that, in the case of s45 at least, there cannot be a contravention in the absence of some agreement or arrangement. The exercise of a regulatory function does not require an agreement or arrangement. (sub. DR32, p. 3)

Thus if Part IV does not apply to the regulatory activities of local government, the rationale for section 2D would simply be to provide clarification and as such would have no practical effect.

The contrasting view is that regulatory activities of local government are potentially subject to Part IV according to their anti-competitive effect. As noted in chapter 2, the Australian Government Solicitor (AGS) (2002) considered that, since the introduction of the Competition Code in 1996 by the State and Territory governments, the Part IV provisions would apply to local government 'according to their tenor', irrespective of whether or not the activities were characterised as regulatory functions of government.

If Part IV applies to the regulatory activities of local government, then a rationale for section 2D would be to enable local government to undertake licensing activities (as defined in section 2D) without the risk of legal action under Part IV.

Internal transactions

In contrast to the exemption of licensing decisions, the rationale for exempting the internal transactions can only have been to restate an accepted legal principle. There was a universal view that an internal transaction of local government could not infringe Part IV.

When introducing the Competition Policy Reform Bill, the then Assistant Treasurer noted that it is not legally possible for an individual entity to carry on a business with itself. He also went on to note that provisions had been included in section 2C of the TPA for the Commonwealth, States and Territories to:

> … make clear that there is no 'business' activity when two government departments deal with each other, because they are both part of a single legal entity, the Crown. (Gear 1995, p. 2798)

In this regard, Finkelstein J. in the Federal Court noted that:

> … to describe the activities of one department or agency as providing services to another, such conduct would not amount to the carrying on of a business. (Corrections Corporations of Australia Pty Ltd v Commonwealth of Australia (at 10) [FCA 1280] 2000)

As part of its legal advice, the AGS said:

> A 'transaction' that is entirely internal to a local government body cannot, of itself, infringe Part IV. This will not change if section 2D is removed from the TPA. (2002, p. 2)

Also the Local Government and Shires Association of New South Wales said:

> From the Association's perspective the exemption simply makes it clear that the accepted legal principle applies to the internal transactions of Local Government and this places Local Government on the same footing as private firms and the Commonwealth and State Governments. (sub. 6, p. 4)

The restatement of the accepted legal principle in regard to internal transactions in section 2D is seen by some participants as providing clarity to the functioning of local government, as would the relevant provision in section 2C for the Commonwealth, State and Territory governments.

Summary

In examining the rationales for including section 2D, it appears that the exemptions are not required to maintain local government preferences, they provide only limited consistency with the other tiers of government and enable local government to maintain minimum standards without potential challenge under Part IV. However, from the discussion as to whether or not section 2D simply restates accepted legal principle there emerge different views as to the application of Part IV to the licensing activities of local government. Were Part IV not to apply to these activities, then section 2D would simply provide clarity as to the scope of the Act. Alternatively, if Part IV were to apply, a rationale for section 2D would be to protect the licensing activities of local government from legal action under Part IV.

As a result, the practical effect of exempting the licensing activities of local government is unclear.

However, as an internal transaction cannot infringe Part IV, there was a universal view that the rationale for including the exemption for the internal transactions of local government was to restate an accepted legal principle.

FINDING 3.1

There was a universal view that local government internal transactions could not infringe Part IV and that this exemption is redundant. However, the opposing views as to the application of Part IV of the TPA to the regulatory activities of local government have resulted in some uncertainty as to the practical effect of exempting licensing from Part IV.

3.2 Are there any benefits provided by the exemptions?

The preceding discussion indicates that there is uncertainty as to the application of Part IV to the regulatory functions of local government such as licensing and hence the practical effect of section 2D. Indeed, the benefits provided by the exemptions reflect these differing views.

Avoiding litigation

Were Part IV not to apply to the regulatory activities of local government, then it could be argued that such an explicit exemption is unnecessary. However, a number of participants, while acknowledging that any legal action was unlikely to succeed, considered that there may be benefits attached to such exemptions. They considered that an explicit restatement reduced the risk of frivolous litigation. As the Local Government and Shires Association of New South Wales said:

> The primary benefits [of section 2D] are clarity and certainty, helping to ensure that councils are not exposed to costly and unnecessary litigation in carrying out their legitimate statutory functions. (sub. 6, p. 6)

The ACCC commented:

> Even if its removal would have little impact on the true legal position, it may encourage litigation against local governments, which they would then be required to bear the cost of defending. Its existence thereby provides local government with additional certainty in relation to some of its activities. (sub. 3, p. 2)

According to ALGA:

> Removing the exemption may encourage frivolous actions being undertaken against Local Government under the auspices of Part IV of the TPA. (sub. 8, p. 11)

Similarly, the South Australian Government said:

> The nature of adversarial litigation is that any advantage, whether specious or real, will be seized upon, particularly by persons with a sense of grievance. Thus, to remove section 2D, and not replace it with a comprehensive alternative, will surely encourage some wild litigation. (sub. 25, p. 21)

The Municipal Association of Victoria said:

> … removing the current exemption offered by Section 2D could have a detrimental effect on local government. It is possible that valuable resources may be taken up by councils to defend inappropriate and vexatious complaints. (sub. 15, p. 9)

However, there have not been any actions taken against local government under Part IV in relation to those regulatory activities not exempted under section 2D, such as the levying of taxes, fees and fines, since the NCP reforms were implemented. The absence of litigation does not support the view that local government would be subject to such frivolous litigation were Part IV not to apply to the regulatory activities of local government.

In contrast, were the regulatory activities of local government subject to Part IV according to their anti-competitive effect, then the effect of, and hence the benefits from the licensing exemption are far more substantial. Indeed, without the exemptions, the licensing activities of local government could be exposed to challenge under Part IV. Consequently, local government bodies could incur litigation costs in defending their licensing decisions from action under Part IV. In addition, to the extent that local government bodies might adapt, and possibly compromise, their licensing activities to avoid litigation, the provision of wider community benefits from such regulation could be diminished.

In commenting on the benefits provided by section 2D, Mr Steinwall noted that:

> If one accepts the proposition that Part IV does apply to the regulatory activities of local government then s2D takes on a much greater significance. For without s2D the licensing activities of a local government would be exposed to Part IV. Even if one assumes that in practice Part IV will have a negligible application, the need for certainty may well justify its inclusion. The lack of certainty may also add to transaction costs. (sub. DR32, p. 3)

Local government licensing activities are undertaken, after due process, to fulfil the legitimate statutory and regulatory functions which provide community benefits not otherwise obtainable. While any anti-competitive effects should be considered when licensing is undertaken, they should not be the sole criterion for determining community benefit. Any legal challenge under Part IV, in the absence of the

exemption, could undermine the achievement of broader community benefits. The benefit from the exemption of licensing under this view then derives largely from the additional community benefits provided by the certainty that all licensing decision of local government would be free from challenge under Part IV.

Contributing to regulatory consistency

Regardless of which view prevails with respect to licensing, arguably the exemptions provide a degree of (but not full) regulatory consistency with the other tiers of government under section 2C. However, the varying roles and functions of the different tiers of government mean that regulatory consistency for its own sake may be of limited value. It is more appropriate that competition policy objectives are set out consistently in legislation rather than attempting to tailor specific exemptions to the different tiers of government.

Recognising local government

Finally, local government pointed to there being a symbolic benefit from its formal recognition in legislation. For example, the Local Government and Shires Association of New South Wales argued that there were benefits provided by section 2D from the recognition of local government:

> The benefits derive from formal and explicit recognition of Local Government as a legitimate sphere of government. (sub. 6, p. 5)

The South Australian Government also noted the symbolic value of section 2D:

> While section 2D has little practical impact, it does have a **significant symbolic value**. (sub. 25, p. 22) [emphasis in original]

The City of Perth of said:

> While it may appear that the Section 2D exemptions are more symbolic than real, it is nonetheless important that they remain in order to ensure certainty. (sub. 12, p. 4)

Indeed, local government often considers itself to be the 'poor third cousin' in relation to the other tiers of government. This was an issue for it during the implementation of the NCP reforms. The House of Representatives Standing Committee on Financial Institutions and Public Administration said:

> … much to the initial chagrin of local government they were not party to the CPA [Competition Policy Agreement]. (HRSCFIAPA 1997, p. 44)

Such symbolic benefits are an insufficient argument in their own right for legislative recognition which could involve the Act being 'cluttered up' unnecessarily.

FINDING 3.2

The benefits provided by section 2D reflect the opposing views as to the application of Part IV to the statutory and regulatory functions of local government. If Part IV were to apply to the regulatory activities of local government, then the benefits would be more substantial.

3.3 Are there any costs attached to section 2D?

There is the potential for the exemption of the licensing activities of local government to restrict competition. This potential cost remains irrespective of the different views as to the applicability of Part IV to local government.

If Part IV were to apply to the licensing activities of local government, then the section 2D exemptions would sanction any anti-competitive licensing behaviour. In contrast, if Part IV were not to apply, then it would be this lack of applicability per se, and not the section 2D exemption of licensing, which would permit any such anti-competitive behaviour.

A local government could potentially use its licensing powers — whether exempted from Part IV by section 2D or by the lack of applicability of Part IV to the regulatory activities of local government — to restrict competition. The Law Council of Australia noted that:

> In theory a local government might refuse to grant a licence, for instance in relation to the use of premises, in order to prevent the entry of a trader into a market or to prevent competitive conduct. (sub. 23, p. 1)

This would be of particular concern where local government is both regulating and competing in the market for a good or service. An example of this would be if a local government body were both to operate a quarry and regulate quarrying within its jurisdiction, but provides its own operation with a regulatory advantage in regard to conditions of operations, such as hours of opening.

Over the course of the inquiry, the Commission sought examples of such anti-competitive behaviour. However, it did not receive any information that section 2D is encouraging or protecting any such behaviour.

Indeed, in commenting on the costs attached to section 2D, the ACCC said:

> The ACCC is of the view that there are no significant, identifiable costs to the process of competition brought about by section 2D. As discussed above, it does not appear to have a practical effect, and cannot therefore, affect competition significantly. (sub. 3, p. 2)

In any case, informal advice from the Commonwealth Competitive Neutrality Complaints Office is that if a local government body were to use its regulatory role in such a manner it would be in breach of competitive neutrality arrangements in all jurisdictions. These arrangements are subject to assessment prior to the provision of competition payments to the States and Territories under the NCP implementation process. As the States and Territories have become more experienced in utilising such arrangements, their effectiveness has continued to improve. Moreover, any such actions could be addressed more effectively through competitive neutrality mechanisms than attempting legal actions through the Courts for breaches of Part IV.

Also, in the case where licensing is carried out by local government on behalf of a State Government under State Government legislation, recourse would be available through the respective State Government's administrative review mechanisms. All these arrangements would provide a mechanism to address any such anti-competitive behaviour undertaken by local government that was not covered by Part IV.

FINDING 3.3

Irrespective of the application of Part IV to local government, potential costs could arise if a local government body were both to regulate and compete in the same market. However, if it were to use its regulatory powers to provide its business activities with a competitive advantage, any such anti-competitive behaviour would be subject to State and Territory competitive neutrality provisions and administrative review mechanisms. Any costs to the community of section 2D are likely to be insignificant.

In summary, in taking both views of the application of Part IV to local government into account, section 2D may provide benefits to local government and the wider community which would outweigh the realisation of any potential costs.

FINDING 3.4

Section 2D provides a net benefit to the community, the extent of which is uncertain, reflecting opposing views as to the application of Part IV to local government.

4 The future of section 2D

In formulating its preferred option for section 2D, the Commission has evaluated a range of options suggested by participants relating to the internal transactions and regulatory activities of local government. Those options, which range from retaining section 2D, through modifying and replacing the section, to repealing the section are outlined and evaluated in the next part of this chapter.

Two of the options — retain section 2D and inserting a direct provision limiting the application of Part IV of the TPA to the business activities of local government — were identified by the Commission as improving community outcomes and put forward publicly in a draft of this report for further consideration by participants. Participants' responses to those two options are given in the second part of the chapter. The final part covers the Commission's further consideration of their relative merits. The chapter concludes by recommending the insertion of a provision which directly limits the application of Part IV to the business activities of local government and the repeal of section 2D.

4.1 Options for section 2D

In the course of the inquiry, the Commission canvassed a number of options including:

- retain section 2D in its current form;
- modify section 2D to address a number of specific concerns raised by participants;
- insert a direct statement as to the application of Part IV; and/or
- repeal section 2D.

Each of these options is discussed below.

Retain section 2D in its current form

Continuation of the status quo is obviously the simplest option and was supported by many local government bodies. The Municipal Association of Victoria said:

> … the sector in Victoria is in favour of actually retaining 2D in its current form … (trans. p. 27)

Such an approach would retain any benefits provided by the exemptions, the extent of which would depend on the view as to the application of Part IV to the licensing activities of local government.

If the regulatory activities of local government were subject to Part IV, then there are benefits to local government and the wider community in retaining section 2D to remove any possibility of legal challenge to the licensing activities of local government under Part IV.

In contrast, if Part IV were not to apply to the regulatory activities of local government, a number of participants still considered that the statement of the exemptions provided some benefit by reducing the risk of frivolous litigation.

Irrespective of the two views, some participants argued that retention would keep the symbolic benefit to local government of its formal recognition and maintain a degree of regulatory consistency between the tiers of government. However, as discussed in chapter 3, further consistency between the tiers of government may not necessarily be relevant or desirable given the fundamentally different roles and functions of local government.

Given that any costs from the retention of section 2D are likely to be insignificant, it may be desirable to consider retaining section 2D. This would avoid any loss of benefits to the community from possible legal challenges that could undermine the legitimate licensing responsibilities of local government.

Modify section 2D

Drawing on the evidence submitted by interested parties, the Commission considered five possible modifications to section 2D, namely:

- more precise specification of what the terms ‘license’ and ‘licensing decisions’ encompass;
- extension of the definition of ‘internal transactions’ to include transactions between local governments and their corporatised businesses;
- extension of the exemptions provided to local government to more closely match the examples of non-business activities of the Commonwealth, State and Territory governments which are outside the scope of the Part IV;
- including the special purpose councils operating in New South Wales under the exemptions; and

- removal of the blanket exemptions for licensing decisions or internal transactions in circumstances where those decisions could impede competition.

Clarification of section 2D terminology

There appear to be several grey areas in relation to the section 2D definition of a licence and hence what constitutes a licensing decision. For example, the legislation at present provides little in the way of a clear definition or example in respect of what constitutes a 'licence' or 'licensing decision'. As the Local Government and Shires Association of New South Wales said:

> In NSW Local Government context we are generally talking about 'approvals' or 'permits'. These are generally regulatory devices applied to protect the public interest, not restrictions on trade or commerce. (sub. 6, p. 4)

A number of participants argued that there is a need to clarify these grey areas through modifications to the existing definition in section 2D. The South Australian Local Government Association said:

> The general concept of 'licensing' and the restricted definition for the purposes of Section 2D are often misunderstood by Councils. It may, therefore, be appropriate to expand the definition to clarify that any statutory licensing function (i.e. not only those for commercial purposes) of a Council is within the conspectus of Section 2D and, thereby, provide absolute certainty that there are no 'anti competitive' conduct concerns for Councils. (sub. 17, p. 7)

As a general principle, the benefits of clarity in legislative intent cannot be disputed. Amongst other things, it can improve certainty for all of those involved in a particular activity, including those charged with administering the legislation, minimise inappropriate application of the legislation and avoid unnecessary litigation.

However, it is questionable whether the effort needed to clarify further terms such as licensing would deliver any practical benefit. It might encourage unproductive debate about what was intended by the changes to the existing wording in the legislation. In this regard, an important message in submissions from legal practitioners to the Commission's recent inquiry on the national access regime (PC 2001) was that considerable caution is required in 'tidying up' existing pieces of legislation. As such 'tidying up' may have unintended consequences, there would need to be clear benefits stemming from making any changes to the terminology used in section 2D.

Moreover, as Mr Steinwall noted:

> … there would be little point in amending s2D if corresponding changes were not also made to s2C. Section 2C(1) (b) and the definition of 'licence' in s2C (3) are in the same

> terms as the corresponding provision of s2D. This raises two issues. It may well be beyond the scope of this review to recommend amendments to s2C. Secondly whatever might be its limitations, s2C has been in place and applied since 1995. (sub. DR32, p. 3)

In any case, a more precise specification of terms would be unnecessary if it were decided to insert a more direct statement as to the application of Part IV to local government and repeal section 2D (see below).

Extending the definition of internal transaction

Some participants called for transactions between local governments and their corporatised businesses to be considered as internal transactions under section 2D. The Queensland Local Government Association (sub. 10) suggested amending the exemption for internal transactions to include transactions between councils and their corporatised business units to provide similar treatment as that provided to transactions between related corporations in the private sector. Similarly, Australian Local Government Association (ALGA) said:

> ALGA believes reference to internal transactions should be maintained and extended to transactions conducted between corporate bodies belonging to Local Government and Local Government.
>
> There is legal ambiguity regarding the transactions conducted between an LGB [Local Government Body] and a corporate entity owned by the LGB. Transactions undertaken between these two bodies are not covered under the provisions of Section 2D. Including such transactions would place those transactions on a similar footing to transactions within vertically integrated private firms. These transactions generally fall outside the purview of Part IV of the TPA. (sub. 8, pp. 8–9)

The TPA (section 4A) defines corporations as being related where a body corporate is:

- a holding company of another;
- a subsidiary of another body corporate; or
- a subsidiary of a holding company of another body corporate.

Local governments in most jurisdictions are deemed to be body corporates. Provided local governments and the operations and structure of such local government corporations are not circumscribed by any State or Territory legislation so as not to fall within the definition of section 4A, the actual transactions between a local government and its corporate entity would not be treated any differently to that between related corporations in the private sector. As the Australian Government Solicitor (AGS) said:

> A council that is a single body corporate already is, in this respect, in the same position as a private company. (2002, p. 15)

Thus, there seems little point in extending the definition of an internal transaction to exempt such transactions for local government.

The NSW Department of Local Government, nevertheless argued that such transactions should not be exempted:

> … transactions between a council and a corporation wholly owned by the council would not be exempt, and nor should they be, because the two are legally separate bodies. (sub. 18, p. 4)

The Law Council (sub. 23, p. 2) argued that while the exemptions for internal transactions in sections 2C and 2D may provide some comfort to governments, these explicit provisions treated governments differently from the private sector and 'clutters the Act unnecessarily'. To this end, the Law Council called for the removal of the exemption for internal transactions and recommended that:

> Paragraph 2D(1)(b) should be repealed subject to repeal of the equivalent provisions of s2C. (sub. 23, p. 3)

Removal of the internal transaction exemption is discussed below.

Extending the range of exemptions

Modifying section 2D to encompass the examples of non-business activities given in section 2C as exemptions for local government was advocated by a number of local government interests, particularly in regard to the inclusion of an exemption in section 2D for the collection or imposition of taxes, levies and licence fees. For instance, the Local Government and Shires Association of New South Wales said:

> … Section 2D should be amended so that it provides Local Government with the same protection as provided to State and Territory Governments under Section 2C. (sub. 6, p. 2)

Similarly, the Western Australian Local Government Association argued:

> Local Government as an equal level of government, with Commonwealth, State and Territory should be treated in an equitable fashion and if any exemption applies to activities then it should equally apply to Local Government. (sub. 7, p. 7)

Extending the exemptions would be unlikely to have any practical effect were the view that the regulatory activities of local government are not subject to Part IV to prevail.

Alternatively, were Part IV to apply the regulatory activities of local government (except those exempted under section 2D), the imposition and collection of taxes and levies and licence fees by local government could be exposed to action under Part IV. In this case, such an exemption (to reflect the examples of non-business activities in section 2C) could be seen as a benefit. However, the fact that there have not been any actions against local government in respect of their non-licensing regulatory activities for breaches of Part IV since the inception of the current arrangements does not appear to support this view.

Also, not all the examples of non-business activities of the State and Territory governments in section 2C would be appropriate as exemptions for local government. For example, local government is not involved in the administration of statutory marketing arrangements for primary products. The roles of State and Territory governments, and of local government are in some cases quite distinct.

In any case, as Part IV only applies to the business activities of the other tiers of government, section 2C simply provides certain examples of the type of activities that are considered not to be business activities of the Commonwealth, States and Territories rather than an inclusive list of exemptions from Part IV.

Some local government interests also requested that the immunity from prosecution and pecuniary penalties afforded to the Commonwealth, State and Territory governments in sections 2A and 2B of the TPA respectively, be extended to local government. In this regard, ALGA proposed that:

> Section 2D be extended (or a new section created) to ensure similar provisions as contained within Sections 2A and 2B are provided to Local Government. (sub. 8, p. 6)

Such an extension would constitute a more significant change to current arrangements than an alignment of the exemptions in section 2D with those in section 2C. As set out in chapter 2, the immunity from prosecution and fines contained in sections 2A and 2B applies to all activities of Commonwealth, State and Territory governments (but not their authorities) and not just to the activities covered by the exemptions in section 2C.

In the Commission's view, consideration of the merits of extending immunity from prosecution and fines to local government therefore falls outside the scope of this more narrowly-based inquiry. Accordingly, it has not considered this issue further.

A variation on adopting the examples of non-business activities in section 2C as exemptions for local government would be to include explicit reference to local government in the prelude to the detailed requirements of section 2C. In this regard, the Lake Macquarie City Council submitted that section 2D be removed and:

A. Local government be recognised as an authority/agent of a State/Territory Government.

B. Local government be exempted from the provisions of Part IV of the Trade Practices Act by specific mention in Section 2C of the Trade Practices Act. (sub. 2, p. 1)

Such a modification would provide local government with exemptions from Part IV, whether they are needed or not. In addition, as noted in chapter 2, such a modification would be unnecessary if the view of the AGS — that in the absence of section 2D, local government bodies would be considered as authorities for the States and the Northern Territory for the purposes of sections 2B and 2C — were to prevail.

Including special purpose councils under section 2D

A further modification to section 2D raised by the Local Government and Shires Association of New South Wales (sub. 6 and sub. DR31) was to amend the definition of a local government body in section 2D to include the 20 specific purpose councils operating in New South Wales. The specific purposes of these bodies include noxious weed and animal control, water supply and flood mitigation. The argument put forward was that these bodies operated under the NSW Local Government Act and performed statutory functions similar to general purpose councils that involved issuing permits and approvals.

The Local Government and Shires Association of New South Wales (sub. 22 and sub. DR31) also called for the section 2D exemptions to be amended to cover two council water authorities operating under the NSW *Water Management Act 2000.*

The definition of a local government body for the purposes of section 2D includes those bodies established under State or Territory legislation for the purposes of local government, but not those bodies established solely or primarily for the purposes of supplying a particular service such as electricity or water.

Consequently, those specific purpose councils that are primarily regulatory bodies, such as noxious weed councils, would be exempted under section 2D, but those specific purpose councils established to provide a particular service, such as water, would not. At the time Part IV was extended to all business activities irrespective of ownership as part of the NCP reforms, those bodies established to provide a particular service were explicitly placed outside the scope of the exemption. Indeed, to amend the definition to include those bodies primarily engaged in business activities, such as water and electricity authorities, within the scope of the exemptions would be contrary to the original intention of the NCP reforms.

Even where specific purpose councils established to provide a particular service undertake certain regulatory activities (eg sewerage and water management) they would fall outside the scope of the exemption. In principle, any regulatory activities undertaken by these bodies should be treated similarly to the activities undertaken by the specific purpose councils that are primarily regulatory bodies. However, it would not appear to be appropriate to amend the definition to include the special purpose councils established to provide a particular service, primarily on a commercial basis, given the intention of the NCP reforms of government monopolies was to separate the commercial and regulatory activities of such bodies to remove any conflict of interest (sub. DR32). The more appropriate response to protect any regulatory activities would be to remove such activities from what are predominantly commercial bodies.

Nevertheless, were Part IV not to apply to the regulatory activities of local government, any amendment to exempt the regulatory activities of these specific purpose councils would be unlikely to have any effect.

In regard to those water authorities operating outside the NSW Local Government Act, it would appear that the New South Wales Government intended that such bodies should not be considered as local government bodies and the legislation under which such bodies operate is an issue for the New South Wales Government rather than through amending section 2D.

Removing blanket exemptions

A fundamentally different modification would be to remove the blanket exemptions in circumstances where licensing decisions could adversely affect competition.

Local governments are involved in providing various goods and services on a commercial or cost recovery basis. In some instances, these services are also available from private suppliers. The operation of childcare and leisure centres and quarrying activities are examples of where local governments compete with private sector entities. As discussed in chapter 3, where local government faces competition in the delivery of a good or service, particular licensing decisions could be used to impede competition, or could incidentally have that effect.

Were Part IV to apply to the regulatory activities of local government, section 2D could, in principle, be used to sanction anti-competitive behaviour. This could provide an argument for modifying the blanket exemptions in section 2D to exclude licensing decisions that impinge upon competition between local government business activities and private sector firms. However, this could raise a new set of problems. The precise nature of the legislative changes required would be the matter

of some debate. It may also be difficult to place, in legislative terms, precise limits on the exemptions.

Alternatively, were Part IV not to apply to the regulatory activities of local government, any such modifications would have no effect.

In any case, the efficacy of seeking to address the sort of outcomes outlined above through exposing the licensing decisions involved to Part IV seems highly questionable. In essence, the key concern is that particular licensing decisions may disadvantage private sector firms competing with local government businesses. As noted in chapter 3, this is clearly a competitive neutrality issue.

In the Commission's view, the use of competitive neutrality complaints mechanisms in such circumstances would be preferable to encouraging expensive actions in the Courts for breaches of Part IV of the TPA.

In summary, after examining their potential effects, the Commission has concluded that none of the modifications to section 2D considered above would improve the operation of the legislation.

Insert a direct provision

In contrast to modifying section 2D, the South Australian Government (sub. 25) proposed that a more comprehensive statement be inserted in the TPA to define the application of the Act to local government. It proposed that a local government body should be exempt from a number of provisions of the TPA, including Part IV, except where it carried on a business:

> The following provisions of this Act do not bind a local government body except in so far as the local government body carries on a business:
>
> (a) Part IV;
>
> (b) Part IVA;
>
> (c) Part IVB;
>
> (d) Part V;
>
> (e) Part VA;
>
> (f) Part VB; and
>
> (g) Part VC. (sub. 25, p. 7)

Under this proposal, section 2D would be replaced and a local government body would be defined as in the current section 2D.

The wider application of the TPA to local government is outside the scope of this inquiry which deals specifically with local government exemptions from Part IV. Nonetheless, a specific provision that stated that a local government body was exempt from Part IV, except in so far as it was carrying on a business, could be considered.

The stated intention of the NCP reforms was to extend Part IV of the TPA to all business activities, irrespective of ownership. In the second reading speech of the Competition Policy Reform Bill 1995, Senator Crowley said:

> The Trade Practices Act will be amended so that, with State and Territory application legislation, the prohibitions against anti-competitive conduct can be applied to all businesses in Australia.
>
> … Many public sector organisations have both commercial and non-commercial functions, and these reforms are not designed to affect the non-commercial functions undertaken for governments. (Senate Hansard, 29 March 1995, pp. 2435–6)

In the Commission's view, Part IV of the TPA should extend to the functions of local government bodies only to the extent that they are carrying on a business. Notwithstanding, the different constitutional position of local government, there is no apparent reason to treat its regulatory activities differently from the other tiers of government. This could be achieved by inserting an explicit provision somewhat similar to section 2B, which applies Part IV to State and Territory governments.

It would be a more direct way of ensuring that only the business activities of local government are subject to Part IV than by specifying exemptions. In addition to being consistent with the original intention of the NCP reforms, this proposal has the advantage of removing the legal uncertainty as to the reach of Part IV in relation to local government regulatory activities. As such, section 2D could be repealed.

Repeal section 2D

Section 2D could be repealed in its own right, without the insertion of a direct provision. As indicated above, the effect of repealing section 2D would depend on the view as to the application of Part IV of the TPA to the regulatory activities of local government.

Were the section 2D exemptions for licensing to have little or no practical effect, then this section could be removed with little, if any, real impact. However, in this case, repealing section 2D would also remove certain intangible benefits such as the overt legal certainty provided by the exemptions against frivolous litigation.

Alternatively, repealing section 2D could result in a loss of more substantial benefits were local government regulatory activities to be subject to Part IV. Local government bodies could incur litigation costs in defending their licensing decisions from action under Part IV. Moreover, in so far as local government bodies might adapt, and possibly compromise, their licensing activities to avoid litigation, there may well be a loss of benefits for the wider community.

ALGA (sub. 8) commented that the removal of section 2D would undermine local government's ability to protect the public interest by maintaining minimum standards through the use of licensing. For example, the Noosa Council (sub. 24), which licenses the use of private and commercial jetties for reasons of public amenity, noted that in the absence of section 2D it could be subject to challenge under the TPA for refusal to grant a licence to construct a jetty or expand the use of a jetty for commercial purposes. In a similar vein, the Launceston Council (sub. 1) remarked that the removal of section 2D may potentially limit local government's ability to engage in licensing activities and thereby affect the revenue obtained from licence fees.

Whether such a loss of benefits would be incurred if section 2D were repealed is debatable. The view of the AGS is that, in the absence of section 2D, local government bodies would be considered as authorities of the States and the Northern Territory for the purposes of sections 2B and 2C. This would give local government all the exemptions provided to the States and Territories and their authorities.

The AGS said:

> Since the State establishes the councils and confers on them part of the legislative and executive powers of the State, the better view is that it does so 'for a purpose of the State'.
>
> It follows, in our view, that, in the absence of section 2D, councils would have been authorities of the States and the Northern Territory within sections 2B and 2C. (2002, p. 10)

Alternatively, the general consensus in submissions was that, in its current form, section 2B and, from that, the exemptions in section 2C would not apply to local government bodies. The key point made was that while local government bodies are established under State and Territory legislation, they are legally autonomous entities rather than 'authorities' of the States and Territories (NSW Department of Local Government sub. 18). The Australian Competition and Consumer Commission (ACCC) (sub. 3) commented that these exemptions could not apply to local government, due to the definition of 'authority' in the TPA.

If, in the absence of section 2D, a local government body was considered to be an authority of a State or the Northern Territory and within the scope of sections 2B and 2C, as argued by the AGS, then local government would also, by default, receive protection outside of Part IV (namely, Part VB dealing with the introduction of the goods and services tax and Part XIB dealing with the telecommunications industry). This may or may not be relevant or desirable, but, as noted above, it is outside the scope of this inquiry.

Importantly, until such time as the applicability of sections 2B and 2C to local government was tested in the Courts, there would be considerable uncertainty as to whether a local government body was considered to be an 'authority' of a State or Territory.

Another option, also discussed in chapter 2, available to local government in the absence of section 2D would be to seek an authorisation from the ACCC under Part VII of the TPA for any activity currently exempted under section 2D. However, the Commission recognises that this mechanism may not be a practical alternative for local government, given the costs and the lengthy processes involved in seeking an authorisation.

On balance, the Commission considers that, by itself, it would be undesirable to repeal section 2D in light of the legal uncertainty as to the coverage of Part IV and sections 2B and 2C. Repeal could deny the community some of the benefits provided by local government licensing. However, there is no need to retain the exemption in section 2D for the internal transactions of local government, given the universal view that it has no practical effect.

4.2 The Commission's draft report options

In the draft report, the Commission put forward two options for further consideration. The first option was to retain section 2D. This has the advantage of providing local government with legal certainty in undertaking its licensing activities. While it does not overcome the underlying uncertainty as to the wider application of Part IV to local government regulatory activities, it at least ensures that any existing benefits to local government and the wider community from licensing are maintained.

The Commission noted that the internal transactions of a local government body could not infringe Part IV, and that this exemption was redundant and should be repealed.

The second option was to replace section 2D with a direct provision that limited the application of Part IV to the business activities of local government. This option addresses the underlying legal uncertainty as to the application of Part IV and is consistent with the original intention of the NCP reforms.

The Commission sought the views of participants on the options and in particular, the appropriateness of a provision that would directly limit the application of Part IV of the TPA to the business activities of local government to replace section 2D. These responses are discussed below.

Participants' views on the two options

There was widespread support from participants for the second option to replace section 2D with a direct provision to limit the application of Part IV to the business activities of local government. It was generally supported by local government interests, apart from the Municipal Association of Victoria, the Shire of Cardwell and the City of Whittlesea.

In comparing the two options, the Local Government and Shires Association of New South Wales said that:

> Replacing 2D with a direct provision limiting the application of Part IV to the business activities of local government would remove much of the ambiguity surrounding the current provisions and, if appropriately worded, would provide a higher degree of certainty to local government. … The other preferred option of maintaining the status quo by simply retaining section 2D would appear to be the inferior alternative or the less preferable. (trans. p. 4)

Similarly, the Premier of Tasmania said:

> … we consider the second option to provide a viable and sensible amendment to Section 2D of the Trade Practices Act. (sub. DR33, p. 1)

The benefits of a direct provision were considered to be the certainty provided to local government as to the application of Part IV, the associated reduction in any transaction costs and the similar treatment of local government with the other tiers of government in respect of the application of Part IV.

Mr Steinwall commented:

> … a distinction can be made between the position occupied by local government and that occupied by the Commonwealth and States under our federal structure. However, it is not apparent that this distinction demands that local government be treated differently, especially if the Hilmer framework is accepted as the policy driver. Certainty and reduced transaction costs would justify a direct statement that limits the

application of Part IV to local government, in much the same way as s2A and s2B. (sub. DR32, p. 4)

The Baulkham Hills Shire Council agreed on the need to:

> … safeguard Local Government from any uncertainties and treat it in a similar manner as other tiers of Government. (sub. DR34, p. 1)

Similarly, in supporting such a provision the Lockhart Shire Council said:

> Such a provision would place local government on a similar footing to state governments in the execution of its regulatory and licensing functions. (sub. 28, p. 1)

Moreover, such a provision would be consistent with the original intention of extending Part IV as part of the NCP reforms. As Mr Steinwall noted:

> The overwhelming impression that one gains from examining this debate is that the reforms were intended among other things, to apply Part IV to all business entities irrespective of their form. As each tier of government undertakes both regulatory and business activities it was therefore necessary to excise regulatory activities from the Act's reach so that only the residue (business activities) is caught. This is what 2A and 2B provide. (sub. DR32, p. 4)

The Penrith City Council commented:

> National Competition Policy (NCP) envisaged the separation of regulatory activities from trading activities. The Trade Practices Act was clearly intended to apply to the latter.

It went on to say that a direct provision:

> Avoids the possibility of varying definitions (between State and Federal Acts) and hence also avoids confusion and administrative effort in maintaining records on different basis and policies to serve potentially conflicting objectives. …
>
> Has no risk of inappropriately classifying a regulatory activity as being subject to the Trade Practices Act. Should such an activity go wrong, its remedy should be pursuant to administrative review mechanisms, not by Trade Practices legislation. (sub. DR35, pp. 1–2)

The ACCC, the body responsible for administering the TPA, said:

> The ACCC does not consider that there would be any notable difference between the two proposed options from an enforcement or compliance perspective and would be comfortable with either option ultimately being recommended. (sub. DR30, p. 1)

However, a few had concerns about replacing section 2D. The Municipal Association of Victoria, while not strongly opposed to the second option, considered that retaining section 2D was preferable. It considered changing the existing arrangements may raise a number of uncertainties and definitional issues in regard to the business and non-business activities of local government. As it said:

> … the MAV [Municipal Association of Victoria] can see the reasons why it would be compelling to have a direct statement in the Trade Practices Act that for all intents and purposes clarifies the application of Part IV in particular to local government activities. We would regard that as the purest approach and in an ideal environment that might indeed be a view that we might advocate. However, the process of clarifying, in our view, the application of Part IV does require the differentiation between governmental, regulatory and statutory functions. As previously indicated in all probability it's going to have some definitional issues that may well be problematic.
>
> … the MAV view therefore is that imperfect as the arrangements might be, they are workable … (trans. p. 30)

From a different perspective, the Balanced State Development Working Group were concerned that any changes to section 2D would impose additional costs on local government. It said:

> In BSDWG's opinion one direct effect of any modification by the Commonwealth Parliament to the present Section 2D would be to impose an additional, and unreasonable, burden on a significant number of 'small' Local Government Authorities. (sub. DR29, p. 2)

These participants' views are discussed below.

4.3 The Commission's preferred approach

In comparing the two options, the Commission notes that the NCP reforms clearly intended to extend the regulation of trade practices under Part IV to all businesses irrespective of ownership. It also notes that while retaining section 2D would ensure that any existing benefits to the wider community and local government are maintained, it would not overcome the underlying uncertainty as to the application of Part IV to the regulatory activities of local government.

In the Commission's view, Part IV should only apply to the business activities of local government. Thus, a direct provision to this effect would be consistent with the original intention of the NCP reforms to extend the restrictions on anti-competitive behaviour under Part IV to all business activities irrespective of their ownership.

Importantly, it would remove any uncertainty as to the application of Part IV to the regulatory activities of local government. Such a provision would remove the risk of litigation involving a local government body's regulatory decisions under Part IV and the administrative and legal costs of defending such decisions. It would, in effect, exempt all regulatory activities of local government, including the imposition and collection of taxes, levies and fees for licences.

Moreover, it would avoid the need for specific exemptions under section 2D. Defining specific exemptions is in itself problematic and any omission, by inference, may lead to debate as to whether or not a particular activity was intended to be exempted. Indeed, it is more appropriate that competition policy objectives are set out consistently in legislation rather than attempting to customise specific exemptions to the different tiers of government. As such a statement removes the need for specific exemptions, both existing exemptions — not just for internal transactions — under section 2D would become redundant.

Such a provision would define the application of Part IV to local government in a manner similar to that of the other tiers of government. However, the Commission wishes to draw attention to the potential inconsistency in treatment with the other tiers of government from section 2C. Such differential treatment might be erroneously interpreted to mean that any relevant activities listed in section 2C could be considered as business activities when undertaken by local government. A number of approaches to overcome this inconsistency are discussed below.

The Commission considers that given the variety of circumstances which could arise, it would be counter productive to attempt to define a business activity. While the TPA itself provides a limited definition of a 'business', there is considerable legal precedent established as to what constitutes 'carrying on a business' in respect of the Commonwealth, States and Territories for the purposes of Part IV. The definition of a business activity for the purposes of Part IV in case law is considerably more substantial then that used to define the licensing activities of local government under the current section 2D arrangements. Also, there would be the question of whether any such definition should apply to all levels of government.

A local government body for the purposes of a direct provision, would be defined as in the present section. As discussed above, this would protect the activities of those special purpose councils established in New South Wales primarily to undertake regulatory functions. To widen the existing definition to include specific purpose councils established to provide a particular service would be contrary to the original intentions of the NCP reforms. To the extent that these bodies undertake regulatory functions, such functions should be removed from what are predominantly commercial bodies.

In drawing on the views of participants, including the ACCC, there appears to be no 'technical' reason as to why such a provision would not be feasible. However, as discussed above, there is the potential that such a provision could be used to sanction the use of local government regulatory activities for anti-competitive purposes.

There has, however, been no evidence that local government has been engaging in such anti-competitive behaviour. Indeed, if a local government body were to use its regulatory functions in such a manner, there are other existing provisions such as competitive neutrality requirements in each State and Territory and, where local governments are regulating on behalf of State Government, recourse under State Government legislation and administrative review mechanisms, which would address such behaviour more effectively than by providing for legal action to be taken for breaches of Part IV.

After assessing the two approaches, the Commission considers that a direct provision limiting the application of Part IV to the business activities of local government is preferable to retaining section 2D. In addition to retaining the benefits of the existing arrangements in regard to local government licensing, the Commission is of the view that a direct provision would remove any uncertainty as to the application of Part IV to local government, be consistent with the original intention of the NCP reforms to extend Part IV to all business activities irrespective of their ownership and clearly define the application of Part IV to local government in a manner similar to that of the other tiers of government.

FINDING 4.1

The Commission finds that the net benefits would be greater if section 2D were to be replaced by a direct provision limiting the application of Part IV to the business activities of local government. In addition to the benefits of the existing arrangements, a direct statement would:

- *remove any uncertainty as to the application of Part IV to local government;*
- *be consistent with the original intention of the NCP reforms to extend Part IV to all business activities irrespective of their ownership; and*
- *define the application of Part IV to local government in a manner similar to that of the other tiers of government.*

Implementing the preferred approach

While a direct provision which limits the application of Part IV to the business activities of the State and Territory governments should be similar to section 2B, it should not necessarily include exemptions from other parts of the TPA or from prosecution and fines. Those exemptions may not be relevant or desirable for local government, but in any case, as noted above, they are outside the scope of this inquiry.

Furthermore, such a provision would not require a definition as to what encompasses a business activity, given the existence of extensive legal precedent in

regard to the application of Part IV to the Commonwealth, States and Territories. A direct provision limiting the application of Part IV to the business activities of local government removes the need to list exempt activities or provide examples of non-business or regulatory activities. A similar argument applies in regard to the other tiers of government, given that they have a number of regulatory activities listed in section 2C as being outside the scope of Part IV and a direct provision in sections 2A and 2B limiting the application of Part IV to their business activities.

Recommending specific legislative amendments to section 2C is outside the scope of this inquiry. However, a number of approaches could be considered to avoid any uncertainty and promote legislative consistency in the treatment of the different tiers of government. Consideration could be given to removing the non-business activities listed in section 2C which are also, in effect, redundant. Alternatively, a direct reference to local government could be included in section 2C or a reference to section 2C added to the direct provision.

To minimise any transaction costs, these amendments to the TPA could be included as part of any other changes arising from the wider (Dawson) review of the TPA currently being undertaken.

RECOMMENDATION

- ***A direct provision be inserted in the Trade Practices Act 1974 to ensure that Part IV of the Act does not apply to a local government body except in so far as the local government body, either directly or by an authority of the local government, carries on a business; and***
- ***section 2D be repealed.***

APPENDIXES

A Conduct of the inquiry

Following receipt of the terms of reference, the Commission placed advertisements in metropolitan newspapers and appropriate publications inviting public participation in the inquiry. Information about the inquiry was circulated to people and organisations likely to have an interest in it. The Commission also released an issues paper to assist parties in preparing their submissions.

To help it understand the key issues, the Commission held informal discussions with a range of interested parties, including local government associations and a cross section of local government bodies in most States. It also sought legal advice on a number of issues from the Australian Government Solicitor.

The Commission received a total of 39 submissions during the inquiry — 28 were received prior to the release of the draft report in May 2002 and a further 11 following its release. All submissions are listed in section A.1.

Following the release of the draft report, the Commission held public hearings in Sydney and Melbourne to enable interested participants to comment on the options contained in the draft report as to the future of section 2D. Those who provided comment on the draft report at public hearings are shown in section A.3.

A.1 List of submissions

The following table lists submissions received. Submissions received after the draft report have been denoted with the prefix DR and those containing commercial-in-confidence information have been denoted with an asterisk (*).

Table A.1 **List of submissions**

Participant	*Sub. No.*
Australian Competition and Consumer Commission	3, DR30
Australian Local Government Association	8
Balanced State Development Working Group	DR29
Bathurst City Council	21
Baulkham Hills Shire Council	5, DR34
City of Perth	12
City of Melville	27
City of Whittlesea	DR36
Department of Local Government — New South Wales	18
Lake Macquarie City Council	2
Launceston City Council	1
Law Council of Australia	23
Local Government and Shires Association of New South Wales	6, 22, DR31
Local Government Association of Queensland Inc.	10, DR38
Local Government Association of South Australia	17
Local Government Association of Tasmania	16
Local Government Association of the Northern Territory	DR39
Lockhart Shire Council	28
Master Builders Australia	4
Municipal Association of Victoria	15
Noosa Council	24
Penrith City Council	DR35
Pine Rivers Shire Council	9
Pittwater Council	13
Resource Allocations Pty Ltd	11*
Shire of Cardwell	DR37
South Australian Government	25
Steinwall, Ray	19, DR32
Tasmanian Government	26, DR33
Western Australian Local Government Association	7
Weddin Shire Council	20
Whitehorse City Council	14

A.2 Meetings with individuals and organisations

Informal discussions were held with the following interested parties.

Australian Capital Territory

- Australian Competition and Consumer Commission
- Australian Local Government Association
- Commonwealth Grants Commission

New South Wales

- Bathurst City Council
- Blaney Shire Council
- Cabonne Shire Council
- Central Tablelands Water
- Cowra Shire Council
- Department of Local Government — New South Wales
- Evans Shire Council
- Forbes Shire Council
- Institute of Engineers, Australia
- Lachlan Shire Council
- Lithgow City Council
- Local Government and Shires Association of New South Wales
- Mudgee Shire Council
- Orange City Council
- Parkes Shire Council
- Rylstone Shire Council
- The Oberon Council
- Waste Management Association of Australia
- Weddin Shire Council
- Wellington Shire Council

Victoria

- Casey City Council
- Civil Contractors Federation
- Greater Geelong City Council
- Knox City Council
- Maroondah City Council
- Melbourne City Council
- Monash City Council
- Municipal Association of Victoria
- Positive Compliance Action
- Stonnington City Council
- Victorian Department of Infrastructure — Office of Local Government
- Victorian Department of Treasury and Finance — Competitive Neutrality Complaints Unit
- Victorian Local Governance Association
- Whitehorse City Council
- Whittlesea City Council

Queensland

- Beaudesert Shire Council
- Brisbane City Council
- Caboolture Shire Council
- Caloundra City Council
- Civil Contractors' Federation
- Gatton Shire Council
- Gold Coast City Council
- Ipswich City Council
- Local Government Association of Queensland
- Logan City Council

- Maroochy Shire Council
- Noosa Shire Council
- Pine Rivers Shire Council
- Queensland Government
- Redcliffe City Council
- Redlands Shire Council
- Toowoomba City Council

South Australia

- Crown Solicitor's Office
- Local Government Association of South Australia
- Office of Local Government
- South Australian Government

A.3 Public Hearings

Public hearings were held in Sydney and Melbourne during June and July 2002. Those who appeared are listed in table A.2.

Table A.2 **Public hearings**

Date	*Participant*	*Transcript page no.*
Sydney		
17 June 2002	Local Government and Shires Association of New South Wales, Australian Local Government Association and the Local Government Association of Queensland	1 – 24
Melbourne		
1 July 2002	Municipal Association of Victoria	26 – 44

B Local Government in Australia

This appendix presents a snapshot of the local government sector in Australia, focussing on its diversity, sources of revenue and how this revenue is spent. It also looks at the level of contracting out of local government services and the extent to which local preference policies are used.

B.1 Local government in Australia

Currently, there are approximately 730 local government bodies in Australia. They include large metropolitan councils, rural and regional councils and small Indigenous councils. There is a great deal of diversity which is well illustrated through the following:

- Silverton Village in New South Wales has a population of 58 in comparison to the Brisbane City Council with a population of 833 000;
- the Shire of Peppermint Grove in Western Australia comprises an area of 1.5 square kilometres while the East Pilbara Shire, also in Western Australia, covers 378 533 square kilometres; and
- in respect of population density, Menzies Council in Western Australia has 2.8 people per 1000 square kilometres in comparison to the 7280 people per 1000 square kilometres in Waverly Council in New South Wales.

Local governments perform a wide range of functions which can be characterised as:

- legislative functions, such as making council by-laws or local laws;
- regulatory functions, including the issuing of licences and permits, as well as enforcement activities involving building standards, animal control and sanitary standards; and
- the provision of a range of services. (sub. 25)

The services provided vary widely and may include:

- engineering services (roads, bridges, footpaths and drainage);
- community services (aged care, childcare and fire fighting);

- environmental services (waste management and environmental protection);
- recreational and tourism services (swimming pools and caravan parks);
- regulatory services (land use, buildings, etc); and
- cultural services (libraries, galleries and museums).

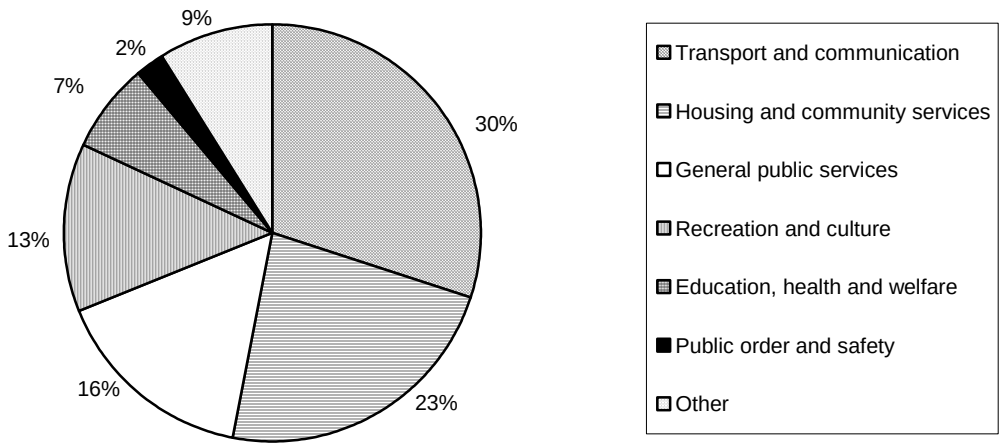
In addition to these services, local governments in Queensland, Tasmania and rural New South Wales also provide water and sewage services. Further, in some remote regions in the Northern Territory, electricity generation is provided by local government bodies. In providing these services, the local government sector across Australia employs nearly 140 000 people (NOLG 2001).

The constitutional responsibility for local government resides with the States and Territories, and local government exists under specific legislation in each State and the Northern Territory. The Australian Capital Territory does not have local government.

B.2 Local government expenditure

Total local government expenditure in 1998-99 was in excess of $13 billion (NOLG 2001). The largest proportion was on transport and communications, accounting for nearly a third of all expenditure, followed by housing and community services accounting for around 23 per cent and recreation and culture accounting for 13 per cent (see figure B.1).

Figure B.1 **Local government expenditure, 1998-99**
Per cent



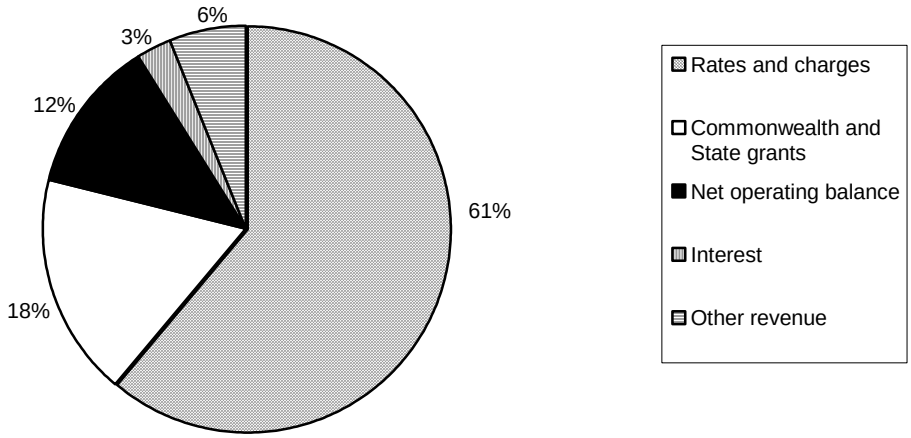
Data source: NOLG (2001).

The pattern of local government expenditure has changed since the mid-1970s. The expenditure on transport and communication, while still the largest outlay across the local government sector, has declined from nearly half of total expenditure in the mid-1970s, while expenditure on 'people services,' such as recreation and culture, and education and health has increased significantly over the same period.

B.3 Local government revenue

Total local government revenue in 1998-99 was over $10 billion (NOLG 2001). The revenue comes from four main sources (see figure B.2). The majority of funding comes from municipal rates and charges, followed by Commonwealth and State government grants and the net operating balance from council businesses.

Figure B.2 **Local government revenues, 1998-99**
Per cent



Data source: NOLG (2001*).*

The situation differs for local government in the Northern Territory where the smaller amount of rateable land results in the largest proportion of funding coming from grants. There is also significant variation in funding arrangements between councils within each state and the Northern Territory.

In addition, there is variation in the amount of grants going to regional and metropolitan local government bodies, with more being provided to the former.

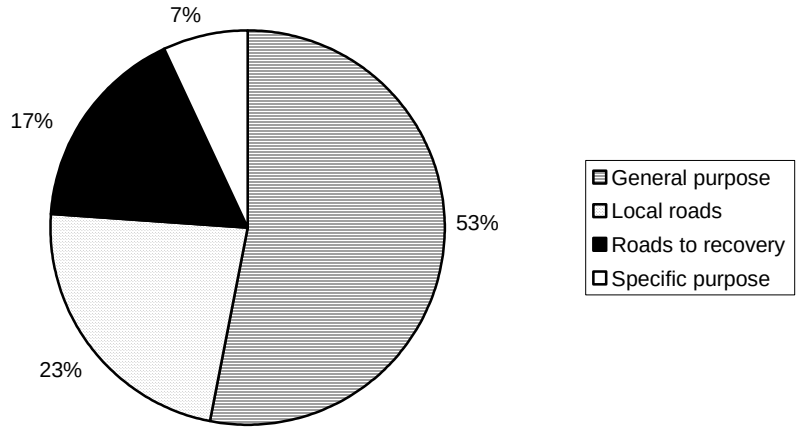
Grants to local government

The principle source of grants to local government is the Commonwealth Government. Since 1974-75, the Commonwealth has provided financial assistance grants to local government in an attempt to provide all councils with similar levels

of fiscal capacity. The Commonwealth provides this funding to the States to pass on to the local government bodies in their respective jurisdictions in accordance with the recommendations of their local government grants commissions.

Commonwealth funding for local government consists of four categories: general purpose, specific purpose, local roads and 'roads to recovery' (see figure B.3).

Figure B.3 **Commonwealth funding to local government bodies, 1997-98**
Per cent



Data source: Commonwealth Grants Commission (2001).

The distribution of general purpose grants depend on two factors. First, the distribution between states is determined on a per capita basis. Then between local governments within a state, the local government grants commission recommends the distribution of grants on the basis of horizontal equalisation and minimum grant criteria (see boxes B.1 and B.2). The grants received by each local council depends on its fiscal capacity to provide the 'average' level of services within that jurisdiction.

Box B.1 **Minimum grant**

Section 6(2)(b) of the *Local Government (Financial Assistance) Act 1995* requires the Minister to ensure that:

'No local governing body in a state will be allocated an amount under section 9 (the general purpose component of the grant) in a year that is less than the amount that would be allocated to the body if 30% of the amount to which the State is entitled under that section in respect of the year were allocated among local governing bodies in the State on a per capita basis.'

Source: CGC (2001).

Box B.2 **Horizontal equalisation**

Horizontal equalisation is a policy objective whereby every council in a State, by means of reasonable revenue-raising effort, should be able to afford to provide a similar range and quality of services. The Commonwealth pursues a policy of horizontal equalisation when it distributes general purpose funding to the States.

More formally, section 6(3) of the *Local Government (Financial Assistance Act) 1995* defines horizontal equalisation as being an allocation of funds that:

1. Ensures each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State; and
2. Takes account of differences in the expenditure required to be incurred by local governing bodies in the performance of their functions and in their capacity to raise revenue.

The distribution of grants is determined by estimating the cost each council would incur in providing a normal range and standard of services, and by also estimating the revenue each council could obtain through the normal range and standard of rates and charges. The grant is then allocated to compensate for these variations in expenditure and revenue and (ideally) bring all councils up to the same level of financial capacity.

This means councils that would incur higher costs in providing normal services, for example, in remote areas (where transport costs are higher), or areas with a higher proportion of elderly or pre-school aged people (where there will be more demand for specific services) will receive additional grant monies. Similarly, councils with a strong rate base (highly valued residential properties, high proportion of industrial and/or commercial property) will tend to receive less grant monies.

Source: CGC (2001).

B.4 Contracting out of local government services

A significant level of local government services are contracted out. For example, a Municipal Association of Victoria (MAV) survey, in 1991-92, found that 95 per cent of Victorian councils contracted out at least one service (MAV 1993).

Local governments point out that there are numerous benefits from contracting the provision of their services. Some of the most common advantages mentioned include economies of scale of contractors, lower labour costs for councils and increased flexibility of council operations. Local governments also state that some of the reasons which prevent them from contracting out include increased supervision costs, lack of direct accountability to ratepayers and hidden costs

arising during contracts (Western Australian Department of Local Government 1994).

The most commonly contracted services are recycling, household refuse collection, sanitation, cleaning of community facilities and maintenance of roads and bridges. Others services commonly contracted out across all states include research, managerial functions, administrative, engineering and planning services (MAV 1993).

There is some evidence that the type of services contracted out by municipalities can vary considerably, depending on the size of the population. Smaller rural councils typically contract out professional services, such as valuations, engineering and planning services. Metropolitan councils are more likely to contract out recycling, construction and maintenance of roads and buildings (MAV 1993). The Western Australian Department of Local Government (1994) found that metropolitan councils had the largest average level of works or services provided by contractors measured by the percentage of gross expenditure.

While aggregate figures on the value of services contracted out by local government are not currently available for most states, studies suggest that around 20 per cent of total local government expenditure was being contracted out by the early 1990s. The Industry Commission (IC) (1996a) in its report on *Competitive Tendering and Contracting by Public Sector Agencies* believed that this figure was likely to underestimate the extent of contracting out undertaken by local government.

While contracts for provision of local government services may be won by private contractors, not-for-profit organisations, other government agencies or the tendering agency's own in-house team, the majority of contracts are awarded to the private sector rather than to public sector agencies. Volunteers are rarely used in formal contracting at the local government level. The 1989 survey of contracting out in New South Wales and Victoria found that only one council contracted to volunteers (IC 1996a). However, volunteers appear to play an important role in the non-contractual provision of some local government services. For example, the same survey found that New South Wales local councils used between 33 000 and 100 000 volunteers to provide over 35 types of local government services, including home nursing, meals on wheels and tourist promotion. This survey also found that the use of volunteers to provide these services appeared to increase during the 1980s (IC 1996a).

B.5 Local government preferences

The use of purchasing preferences by local governments does not appear to be wide-spread. As the Local Government and Shires Association of New South Wales said:

> It is also unlikely that local preference ever constituted a large proportion of overall Local Government purchasing expenditure. The practice has not been common in urban councils or larger regional councils, it has been largely constrained to smaller rural councils. Further, many major purchases would not be commonly available locally, for example, large road making plant and computer equipment. (sub. 6, p. 3)

The Local Government Association of South Australia (LGASA) noted:

> The LGASA is of the view that since the introduction of the Clause 7 Statement [as part of the NCP reforms] in South Australia and the general trend towards competition, local preferences are used less frequently by councils. (sub. 17, p. 4)

In the Industry Commission (1996b) survey of local government assistance to industry, approximately one-third of replies stated that they had local purchasing preferences in place. However, only 10 per cent of respondents mentioned local purchasing preferences as a significant cost and none mentioned it as the most significant cost.

The value of local government assistance in the form of local purchasing preferences is relatively small. NOLG (2001) states that for the year 1997-98, total local government revenue (for all Australia) was approximately $10 billion. The Industry Commission's (1996b) estimate of assistance provided by local government of 2.6 per cent of total revenue would yield the total provision of assistance by local government in 1997-98 of $260 million. Local purchasing preferences would comprise only a very small portion of that total.

C Legal advice from the Australian Government Solicitor

As part of the review process, the Commission requested advice from the Australian Government Solicitor (AGS) as to the application of Part IV of the TPA to local government activities in the absence of section 2D. The response of the AGS is reproduced in this appendix.

AUSTRALIAN GOVERNMENT SOLICITOR

Our ref: 02023117

16 April 2002

Ms Helen Owens
Commissioner
Productivity Commission
PO Box 80
BELCONNEN ACT 2617

Dear Ms Owens

National Competition Policy Legislation Review of Section 2D of the Trade Practices Act 1974 ('TPA')

1. We refer to your letter of 6 March 2002 concerning the review at present being conducted by the Productivity Commission of section 2D of the TPA. Section 2D exempts the licensing decisions and internal transactions of local government bodies from Part IV of the TPA.

2. You say that, in conducting the review, the Commission is examining a number of options, including the removal of section 2D from the TPA. The Commission is therefore seeking advice as to the application of the TPA to local government activities in the absence of the specific exemption. In this regard, you ask:

1: In the absence of section 2D:

(a) Q: Would the licensing activities currently exempted be considered to be regulatory or statutory functions of government and therefore not subject to the TPA?

A: The application of the Competition Code, including the Schedule version of Part IV, to the licensing activities of local government bodies would not depend on whether those activities were characterised as regulatory or statutory functions of government. In the absence of section 2D, the various provisions of the Schedule version of Part IV would apply according to their tenor to the licensing activities of local government bodies.

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(b) Q: Would the internal transactions of local government bodies not be subject to the TPA?

A: A 'transaction' that is entirely internal to a local government body cannot, of itself, infringe Part IV. This will not change if section 2D is removed from the TPA.

3. You say that the Commission is also interested in our opinion on the comments made in a submission attached to your request for advice that was made to the Commission by Mr Ray Steinwall in response to the Commission's issues paper, 'Review of Section 2D of the Trade Practices Act 1974', December 2001 ('issues paper'). In particular, you ask:

2. Q: While sections 2A and 2B limit the application of the TPA to the business activities of the Commonwealth, States and Territories, how, if at all, does Part IV of the Act affect the non-business activities (ie regulatory and statutory functions) of local government?

A: Apart from the operation of the exemptions in section 2D, the Schedule version of Part IV applies according to its tenor to the non-business activities of local government.

3. Q: Has there been any judicial interpretation of the applicability of the TPA to local government since the case involving Mid Density Development Pty Limited and Rockdale Municipal Council in 1992? Is this case still relevant to the application of Part IV of the TPA to local government since the extension of the TPA through the *Competition Policy Reform Act 1995*?

A: *Mid Density Development Pty Limited v Rockdale Municipal Council* (1992) 39 FCR 579, which continues to be applied by the courts, is relevant to the question whether a council is a 'trading corporation' within the meaning of section 51(xx) of the Constitution and is therefore an entity to which Part IV of the TPA itself applies. However, the case is not relevant to the question whether the Competition Code, which includes the Schedule version of Part IV, as applied by State law, applies to a council, because the application of the Competition Code does not depend on the entity in question being a 'trading corporation'. The decision in *Mid Density* that Rockdale Council was not acting 'in trade or commerce' was is relevant to the application of Part IV (it concerned Part V of the Act) and is not relevant to the application of the Schedule version of Part IV.

4. You say that, in conducting the review, the Commission is required to take account of 'the need to promote consistency between and within regulatory regimes'. An option under consideration is to retain section 2D and extend its exemption provisions to incorporate the imposition and collection of taxes, levies or fees for licences by local government. These activities when undertaken by the Commonwealth, State and Territory governments are exempted by section 2C of the TPA. You ask:

> 4. Q: Are the imposition and collection of taxes, levies or fees for licences by local government currently subject to the TPA?
>
> A: Yes.

QUESTIONS 1(a), 2 AND 3

(i) Coverage of Part IV and of Competition Code (Schedule version of Part IV)

5. The coverage of Part IV of the TPA is limited by the extent of the constitutional powers of the Commonwealth. As far as may be relevant to the activities of local government bodies, Part IV extends only to entities that are 'financial corporations' or 'trading corporations' within section 51(xx) of the Constitution. While it is not impossible that the financial activities of a local government body might be sufficiently extensive to make it a 'financial corporation', we are not aware of it ever occurring. The relevant category is therefore 'trading corporations'.

6. In *Mid Density Development Pty Limited v Rockdale Municipal Council*, the Federal Court held that the local government council in question was not a 'trading corporation', as its trading activities were too insignificant in relation to the totality of its activities to confer the requisite character. While there may be individual local government bodies that are able to be characterised for constitutional purposes as 'trading corporations', it appears that a typical council providing the usual range of local government services will be outside the scope of the Commonwealth's constitutional power and Part IV, as applied by the TPA itself, will therefore not apply to it – see, generally, per Davies J in *Mid Density* at pages 53,428-9.

7. The part of the decision concerning the question whether Rockdale Council acted 'in trade or commerce' when issuing a flooding certificate was relevant to Part V of the TPA. It had, and has, no relevance to Part IV, which is not confined to conduct engaged in 'in trade or commerce'.

8. The *Competition Policy Reform Act 1995* inserted Part XIA into the TPA. This provided for the application by the States and Territories of the 'Competition Code'. The 'Competition Code' consists of:

- the 'Schedule version of Part IV' (ie the text of Part IV as set out in the Schedule to the TPA, with references to corporations changed to 'persons');
- the remaining provisions of the Act that relate to Part IV, including eg sections 2B, 2C and 2D; and
- relevant regulations under the TPA.

All States and Territories have enacted legislation applying the Competition Code. As so applied, Part IV applies as State and Territory law. It is therefore not confined in its reach by the limits of Commonwealth constitutional power. It applies generally to 'persons'. Under State and Northern Territory laws relating to local government bodies, such bodies are incorporated and so are 'persons'. Apart from the operation of sections 2B, 2C and 2D, therefore, the Schedule version of Part IV will apply to local government councils, unless crown immunity operates in relation to them. As we advise below – see paragraphs 12 to 19, councils do not have crown immunity. It is therefore true, as Mr Steinwall says in his submission at page 2 that, subject to section 2D:

> (t)he consequence is that since 1995 there is no longer any dispute that a local government body is subject to Part IV through the Competition Code of each State and Territory.

9. It is to be noted that there is no general provision that limits the application of the Schedule version of Part IV to bodies that are engaged in business activity. The Commission's questions asked in your letter appear to reflect a general assumption that Part IV extends only to bodies engaged in trade or commerce. This assumption emerges also at several points in the issues paper – see at pages 16 and 18. It appears to be derived from the second reading speech to the Competition Policy Reform Bill 1995 and the explanatory memorandum for the Bill. For example, the second reading speech says at Hansard, Senate, 29 March 1995 at pages 2435-6:

> The Trade Practices Act will be amended so that, with State and Territory application legislation, the prohibitions against anti-competitive conduct can be applied to all businesses in Australia.
>
> ... ...
>
> Many public sector organisations have both commercial and non-commercial functions, and these reforms are not designed to affect the non-commercial functions undertaken for governments.
>
> In sectors such as education, health, welfare, community services and labour market programs where the public sector has, and will continue to have, a dominant role, the relevance of competition policies will be limited to those circumstances where enterprises are engaged in business activity.

10. There is in fact no special category of 'regulatory' or 'statutory' functions to which the Schedule version of Part IV expressly does not apply. (Statutory functions can, in any event, be business functions.) While it is probably broadly true to say that Part IV is concerned with commercial conduct, the focus of most of the relevant provisions of Part IV is on the *effect on trade* that a person's conduct may have and/or a person's *purpose* of affecting trade. Most of the prohibitions in Part IV do not contain, as an element, a requirement in any form that the person whose conduct is in question be engaged in trade or commerce. See paragraphs 31 to 42 below, where we consider the operation of specific anti-competitive conduct rules in Part IV in relation to licensing and other activities of councils.

(ii) Operation of section 2D

11. Section 2D reads:

> **2D Exemption of certain activities of local government bodies from Part IV**
>
> (1) Part IV does not apply to:
>
> (a) the refusal to grant, or the granting, suspension or variation of, licences (whether or not they are subject to conditions) by a local government body; or
>
> (b) a transaction involving only persons who are acting for the same local government body.
>
> (2) In this section:
>
> *licence* means a licence that allows the licensee to supply goods or services.
>
> *local government body* means a body established by or under a law of a State or Territory for the purposes of local government, other than a body established solely or primarily for the purposes of providing a particular service, such as the supply of electricity or water.

12. In our view, there are two aspects of the present operation of section 2D of the TPA that require consideration for the purpose of determining the effect that removing the section from the Act would have on the activities of councils. These are:

(i) whether councils have the immunity of the State and Territory crowns; and

(ii) whether, if section 2D were removed, councils would be authorities of the States and Northern Territory within sections 2B and 2C.

(i) Would councils be immune from the Schedule version of Part IV because they share the immunity of the State or Territory crown?

13. In *Bradken Consolidated Ltd & Anor v Broken Hill Pty Limited & Ors* (1979) 145 CLR 107 the High Court held that the TPA did not bind the States and Territories, by necessary implication from the presence in the Act of section 2A. Notwithstanding the modification of the *Bradken* doctrine in *Bropho v Western Australia* (1990) 171 CLR 1, the decision in *Bradken* in so far as it related to the TPA itself has since been upheld in *Woodlands v Permanent Trustee Company Ltd* (1996) 139 ALR 127 and *Corrections Corporation of Australia Pty Ltd v Commonwealth* (2000) FCR 448. The inclusion in the TPA of section 2B now appears to confirm that, except as provided by that section and section 2C, neither the TPA nor the Competition Code would bind the crown in right of the States and Territories or bodies having the immunities of the crown.

14. The explanatory memorandum to the Competition Policy Reform Bill, in the clause note to clause 81 which inserted sections 2B, 2C and 2D, appears to assume that local government bodies have the immunities of the crown. This may also be a more widely-held assumption – see W J Pengilley, S G Corones and D J Healey in *Australian Trade Practices Reporter* Vol 1 page 713. In our view, while there may be individual cases in which a council may be held to have engaged in a particular activity as an instrumentality of the crown and so to have crown immunity in relation to that activity, local councils do not, in general, share the immunity of the crown.

15. In the early High Court case of *Federated Municipal and Shire Council Employees' Union of Australia v The Lord Mayor, Aldermen, Councillors and Citizens of the City of Melbourne* (1918-19) 26 CLR 508, the Court held that municipal corporations established under State laws are not, with regard to the making, maintenance, control or lighting of public streets, instrumentalities of State government and therefore are not, in respect of such operations, within the State crown's immunity from Commonwealth laws. Isaacs and Rich JJ examined in some detail the English case-law relating to the position of municipal corporations in relation to the crown, both where the corporations were established by charter and by statute. In either case, their Honours found that municipalities have been historically regarded as functioning as independent local authorities that act in the interests of, and as elected representatives of, their local communities and that they do not represent, or carry out functions on behalf of, the crown.

16. More recently, courts have generally held that local governments do not operate as instrumentalities of the State or Territory crown – see *Sydney City Council v Reid* (1994) 34 NSWLR 506; *Bodney v Westralia Airports Corporation Pty Ltd* (2000) 180 ALR 91 at 103-4. In *Reid*, a decision of the New South Wales Supreme Court, Kirby P (now of the High Court) said:

> Whilst local government is indeed a form of government, it is also a creature of statute. Out of recognition of the imperatives of democratic self-government, the statutory provisions have enacted the creation of largely independent corporations accountable (in the ordinary course) not to the minister (that is, the Crown), but to the people who elect them. In this sense, the high measure of independence of statutory corporations, by which local government is ordinarily carried out is inconsistent with viewing their employees as servants of the Crown.

This passage was cited with approval in *Townsend v Waverley Council* [2001] NSWSC 384. Meagher JA in *Reid* also said:

> Even the learned solicitor who argued the case for the respondent, Mr D M Bennett QC, did not advance so farouche a submission that a municipal council was the Crown, or an arm of the Crown, or an emanation of the Crown, or an agent of the Crown. The aldermen of a council are elected by popular suffrage, not appointed by the Crown. They neither ask for, nor
>
> , in general, receive, any assistance from the Crown in the discharge of their daily tasks. The extent to which the Crown can interfere with their activities is slight, and the extent to which it does is minimal.

17. There have been cases in which a council has been regarded as exercising governmental functions on behalf of the crown, in circumstances where it might be considered that the council therefore had the immunities of the crown – see *Stack v Brisbane City Council* (1995) 59 FCR 71 at 83-84. There are remarks of Cooper J of the Federal Court in that case that appear inconsistent with the judgments in *Reid*. The case is to be explained, however, on the basis that it was a decision on the status of the Brisbane City Council under a particular Act – ie the Commonwealth *Patents Act 1990*. See also *Carpentaria Land Council v Queensland* (1998) 83 FCR 483 at 507 per Beaumont J, where the decision that the Council had acquired land as a state instrumentality was evidently reached for reasons related to the particular Act before the court in that case.

18. The possibility needs to be considered that, while councils might not generally have the immunity of the crown, they might enjoy that immunity when carrying out some particular functions that might be considered to belong peculiarly to the central crown, rather than to local government in its own right, and are therefore exercised as agent of the crown. The relevant functions in the present context are the levying of taxes such as rates and the issuing of licences that allow the licensee to supply goods or services. The position appears to be, however, that both of these functions are, on the contrary, typical functions of local government. The judgment of Isaacs and Rich JJ in the *Federated Municipal and Shire Council Employees' Union* case at page 527 indicates that the right to levy rates to finance such functions as road building and maintenance and the supply of water are rights traditionally enjoyed by

municipal corporations. And the right of regulating markets (for example, by the issue of licences):

> 'is part of the municipal government of the town' and 'is vested in the corporation for the benefit of the town as part of the government of the town'

(at page 528, citing Jessel M R in *Attorney-General v Mayor of Brecon* 10 Ch D 204). In our view, neither of these types of activity would therefore attract the immunity of the crown.

19. In any case, the terms of section 2D are, in our view, inconsistent with local government bodies generally having the immunities of the crown, for the purposes of the TPA and the Competition Code, and so being generally immune from Part IV in either form. Section 2D is framed as an exemption from Part IV for certain categories of activities of local government bodies. An exemption can only operate on the basis that, if section 2D were not there, the Schedule version of Part IV would apply, at least in those respects, to local government bodies. (Compare the contrary view of W J Pengilley et al in *Australian Trade Practices Reporter* Vol 1 page 713, with which we disagree.) Moreover, we do not see any basis on which local government bodies might be considered to have the immunities of the crown when carrying out some types of function, if they did not also have such immunities when issuing licensees that allow the licensees to supply goods or services. If any function of a council could be expected to attract the immunity of the crown, the administration of regulatory licensing schemes would be one of the likeliest candidates.

(ii) Authorities of States and Northern Territory?

20. In the absence of a negative implication that arises from the presence of section 2D in the Act, councils would, in our view, be authorities of the States and the Northern Territory for the purposes of sections 2B and 2C, and so be within the coverage of the exemption in those sections for activities that are not business. Subsection 4(1) of the Act relevantly defines 'authority' as follows:

> *authority*, in relation to a State or Territory (including an external Territory), means:
>
> (a) a body corporate established for a purpose of the State or the Territory by or under a law of the State or Territory;
>
> (b) ... .

In all States and the Northern Territory, local government councils are established either by or under the various Local Government Acts, and so, in our view, would be 'authorities' of the relevant State or Territory for the purposes of this definition and of section 2B.

21. The contrary view has been expressed by a number of State departments of local government in their submissions to the Inquiry. Mr Bill Henderson has provided us with an extract from the submission of the New South Wales Department of Local Government (sub 18, page 1), which states:

> Local Government in NSW is established under the *Local Government Act 1993* (LG Act). Each council is a statutory corporation (s.220 LG Act) and has all the powers of a body corporate (see *Interpretation Act 1987*), as modified under the LG Act.
>
> Councils are not regarded as "the Crown" (see *Federated Municipal and Shire Council Employees' Union of Australia -v- Melbourne Corporation* (1919) 26 CLR 508) nor is a council an authority representing the Crown (see *Deniliquin Municipal Council -v- Murray Shire Council* (1986) 58 LGRA 161). While councils are statutory bodies exercising public functions, this probably does not mean that they are authorities of the State, as the term is used in section 2C of the *Trade Practices Act 1974*. While established under State legislation, councils are democratically elected and are not under the direct control or administration of a Minister.

Mr Henderson also informed us that local government departments in Victoria and Queensland indicated in informal discussions that it was unlikely that local government bodies in their respective jurisdictions would fall under the definition of an 'authority' of the State Government.

22. For the purposes of sections 2B and 2C of the TPA, however, the question is not whether a council is an 'authority of the State' in a general sense but whether a council falls within the definition of 'authority in relation to a State' in subsection 4(1). Given that councils are undoubtedly bodies corporate established by or under State and Territory laws, the point of disagreement by State departments with our view that councils fall within the definition must centre on whether councils are established 'for a purpose of the State or the Territory' within the meaning of subsection 4(1) of the TPA.

23. While the New South Wales submission set out above does not give a very clear idea of the reasons for the State departments' view, it seems to be based on arguments such as those set out above in relation to councils not being within the immunities of the crown – ie that councils fulfil entirely local functions and represent, and act for the benefit of, the local community rather than the State or Territory crown, and that their operations are largely free of control by the State government. Although there is some substance to these considerations, they do not require the conclusion that local governments are not established 'for a purpose of the State or Territory' within the definition in the TPA. While councils undoubtedly do perform local rather than central functions, and while they perform them in the interests of the local community and as the elected representatives of those

communities, in relative freedom from control by the central government, *these are simply the attributes with which the State has chosen to establish them.*

24. In *The Municipal Council of Sydney v The Commonwealth* (1904) 1 CLR 208, a case that concerned the question whether the Council was 'a State' for the purposes of section 114 of the Constitution, O'Connor J said at page 240:

> The State, being the repository of the whole executive and legislative powers of the community, may create subordinate bodies, such as municipalities, hand over to them the care of local interest, and give them such powers of raising money by rates or taxes as may be necessary for the proper care of these interests. But in all such cases these powers are exercised by the subordinate body as agent of the power that created it.

Cases on section 114 of the Constitution are not relevant to a determination whether a body has the immunity of the crown – *Deputy Commissioner of Taxation v State Bank (NSW)* (1991-92) 174 CLR 219 at 230. However, the above passage from *Municipal Council of Sydney* is, in our view, relevant to the question whether a council is established 'for a purpose of the State'. Since the State establishes the councils and confers on them part of the legislative and executive powers of the State, the better view is that it does so 'for a purpose of the State'.

25. It follows, in our view, that, in the absence of section 2D, councils would have been authorities of the States and the Northern Territory within sections 2B and 2C. It would follow that Parts IV and VB of the TPA would apply to councils only in so far as they carried on a business, and that imposing or collecting taxes, levies or licence fees would be expressly excluded from the category of business activity, as well as licensing activities. The presence in the Act of section 2D is, however, clearly inconsistent with councils being within the scope of sections 2B and 2C.

26. If section 2D were to be removed from the Act, the question would arise whether local government bodies that fell within the above definition would thereby *become* authorities of the States and Northern Territory, because there would then be nothing in the Act that would prevent section 2C and the definition from operating according to their tenor. Any amendment removing section 2D would need to deal expressly with the application or non-application of sections 2B and 2C. In the absence of such express provision it would be unclear whether Parliament intended the removal of section 2D to strip councils of the limited immunity conferred by that provision, or confer on councils the broader immunity provided by sections 2B and 2C for 'authorities' of a State.

Application of Part IV to councils

27. As indicated above, there is nothing that generally limits the application of Part IV to persons engaging in business. Moreover, with the exception of the provisions

relating to exclusionary provisions (section 4D and subparagraph 45(2)(a)(i)) and section 48 relating to resale price maintenance, the individual provisions in Part IV are such that they are all capable, at least in theory, of being infringed by a council engaging in a non-commercial activity.

28. The issues paper states on page 15 under the heading 'Licensing decisions':

> Governments impose standards and conditions on the supply of many goods and services. Appropriate product standards can provide significant benefits to the community ...
>
> However, the imposition of minimum standards will often have the effect of reducing competition in the market for the good or service concerned. For example, State and Territory licensing requirements for health professionals mean that only persons with the relevant qualifications are allowed to offer these services. Similarly, conditions attaching to the licensing of retail premises by local governments may limit the number of premises in which retail operations can be conducted.
>
> Were it possible to challenge such licensing requirements under the TPA on the grounds that competition was reduced, the capacity of governments to establish beneficial minimum standards for the supply of particular goods and services could be undermined. ...

29. While Mr Steinwall in his submission disagreed that the setting of minimum standards would be likely to have the effect of substantially reducing competition in a market (at page 6), it seems to us that the imposition of minimum standards as part of a licensing scheme for particular categories of business that supply goods and services might well reduce the number of entrants to the relevant market. We propose therefore to take this as one of the examples against which to test the potential application of individual provisions of Part IV. The other example we take is the entering into by a council of a contract with a single supplier for the supply of all of the council's requirements of a particular commodity or a particular type of services. The licensing activity would at present be exempted by section 2D. Entering into a contract for supply of goods or services would at present be subject to the Schedule version of Part IV.

30. We consider below the provisions of Part IV that appear to have possible relevance to councils.

Subsection 45(2)

31. Section 45(2) prohibits the making of, or giving effect to, a contract, arrangement or understanding that has the purpose, or would have or be likely to have the effect, of substantially lessening competition.

32. Minimum standards imposed as conditions under a licensing scheme will not fall within subsection 45(2). The 'contracts, arrangements or understandings' to which subsection 45(2) refers are in the nature of agreements, whether formal or informal, between two or more persons and containing a term or terms that has the proscribed purpose of effect. Minimum standards imposed as licence conditions or otherwise imposed under a licensing scheme are not contained in any form of agreement but are imposed unilaterally by the regulatory body. They therefore cannot infringe subsection 45(2).

33. It is possible that minimum standards could be imposed under a contract with a supplier of goods or services, but it does not seem likely that such a contract could have the effect of substantially reducing competition in a market or, therefore, that it could infringe subsection 45(2).

34. There does, however, remain a possibility that a council could enter into a contract, whether a contract for the supply of goods or services to the council or some other type of contract, that did have the effect of substantially lessening competition. While it would presumably not occur at all frequently, it is not impossible. If it did occur, the council would be infringing subsection 45(2) both by entering into the contract and by giving effect to it.

Section 45A

35. Subsection 45A(1) provides that a provision of a contract, arrangement or understanding shall be deemed for the purposes of section 45 to have the purpose or effect of substantially lessening competition if it fixes, controls (etc) the price for, or a discount, allowance, rebate or credit in relation to, goods or services. A contract made by a council could fall within the terms of subsection 45A(1) if the council entered into a single contract with a number of suppliers for the supply of the same goods or services, if the contract fixed prices, discounts, rebates or credits. The application of subsection 45A could be avoided simply by entering into a separate contract with each supplier.

Section 45B

36. Section 45B prohibits the requiring or giving of covenants that have the purpose or effect of substantially lessening competition. Minimum standards imposed as part of a licensing scheme are not imposed by means of covenants. There is again a possibility that a council might infringe section 45B, eg in a contract for the supply to the council of goods or services.

Section 45E

37. Subsection 45E(3) prohibits a person from agreeing with an organisation of employees that it will no longer acquire goods or services from a supplier from which it was previously acquiring goods or services, or that it will continue to do so

only subject to new conditions. This appears to be a provision that a council might infringe.

Section 46

38. Section 46, relating to misuse of market power, is considered by Mr Steinwall in his submission (page 7) to be a possible rationale for section 2D having been included in the TPA. Section 46 provides:

> **46 Misuse of market power**
>
> (1) A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
>
> (b) preventing the entry of a person into that or any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

39. Mr Steinwall submits that, while the matter is not settled, the current weight of judicial opinion is that the exercise of a statutory power to licence is not an exercise of market power but the discharge of a statutory function. Mr Steinwall's conclusion appears to be that a body carrying out regulatory activities will not be held to be exercising a substantial degree of power in a market (although he says that a concern will remain unless there is an unequivocal judicial pronouncement to that effect).

40. In our view, the decision in *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000] FCA 38 does not purport to establish, as a simple proposition, that an exercise of a regulatory power cannot constitute a misuse of market power. The characterisation of the licensing decision by the Bunbury Port Authority as a discharge of a regulatory function rather than as an exercise of 'market power' came after a consideration by the Full Federal Court on appeal ((2000) ATPR 41-783) of a number of factors, ie:

- that the Bunbury Port Authority was not itself a participant in the market;
- the motivation of the Authority in offering an exclusive licence;
- that the Authority did not act for any of the purposes proscribed by paragraphs 46(1)(a), (b) and (c)

(see *NT Power Generation Pty Ltd v Power and Water Authority* (2001) 184 ALR 481 at 554-5). It is significant that an entity can exercise a degree of power in a market even where that entity does not itself participate (ie trade) in that market – see *NT Power* at page 557 per Mansfield J.

41. Most significant, however, from the perspective of local government councils, is the fact that section 46 by its terms can only be infringed by an entity that *takes advantage of* its substantial degree of power in a market *for one of the purposes proscribed by paragraphs 46(1)(a), (b) and (c)* – ie for the purpose of eliminating or damaging a competitor, of preventing the entry of a person into a market or of deterring or preventing a person from engaging in competitive conduct. It seems unlikely that a council would exercise one of its powers for such a purpose. And a council that did so ought, presumably, to be subject to the TPA.

Section 47

42. Section 47 prohibits the practice of exclusive dealing. A council would be capable of engaging in conduct that amounted to exclusive dealing within subsections 47(4) and (5), in relation to its acquisition of goods and services, although it seems highly improbable that a council would do so. Presumably, the policy is that a council that engaged in exclusive dealing should be subject to the TPA.

QUESTION 1(b)

43. It is difficult to give a meaning to the expression 'a transaction involving only persons who are acting for the same local government body' and therefore difficult to work out the present effect of paragraph 2D(1)(b).

44. The word 'transaction' can have a wide or narrow meaning, depending on the context in which it is used – see *Hambro v Duke of Marlborough* [1994] 3 All ER 332. In the context of the TPA, there is no reason for giving the word anything other than its widest meaning. Clearly, for example, it is not confined to actions having a legal effect. On the other hand, however, it is apparent both from the ordinary meaning of the word and from the fact that paragraph 2D(1)(b) exempts internal transactions from the application of Part IV that, in order to be a 'transaction', an action must be capable of having some practical effect, either actual or potential, on persons *external* to the local government body itself. Part IV applies only to conduct that has or may have an effect on a market or on the commercial operations of another person.

45. The expression 'a transaction involving only persons who are acting for the same local government body' therefore seems to us, in practice, not to extend to the kinds of action that could involve any infringement by a council of Part IV. For example, where one part of a council provides services to another part of the council, no entity other than the council is affected. The council is in the same position as a private company that has work done in-house – there is no 'transaction' in any ordinary sense of the word. Simply, employees working for the same employer have carried out their different duties for their employer. Similarly, where two council employees work together on the processing of licence applications (eg if one does

the initial processing and prepares a report for the other who will then prepare the recommendation for the council) or if they together settle the terms on which the council will be prepared to contract with suppliers, there is not at that stage any action of the council that can infringe Part IV. There will not be any relevant conduct unless and until somebody, on behalf of the council, takes some action that has or may have a proscribed purpose or effect – eg issues the licence or enters into the contract or notifies its intention to do so only upon certain terms or conditions. In our view, Part IV only applies to actions of council employees that have external effects, ie where an employee takes action on behalf of the council that affects or has the potential to affect the commercial activities of an outside party. (Once there is a primary contravention by a council or an employee, the question of aiding and abetting can become relevant, but it need not be considered here.)

46. Mr Steinwall says in relation to the rationale for including paragraph 2D(1)(b) in the TPA:

> ... a person may act on behalf of an entity rather than in their personal capacity. In this case their actions have a number of consequences. They may be personally liable or liable as an accessory. Their actions may simultaneously render the entity for which they act also liable. The exemption is particularly relevant to this second case. It protects the transaction and hence the local government body from Part IV liability. The intent of s2D(1)(b) is that if those persons are in fact acting for the same local government body then Part IV does not apply to a transaction between them.

It is not entirely clear to us what persons Mr Steinwall had in mind when making these comments. Council employees performing internal functions for the council do not act 'on behalf of' the council in a legal sense but merely carry out their duties as employees. An entirely internal transaction cannot render the council liable, and the employee then cannot be liable as an accessory. If an employee acts in a transaction involving a third party that infringes Part IV, the exemption for internal transactions will not protect either the council or the employee, because the transaction is not internal.

47. We agree with the suggestion in the issues paper that the paragraph was probably intended to place a council in the same position as a private company. In fact, however, no special exemption is needed to achieve this. A council that is a single body corporate already is, in this respect, in the same position as a private company.

48. It will be apparent that we doubt that paragraph 2D(1)(b) has any practical operation and, therefore, that removing it would have any practical consequences.

QUESTION 4

49. The imposition and collection of taxes, levies or fees for licences by local government are at present subject to the Schedule version of Part IV. On the assumption that taxes, levies and fees for licences are generally not imposed by any form of agreement, the only provision of Part IV that seems to us likely to be applicable is section 46, which prohibits misuse of market power. As we have advised above, section 46 can only be infringed by a council that takes advantage of its substantial degree of power in a market *for one of the purposes proscribed by paragraphs 46(1)(a), (b) and (c)* – eg for the purpose of eliminating or damaging a competitor. There is a question whether 'the need to promote consistency between and within regulatory regimes' would warrant exempting such conduct by a council from the operation of Part IV.

50. Please do not hesitate to contact us if you wish to discuss any aspect of this advice.

Yours sincerely

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