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The *International Trade and Business Law Review* publishes leading articles, comments and case notes as well as book reviews dealing with international trade and business law, arbitration law, foreign law and comparative law. It provides the legal and business communities with information, knowledge and understanding of recent developments in international trade, business and international commercial arbitration. The *Review* contributes in a scholarly way to the discussion of these developments while being informative and having practical relevance to business people and lawyers. From time to time, the *Review* also devotes a section to the Willem C. Vis International Commercial Arbitration Moot and publishes the memoranda prepared by a team coached by Professor Gabriël A. Moens.

The Review is edited by Professor Gabriël A. Moens, who is an Emeritus Professor of Law at the University of Queensland. He also served as a foundation Professor of Law at Curtin University School of Law in Perth, Australia, during the editing of Volume XXII. The Review is an internationally refereed journal and is supervised by an international board of editors consisting of leading international trade law practitioners and academics from the European Union, the United States, Asia, and Australia. The Editorial Consultants for Volume XXII are Georgia Cole, Nicole Johnston and Rowan Ratter-Stotesbury.

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BLOCKCHAIN TECHNOLOGY: ITS ABILITY TO TRANSFORM CORPORATIONS' CORPORATE SOCIAL RESPONSIBILITY PRACTICES

PAM LY*

ABSTRACT

International Regulation – Blockchain Technology – Bitcoin – Financial Market – Corporate Governance – Responsible Investment – Triple Bottom Line – Supply Chain Management – Corporate Social Responsibility

The technology of blockchain ('Blockchain') realises a more efficient, equitable, and transparent distributed ledger system. An important characteristic of Blockchain is its automated, de-centralized, and neutral ledger system which could be useful to carry out Corporate Social Responsibility ('CSR') initiatives. Part I of this paper suggests that the Blockchain will evolve to become a permanent 'disruptor' with the potential to transform corporations' CSR practices. Part II introduces the Blockchain and identifies its significance to CSR, both in the United States ('U.S.') and internationally. Part III explains how the Blockchain can help demonstrate that a corporation is a 'responsible business' through good corporate governance, effective supply chain management, and exercise of the triple bottom line – people, profit, and planet. Part IV examines how the Blockchain's disruptive role influences corporate decision-making, especially its implications for corporate investors, financial institutions, and the practice of law as well as its impact on intellectual property and data privacy functions. Part V discusses the U.S. current regulatory landscape and growing trends relating to the Blockchain. Finally, Part VI recommends lawmakers and corporations consider adopting a legislative framework that aligns with the United Nations Sustainable Development Goals ('UN SDGs') to demonstrate responsible investment and good corporate governance. Accordingly, the Blockchain can help corporations transform CSR practices and assist lawmakers to regain public trust through effective rulemaking that demands corporate accountability on domestic and international issues.

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I INTRODUCTION

The aftermath of the 2008 global financial crisis became the catalyst for the rise of Bitcoin and other virtual currency operations.¹ Due to public distrust of the financial ecosystem at the time, consumers began transitioning to virtual currencies promising more efficient, transparent, and equitable payment systems than traditional banks.²

Following the rise in popularity of Bitcoin and other virtual currencies running on blockchain platforms, businesses began exploring the capacity for blockchain technology ('Blockchain') to move beyond Bitcoin.³ As global competition for technological advances continues to increase, the World Economic Forum estimated more than twenty-five countries are actively investing in the Blockchain. Correspondingly, the number of patent applications has increased along with interest in regulation of the Blockchain to ensure its stability without stifling future market developments.⁴ This new technology's ability to establish 'proof of trust' through transparency and traceability in an automated, de-centralized, and neutral way is an important characteristic within the scope of Corporate Social Responsibility ('CSR').⁵ For instance, a consumer will have information from a more trusted source on which to base his or her purchasing decisions especially when it comes to products that are tracked for human rights violations (eg, conflict minerals in the supply chains). The Blockchain also enables businesses to build transactional records, monitor various stages of a product's supply chain, and mitigate instances of criminal or fraudulent activities.⁶

¹ Elizabeth Sara Ross, 'Nobody Puts Blockchain in a Corner: The Disruptive Role of Blockchain Technology in the Financial Services Industry and Current Regulatory Issues' (2017) 25 *Catholic University Journal of Law and Technology* 353, 355.

² See RESET, *Blockchain: A Digital System for Real World Sustainability* (28 August 2017) <<https://en.reset.org/knowledge/blockchain-digital-system-real-world-sustainability-08282017>>.

³ White Paper, 'The Future of Decentralised: Block Chains, Distributed Ledgers, and The Future of Sustainable Development' (2 March 2018) *United Nations Development Programme* 1, 7 <<http://www.undp.org/content/undp/en/home/librarypage/corporate/the-future-is-decentralised.html>>.

⁴ Ross, above n 1, 356-7.

⁵ See, eg, Dennis Kennedy, 'Thinking Smartly About Smart Contracts' (2018) 44 *American Bar Association Law Practice Magazine* 56, 58 and Inigo Molero, *Blockchain as a new concept of CSR* (6 September 2017) Banco Bilbao Vizcaya Argentaria <<https://www.bbva.com/en/blockchain-new-concept-csr/>>.

⁶ UN Blockchain: Multi-UN Agency Platform, *One* <<https://un-blockchain.org/>>.

Similarly, civil society can verify CSR conditions with information recorded in encrypted transactions, or ‘smart contracts’, as secured by the Blockchain to measure companies’ supply chain transparency and sustainability practices.⁷ However, while the Blockchain could be useful in carrying out CSR initiatives, lawmakers are becoming more concerned about how to regulate this open source innovation in the United States (‘U.S.’) and abroad.⁸ Part I of this paper suggests that the Blockchain is not a temporary hype; rather, it will evolve to become a permanent ‘disruptor’ with the potential to empower consumers, suppliers, manufacturers, civil society, and other parties to demand CSR principles be applied to the corporate landscape.

While technical differences exist between public, private, and permissioned blockchains,⁹ this article discusses the Blockchain at a more general level. Part II introduces the Blockchain and identifies its significance to CSR, both in the U.S. and internationally. Part III explains how the Blockchain can help a corporation demonstrate it is a ‘responsible business’ through good corporate governance, effective supply chain management, and exercise of the triple bottom line – people, profit, and planet. Part IV examines how the Blockchain’s disruptive role influences corporate decision-making, especially its implications for corporate investors, financial institutions, and the practice of law as well as its impact on intellectual property and data privacy functions. Part V discusses the U.S. current regulatory landscape and growing trends relating to the Blockchain. Finally, Part VI recommends lawmakers and corporations consider adopting a legislative framework that aligns with the United Nations Sustainable Development Goals (‘UN SDGs’) to demonstrate responsible investment and good corporate governance. Accordingly, the Blockchain can help corporations transform CSR practices and assist lawmakers to regain public trust through effective rulemaking that demands corporate accountability on domestic and international issues.

⁷ Cindy Huynh, *How Blockchain Helps with Corporate Social Responsibility* (18 December 2017) Coinsquare <<https://discover.coinsquare.io/business/corporate-social-responsibility-blockchain/>>.

⁸ Austin Mills, *What to Expect from Blockchain in 2018* (21 December 2017) Law360 <<https://www.law360.com/articles/996634/what-to-expect-from-blockchain-in-2018>>.

⁹ Alan Cohn et al, ‘Smart After All: Blockchain, Smart Contracts, Parametric Insurance, and Smart Energy Grids’ (2017) 1 *Georgetown Law Technology Review* 273, 280.

II WHAT IS BLOCKCHAIN TECHNOLOGY

A *Blockchain as a Distributed Ledger Technology*

The Blockchain is a type of open ‘distributed ledger technology’ that can automatically record transactions in an efficient and verifiable way between two parties to a mutual agreement.¹⁰ It has also garnered interest and widespread attention from software developers, start-up businesses, corporations, governments, and the international community who sought to establish a de-centralized organization without a central authority.¹¹ The Blockchain is based on cryptographic algorithms distributed over a peer-to-peer network, which allow a wide range of people to record their agreements on particular transactions in a secure and verifiable manner.¹² The Blockchain is capable of storing all kinds of information, such as credit cards, medical and financial records, a person’s identity, a product’s shipment history, or even digital assets.¹³ The ledger duplicates transactions simultaneously through a series of unrelated computers or servers called ‘nodes’ so that the same data gets recorded anonymously across a network of computers.¹⁴ Each block is added and linked to the prior block, so whenever the nodes within that network have reached a consensus, the group of blocks, or transactions, on that chain gets validated – hence the technology is called the Blockchain.¹⁵

Generally, for a block to be secure it will contain four pieces of information:

- (1) the ‘hash’ of the previous block;
- (2) a summary of the included transaction;
- (3) a time stamp; and
- (4) proof that the block is ‘valid’ by solving a highly complex algorithm.¹⁶

¹⁰ Marco Iansiti and Karim R. Lakhani, *The Truth About Blockchain* (January – February 2017) Harvard Business Review <<https://hbr.org/2017/01/the-truth-about-blockchain>>.

¹¹ Carla L Reyes, ‘Moving Beyond Bitcoin to an Endogenous Theory of Decentralized Ledger Technology Regulation: An Initial Proposal’ (2016) 61 *Villanova Law Review* 191, 192.

¹² Ibid 196.

¹³ White Paper, above n 3, 3.

¹⁴ John McKinlay, *Blockchain: background, challenges and legal issues* (2 February 2018) DLA Piper <<https://www.dlapiper.com/en/uk/insights/publications/2017/06/blockchain-background-challenges-legal-issues/>>.

¹⁵ Dror Futter, ‘Blockchain Law: ICO Regulation and Other Legal Considerations in the Blockchain Ecosystem’ (2018) 2 *Practicing Law Institute Press* 21, 22.

¹⁶ McKinlay, above n 14.

The Blockchain functions as a self-maintaining database that authenticates and verifies transactions while preventing fraudulent parties from exploiting a transaction's vulnerabilities and detecting any unauthorized alterations to a transaction.¹⁷

Bitcoin is the most widely understood application of the Blockchain, but there is a notable distinction to be drawn between the two terms. Bitcoin is simply a digital coin that is synonymous to money.¹⁸ Bitcoin became the first and largest virtual currency that used a peer-to-peer version of electronic cash, within a consensus network of Bitcoin clients. It allows digital payments to be sent directly between two parties absent an intermediary.¹⁹ The Blockchain, on the other hand, has the unique capacity to store, track, trade, and verify all transactions within its database in a chronological and linear order.²⁰ Each application of the Blockchain carries a unique set of properties with its own 'road map'.²¹ Thus, the Blockchain's function is well beyond the simple movement of digital assets, which often gets misunderstood in the Bitcoin-Blockchain lexicon and the conflation of the two terms.²²

B Blockchain Technology's Role in Corporate Social Responsibility

1 Blockchain Technology Enhances Regulatory Compliance Requirements

The Blockchain's potential to enhance companies' regulatory compliance requirements is indicative of its application to CSR. For instance, Blockchain's fundamental concepts of de-centralization, immutability, and transparency are key CSR concepts. Support for these concepts have

¹⁷ Ibid. See Trevor I Kiviat, 'Beyond Bitcoin: Issues in Regulating Blockchain Transactions' (2015) 65 *Duke Law Journal* 569, 573.

¹⁸ Camilleri Preziosi, *The Difference between Blockchain and Bitcoin* (7 October 2017) LEXOLOGY <<https://www.lexology.com/library/detail.aspx?g=4b53ac69-bdab-4967-afa3-90576dc436f3>>.

¹⁹ Ross, above n 1, 359-60.

²⁰ Joseph Guagliardo and Brittany Birnbaum, *Blockchain: Preparing For Disruption Like It's The '90s* (14 March 2016) *Law360* <<https://www.law360.com/articles/771200/blockchain-preparing-for-disruption-like-it-s-the-90s>>.

²¹ Shelly Hagan, *Cryptocurrencies Are Like Ponzi Schemes*, *World Bank Chief Says* (8 February 2018) *Bloomberg Law* <<https://www.bloomberglaw.com/exp/>>

²² Preziosi, above n 18.

attracted numerous developers, including the U.S. Federal Government, to want to refine the technology's capabilities, applying Blockchain's use in various fields beyond the financial sector.²³ In fact, the U.S. Environmental Protection Agency ('EPA') and other federal agencies have adopted a federal technical assistance framework – E3: Economy, Energy, and Environment – with the aim of helping communities and businesses reduce pollution and energy use.²⁴ The Blockchain can assist this framework by revolutionising the sharing economy, enabling individuals to use smart contracts for buying and selling energy.²⁵ It also allows companies to accurately track and allocate water and greenhouse gas emission resources more efficiently and effectively.²⁶ For instance, especially in the renewable energy and emissions-trading markets, the Blockchain can help reduce costs and simplify the audit process that have traditionally been validated by expensive audit companies.²⁷ Furthermore, the Blockchain can help companies comply with the EPA's environmental laws and regulations.²⁸ It would also have assisted in advancing former President Barack Obama's Executive Order calling for federal sustainability laws that required federal agencies to increase efficiency and improve their environmental performance.²⁹ Additionally, the Blockchain could be used to record and report the manufacturing

²³ RESET, above n 2.

²⁴ United States Environmental Protection Agency, E3: *Economy – Energy – Environment* (19 April 2018) <<https://www.epa.gov/e3>>.

²⁵ Caroline Stewart, *How Blockchain Could Change the Energy Industry: Part 1* (21 November 2017) Law360 <<https://www.law360.com/articles/987354/how-blockchain-could-change-the-energy-industry-part-1>>.

²⁶ N Rana and U Majmudar, *Blockchains and responsible business*, (3 October 2017) The Economic Times <<https://blogs.economictimes.indiatimes.com/ResponsibleFuture/blockchains-and-responsible-business/>>.

²⁷ Caitlin Shields and Macklin Henderson, 'BLOCKCHAIN: FUTURE OF RENEWABLE TRADING?' (2018) 156:10 *Public Utilities Fortnightly* 52, 53-4.

²⁸ See United States Environmental Protection Agency, *Laws and Executive Orders* (14 September 2017) <<https://www.epa.gov/laws-regulations/laws-and-executive-orders>> and Laws and regulations relevant to the EPA's mission to protect human health and environment can be found under Title 40 of the U.S. Code of Fed. Reg. See generally *Protection of the Environment*, 40 CFR § 1-1899 (2017).

²⁹ The White House Office of the Press Secretary, 'Executive Order – Planning for Federal Sustainability in the Next Decade' (Press Release, 19 March 2015) <<https://obamawhitehouse.archives.gov/the-press-office/2015/03/19/executive-order-planning-federal-sustainability-next-decade>>.

processes of human and animal food in compliance with regulations set by the U.S. Food & Drug Administration ('FDA').³⁰ Specifically, it would enable individuals and companies to track a food product's supply chain and verify ingredients throughout the process as each item moves from manufacturer to end consumer.³¹ However, most notable of the Blockchain's applications is its ability to assist governments and banks with tracing and reporting suspicious financial transactions and proceeds of crime. This application assists in reducing corruption practices nationally and internationally, aiding in compliance with various U.S. federal corruption statutes and banking regulations.³²

2 Blockchain Technology Adopted by the International Community

The Blockchain is not just a domestic phenomenon. It has been recognized by various international organizations, including the United Nations ('UN') and World Bank. It draws particular attention to issues related to 'development aid, digital identity, remittances, supply chain management, energy, and property rights'.³³ The UN has (1) acknowledged the Blockchain's potential disruption to existing governance systems in both the public and private sectors; and (2) embraced the Blockchain as an opportunity to 'defend the rights of those they represent and to accelerate our collective progress towards meeting the [UN SDGs]'.³⁴

³⁰ United States Food and Drug Administration, Guidance for Industry: *Supply-Chain Program Requirements and Co-Manufacturer Supplier Approval and Verification for Human Food and Animal Food* (8 November 2017) <<https://www.fda.gov/Food/>

³¹ Rana et al, above n 26.

³² RESET, above n 2. See generally Columbia Law School, *A Guide to Commonly Used Federal Statutes in Public Corruption Cases: A Practitioner Toolkit* (August 2017) Center For the Advancement of Public Integrity <https://www.law.columbia.edu/sites/default/files/microsites/public-integrity/a_guide_to_commonly_used_federal_statutes_in_public_corruption_cases.pdf> and Federal Financial Institutions Examination Council, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (11 November 2014).

³³ White Paper, above n 3, 33.

³⁴ Ibid 2.

The European Union ('EU') also recognised the Blockchain's positive attributes, particularly in areas relating to Regtech, insurances, finance, intellectual property, and healthcare.³⁵ On 1 February 2018, the European Commission ('EC') launched the EU Blockchain Observatory, a member States-driven initiative consisting of twenty-eight EU countries, with the dual objectives of making Europe the benchmark for Blockchain and preventing the adoption of duplicate or fragmented initiatives.³⁶ The EU is also exploring ways the Blockchain can improve cross-border services in Europe such as VAT reporting, taxation, and customs, and how it can affect international trade and transactions.³⁷ Therefore, it would be a 'responsible business' decision for companies to begin incorporating the Blockchain into corporate practices. Delayed adoption could result in the technology disrupting a business's activities depending on how the Blockchain spreads and the speed of its proliferation.³⁸

III BLOCKCHAIN TECHNOLOGY IS RESPONSIBLE BUSINESS

New uses for the Blockchain emerge almost every day as the world turns to this new system of transacting and securing contracts. With the Blockchain being used as a foundational technology, every agreement, every process, and every transaction can now obtain a digital record

³⁵ The term 'Regtech' stands for 'regulatory technology.' The word was created to address companies that used technology to assist businesses with regulatory compliance and efficiency. See INVESTOPEDIA, *DEFINITION of 'Regtech'* (2018) <<https://www.investopedia.com/terms/r/regtech.asp>>. European Commission, *Digital Single Market Factsheet: How can Europe benefit from blockchain technologies* (1 February 2018) <<https://ec.europa.eu/digital-single-market/en/news/how-can-europe-benefit-blockchain-technologies>>. See *European Commission, European Commission launches the EU Blockchain Observatory and Forum* (1 February 2018) <http://europa.eu/rapid/press-release_IP-18-521_en.htm>.

³⁶ See *European Commission, European Commission launches the EU Blockchain Observatory and Forum* (1 February 2018) <http://europa.eu/rapid/press-release_IP-18-521_en.htm>.

³⁷ European Commission, *Blockchain Technologies* <<https://ec.europa.eu/digital-single-market/blockchain-technologies>>. Luz Fernandez Espinosa, *BBVA and Wave carry out the first blockchain-based international trade transaction between Europe and Latin America* (27 November 2017) Banco Bilbao Vizcaya Argentaria <<https://www.bbva.com/en/bbva-and-wave-carry-first-blockchain-based-international-trade-transaction-europe-and-latin-america/>>.

³⁸ Rana et al, above n 26.

and signature that can be identified, validated, stored, and shared.³⁹ As transactions become frictionless and everyone can readily access specific information about their particular contract, corporations would be better positioned as ‘responsible business’ if they use the Blockchain to help govern corporate practices, manage their supply chains, and carry out blockchain-based CSR initiatives that furthers the ‘triple bottom line’ agenda.

A Corporate Governance

1 Building Trust under a Distributed Governance Model

The Blockchain can be used as a tool for establishing more transparent, flat, and participatory governance structures to address CSR issues such as managerial accountability, board structure, and shareholder rights.⁴⁰ Start-up companies like Backfeed use the Blockchain to build infrastructure for distributed governance and de-centralized cooperation,⁴¹ to see contributions and rewards in the digital economy are distributed evenly.⁴² Backfeed’s algorithm assesses how original workers are objectively valued by management based on data stored in its protocol, so people will become more invested in their work and more motivated to increase production and quality.⁴³

The Blockchain can also influence the way corporations govern their decisions based on changes to capital market structure. Nasdaq has begun pursuing its own version of the Blockchain to facilitate the issuance, transfer, and management of securities using full electronic services.⁴⁴ This reduces capital market inefficiencies and ‘redundant or

³⁹ Ibid.

⁴⁰ Carla L Reyes et al, ‘Distributed Governance’ (2017) 59 *William and Mary Law Review Online* 1, 8, 12.

⁴¹ Backfeed is a start-up technology company that enables mass open source collaboration between individuals on a social operating platform without any central authority. See generally Backfeed, *A Social Operating System for Decentralized Organizations* <<http://backfeed.cc/>>.

⁴² Geektime, *Backfeed wants to decentralize the Internet and help you earn what you deserve* (19 August 2015) <<https://www.geektime.com/2015/08/19/backfeed-wants-to-decentralize-the-internet-and-help-you-earn-what-you-deserve/>>.

⁴³ Reyes et al, above n 40, 12.

⁴⁴ See generally Nasdaq, *The Nasdaq Story* (2018) <<http://business.nasdaq.com/discover/index.html>>.

duplicative systems'.⁴⁵ Overstock.com is another major online retailer that created the 'T Zero' blockchain platform to improve its existing market processes.⁴⁶ It aims to reduce its settlement time to same day settlement and increase its transparency, efficiency, and auditability.⁴⁷ Indeed, when corporations operate with a distributed governance mindset, they are likely to benefit from de-centralization.⁴⁸ Moreover, the Blockchain's distributed governance model can help corporations build the public's trust because they have more certainty in the recording security of confidential information.⁴⁹

2 A Blockchain-based Proxy Voting System to Improve Accuracy

Public companies' disclosure filings can be incomprehensible due to their complicated formatting and large wall of information. Therefore, with a user-friendly Blockchain interface, investors can more easily understand and monitor board decisions in real time, especially when it comes to executive compensation.⁵⁰ Nevertheless, while having effective transparency and disclosure rules via the Blockchain allows shareholders to make informed decisions and hold corporate executives accountable, not all disclosures need to be stored on the Blockchain.⁵¹ An uninformed or inexperienced market observer may not fully understand the cause for the movement of market shares in certain situations. This could result in an unwarranted market drop if the corporate executives lacked business judgment or failed to be transparent about their managerial decisions.⁵²

⁴⁵ Reyes et al, above n 40, 13-4.

⁴⁶ Ibid 14.

⁴⁷ Ibid.

⁴⁸ Scott J Shackelford and Steve Myers, 'Block-by-Block: Leveraging the Power of Blockchain Technology to Build Trust and Promote Cyber Peace' (2017) 19 *Yale Journal of Law and Technology* 334, 355.

⁴⁹ Fiammetta S Piazza, 'Bitcoin and the Blockchain as Possible Corporate Governance Tools: Strengths and Weaknesses' (2017) 5 *Penn State Journal of Law and International Affairs* 262, 262.

⁵⁰ Piazza, above n 49, 278.

⁵¹ Ibid 276-7.

⁵² Ibid 278.

On the other hand, the Blockchain can positively contribute to the proxy voting system, especially to resolve common problems such as shareholder absence at voting meetings, inexact voter lists, incomplete distribution of ballots, and problematic vote tabulations.⁵³ For example, Broadridge Financial Solutions, Inc. ('Broadridge'), a U.S. proxy vote processing company for the financial services industry, announced it would use the Blockchain to cast investor votes on matters ranging from executive pay to director elections.⁵⁴ Broadridge took the position that the Blockchain can record the entire voting process into a single recordkeeping ledger in real time, thus making it more efficient, transparent and secure.⁵⁵ However, the Blockchain's full value will depend on whether all the parties involved in voting can agree to use the same platform in order for it to work effectively.⁵⁶

Despite this, eligible voters can still obtain an allocated number of voter tokens that are representative of their voting power and transmit and register those votes on the ledger.⁵⁷ That way, the Blockchain's real-time stamping and high accuracy level can help corporations avoid any ambiguities or manipulation of election outcomes.⁵⁸

B Supply Chain Management

The Blockchain's ability to register and validate all transactions on a public network is important for achieving supply chain transparency, tracing a product's movement from manufacturer to end consumer, and securing sustainable transportation contracts.⁵⁹ Transactions involving supply chains often deal with multiple actors who transact based on concealed information or with a lack of knowledge regarding the

⁵³ Ibid 279.

⁵⁴ Andrea Vittorio, *Broadridge Tests Blockchain for Corporate America's Ballots* (15 February 2018) Bloomberg Law <<https://www.bloomberglaw.com/exp/>

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Piazza, above n 49, 279.

⁵⁸ Ibid 279, 283.

⁵⁹ Amina Badzar, 'Blockchain for Securing Sustainable Transport Contracts and Supply Chain Transparency: An Explorative Study of Blockchain Technology in Logistics' (unpublished Masters Thesis, Lund University, Department of Service Management and Services Studies, 24 May 2016) 8, 41 <<http://lup.lub.lu.se/student-papers/record/8880383>>.

product's origin.⁶⁰ Corporations can use the Blockchain to identify these multiple layers that are often linked to human and natural resource exploitations, environmental footprints, and waste productions and gain a more transparent supply chain as a result.⁶¹ Power Provenance Ltd. ('Provenance'), a London-based company with a mission to empower brands to become more transparent about their products' supply chains, used Ethereum as the blockchain platform to achieve its goals.⁶² In fact, Provenance's partnership with a United Kingdom ('UK') retailer allowed it to:

1. track fresh food such as fish, eggs, and dairy;
2. access information about the product's journey through a mobile application; and
3. collaborate with third-party auditors to authenticate and certify the product's safety, fair trade, and sustainable processing throughout its production.⁶³

By making a product's chain of custody – from origin and ownership to exchange – traceable via the Blockchain, corporations can prevent counterfeit and fraudulent activities, potential loss in company revenues, negative effects on customers' purchasing decisions, and risks of human errors by intermediaries.⁶⁴

IBM, a U.S. multinational company, also began using the Blockchain to conduct supply chain traceability for a wide variety of products, from pork to rough-cut diamonds.⁶⁵ The company believed the Blockchain is the new supply chain solution that will transform the way global trade is done.⁶⁶ In October 2016, IBM, the Tsinghua University (Hong Kong, China), and Walmart signed a collaboration agreement to use the Blockchain as a mechanism to trade and authenticate the production of

⁶⁰ Ibid 6, 8.

⁶¹ Ibid 6.

⁶² Project Provenance Limited, *We live in the world we buy into* (2018) PROVENANCE <<https://www.provenance.org/about>>.

⁶³ Henrik Sternberg and Giulia Baruffaldi, 'Chains in Chains – Logic and Challenges of Blockchains in Supply Chains' (2018) *Proceedings of the 51st Hawaii International Conference on System Sciences Hawaii* 3936, 3937-38.

⁶⁴ Badzar, above n 59, 31, 34.

⁶⁵ Heather Clancy, *Why IBM sees blockchain as a breakthrough for traceability* (8 December 2016) GreenBiz <<https://www.greenbiz.com/article/why-ibm-sees-blockchain-breakthrough-traceability>>.

⁶⁶ Sternberg et al, above n 63, 3936.

its pork.⁶⁷ This included a recording of a variety of data, including the project's origin, batch number, processing plant information, expiration dates, and storage temperature.⁶⁸

In another project, IBM partnered with Everledger, a London-based company focused on digitising the Kimberley Process, to detect fraudulent or synthetic diamonds slipping into the supply chain.⁶⁹ The Kimberley Process is a diamond certification process that involves governments, civil society, and the wider industry's commitment to remove conflict diamonds from global supply chains around the world.⁷⁰ Similarly, Dharmanandan Diamonds, a Mumbai-based manufacturer, partnered with Everledger in 2015 in a joint initiative called the Diamond Time-Lapse Protocol to encrypt its Diamond Time-Lapse diamond-tracking reports onto the Everledger blockchain.⁷¹ Several other industry-related companies, including the De Beers Group,⁷² an international diamond corporation, supported this movement and expressed interest in using the Blockchain as a way to revive consumer confidence.⁷³ However, one of the greatest philosophical obstacles continues to concern the issue of trust, as supply chain data is accessible across multiple stakeholders, it risks getting into the hands of unauthorised persons. Therefore, for corporations to demonstrate good corporate governance, they still need to understand their industry-specific nuances and the problem(s) they want to solve before they start storing information on the Blockchain.⁷⁴

⁶⁷ International Business Machines Corporation, 'Walmart, IBM and Tsinghua University Explore the Use of Blockchain to Help Bring Safer Food to Dinner Tables Across China' (Press Release, 16 October 2016) <<http://www-03.ibm.com/press/us/en/pressrelease/50816.wss>>.

⁶⁸ Clancy, above n 65.

⁶⁹ International Business Machines Corporation, above n 67.

⁷⁰ Ibid. See Kimberley Process, *What is the Kimberley Process?* (2018) <<https://www.kimberleyprocess.com/en/what-kp>>.

⁷¹ Rapaport News, *Diamond Firms Press Ahead with Blockchain: Dharmanandan and Hari Krishna have adopted the technology to improve traceability* (28 February 2018) RAPAPORT <<http://www.diamonds.net/News/NewsItem.aspx?ArticleID=61961>>.

⁷² See generally De Beers Group of Companies <<http://www.debeersgroup.com/en/index.html>>.

⁷³ Monica Coca, *Social enterprises are committed to blockchain technology* (4 January 2018) Banco Bilbao Vizcaya Argentaria <<https://www.bbva.com/en/social-enterprises-are-committed-blockchain-technology/>>.

⁷⁴ Ibid.

C *Triple Bottom Line*

1 *People – Social Impact and Human Rights*

As Bitcoin became increasingly widespread, social entrepreneurs also imagined a world where the Blockchain can be used in a variety of ways that positively contribute and improve society.⁷⁵ What started out as a financial transaction protocol has progressed to become an all-purpose utility for a variety of transactions that operate on the Blockchain as ‘smart contracts’.⁷⁶ Supply chain manufacturers not only have a methodology in which to track and record their performances, they also have a way to detect child labour abuse especially in countries plagued by lawlessness.⁷⁷ For instance, a number of Chinese businesses, along with Apple and Samsung, piloted a scheme through its Responsible Cobalt Initiative to track cobalt informally mined from artisanal mines in the Democratic Republic of Congo.⁷⁸ Cobalt is often used in lithium-ion batteries found in iPhones and electric cars. Companies such as Apple, Tesla, and Volkswagen would therefore want to implement the Blockchain or other practices to instil public trust that their processes are transparent and free from child labour.⁷⁹ For this reason, the World Economic Forum and Amnesty International believed the Blockchain could be a useful tool to help trace and separate the ‘clean’ cobalt from cobalt mined by children.⁸⁰

In communities where financial transactions via Bitcoins make donations to charitable causes in real time more challenging, Blockchain-based ‘smart contracts’ can help reduce international transfer costs. ‘Smart contracts’ will ensure that funds reached the desired recipient while permitting users to track their donation spending.⁸¹ Organisations like BitGive Foundation and UNICEF might have an easier time

⁷⁵ Ibid.

⁷⁶ Emmy B Gengler, *Leveraging Blockchain Technology for Corporate Social Responsibility* (29 August 2017) PaymentsJournal.com <<http://paymentsjournal.com/leveraging-blockchain-technology-for-corporate-social-responsibility/>>.

⁷⁷ Reuters, *Blockchain to track Congo's cobalt from mine to mobile* (2 February 2018) CNBC Africa <<https://www.cnbc.com/news/2018/02/02/blockchain-track-congos-cobalt-mine-mobile/>>.

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Ibid.

⁸¹ Coca, above n 73.

facilitating charitable donations and allocating these digital funds to global and emergency aid.⁸² Softjourn Foundation is another technology service provider that used the Blockchain to help Fortune 500 companies run their social causes.⁸³ For instance, if an employee votes to spend a certain amount of ‘SJ coins’ in support of a particular community program, the foundation will match that amount and allocate it to the same program.⁸⁴ More importantly, the Blockchain gives employees the privacy and ability to choose where the money goes without their employers’ involvement based on the pre-conditions as set-up on the smart contract.⁸⁵

The Blockchain can also positively contribute to identify management for refugees by providing them with formal access to governmental resources and financial services.⁸⁶ For example, MONI, a Finland start-up company, offers people seeking refugee status in another country throughout Europe a card that is linked to a unique digital identity on the Blockchain to allow those people the ability to transact with the Immigration Service so that the agency can monitor their movements in a more secure and legitimate way.⁸⁷ Moreover, governments can use the Blockchain to identify and track criminals who have trafficked and coerced refugees, women, and children into forced labour, thereby complying with anti-trafficking and slavery laws.⁸⁸ Thus, the Blockchain creates countless scenarios where people can positively impact and improve society with their contributions to social projects and efforts to end human and labour trafficking.

⁸² BitGive is a non-profit organization that leverages Bitcoin and blockchain technology to achieve global philanthropic missions, including donations to charities via bitcoins. See generally BitGive Foundation (2018) <<https://www.bitgivefoundation.org/>> and Gengler, above n 76.

⁸³ Ibid.

⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ Ibid.

⁸⁷ Coca, above n 73.

⁸⁸ Amanda Ziadeh, *State Department Looks to Blockchain to Fight Human Trafficking, Forced Labor* (26 April 2018) GovernmentCIO Magazine <<https://www.governmentciomedia.com/state-department-looks-blockchain-fight-human-trafficking-forced-labor>>. See generally American University, *A Modern Slavery Act for the United States* (10 November 2015) National Security Law Brief <<http://nationalecuritylawbrief.com/2015/11/10/a-modern-slavery-act-for-the-united-states>>.

2 Profit – Anti-corruption and Financial Inclusion

The Blockchain's ability to record transactions more efficiently and securely allows it to also fight against global corruption. More specifically, the Blockchain can trace misappropriated funds that stem from corrupt loan programs, charitable donations, and foreign direct investments by governments.⁸⁹ This is especially relevant in countries where governments are fragile, and the country's land and property are not well documented or records easily altered.⁹⁰ Yet, even if property rights have been recorded, that record and guarantee are provided by the state, stored by the state, and updated by the state.⁹¹ So if the government in that particular state is corrupt, the land registry system loses its legitimacy because the system is less secure or the registry is non-existent.⁹² If governments implement the Blockchain's speedy and digitally identifiable land registry system to encourage participation and investments, it will result in greater landholder confidence in such countries.⁹³ For example, Georgia was one of the first national governments to use the BitFury Group's technology to transfer its country's land titles (approximately 200,000) onto the Blockchain.⁹⁴ This move became one of the factors that helped improve the country's ranking on Transparency International's Corruption Perception Index from 123rd place, as of 2003, to 48th place by 2016.⁹⁵

The Blockchain-based land registry system also has long-term benefits, including reduction of human error during the transaction process.⁹⁶ In developed countries like the U.S. where property records are managed by a central entity or county government, this process is still prone to inaccurate data.⁹⁷ This stems largely from systems that operate heavily on human action for repeated data entry, the unchecked

⁸⁹ RESET, above n 2.

⁹⁰ White Paper, above n 3, at 30.

⁹¹ Ibid.

⁹² Ibid.

⁹³ Ibid.

⁹⁴ See generally Bitfury Group Limited (2018) <<http://bitfury.com/>>.

⁹⁵ Ibid.

⁹⁶ Maksymilian Ewendt, 'Leveraging Blockchain Technology in Property Records: Establishing Trust in a Risk-Filled Market' (2017) 19 *North Carolina Journal of Law and Technology Online* 99, 105.

⁹⁷ Ibid.

element of this process exposing buyers and sellers to risk.⁹⁸ The problem is even worse for 70% of the world's population in developing and less developed countries because they lack access to proper land titling.⁹⁹ A person's access to land is one of the principles identified on the UN SDGs because it aligns 'with significant socio-economic development including poverty eradication, food security, and gender equality'.¹⁰⁰ Therefore, the Blockchain's recordkeeping mechanism for legitimising land registry data is a benefit stimulating growth and stability in less developed regions. Investors will have more trust in the system which prompts encouraged investment in those countries' properties.¹⁰¹

Mobile banking and payment solutions via the Blockchain can also help open new access routes for adults without bank accounts. This can help promote financial inclusion, especially for those who live on less than \$2.50 USD a day.¹⁰² People living in rural areas in developing countries usually lack access to banks and are excluded from the formal financial system. However, more than 50% of the people from the poorest nations have access to mobile phones.¹⁰³

Cognizant, a U.S.-based corporation specializing in digital technologies, estimated that banks could generate about \$380 billion by 2020 if they tap into the unbanked population.¹⁰⁴ Moreover, Blockchain-powered mobile financial services can:

⁹⁸ Ibid.

⁹⁹ Ibid 113.

¹⁰⁰ Goal 11 of the UN SDG focuses on setting global standards for ensuring universal access to adequate, safe, and affordable housing for all; implementing policies that protect cultural and natural heritage sites; and strengthening efforts to develop sustainable cities and communities. See United Nations, *Goal 11: Make cities inclusive, safe, resilient and sustainable* (2018) Sustainable Development Goals: 17 Goals to Transform our World <<https://www.un.org/sustainabledevelopment/cities/>> and Ewendt, above n 96, 113.

¹⁰¹ Ewendt, above n 96, 125.

¹⁰² Cognizant Corporation presented a PowerPoint presentation on how the Blockchain can help foster financial inclusion. Pani Baruri, 'Blockchain Powered Financial Inclusion' (2016) Cognizant 1, 4 <<http://pubdocs.worldbank.org/en/710961476811913780/Session-5C-Pani-Baruri-Blockchain-Financial-Inclusion-Pani.pdf>>.

¹⁰³ Ibid.

¹⁰⁴ See generally Cognizant Corporation <https://www.cognizant.com/?gclid=EAIaIQobChMIgfPb_4_-2gIVF73sCh28CAciEAYASAAEgJbD_D_BwE>. Cognizant, above n 109, 5.

1. provide a digital identity to enhance privacy;
2. facilitate instantaneous international money transfers; reduce poverty by lowering remittance service costs for transfers between individuals and micro-financed institutions; and
3. encourage citizens to gain higher financial independence and better welfare.¹⁰⁵

Additionally, financial institutions will have a more efficient way to identify suspicious behaviour via digital profiles created on mobile devices. This will permit continuous monitoring with very minimal manual updating, thereby eliminating out-dated techniques and preventing regulatory abuses.¹⁰⁶ From a corporate governance standpoint, use of the Blockchain in financial institutions has both the potential to improve lives for the unbanked population and to increase a company's profits as operational costs decrease.

3 Planet – Environment Sustainability and Climate Action

In addition to the Blockchain's ability to securely validate environmentally sustainable supply chain contracts, this disruptive technology has expanded into the energy sphere.¹⁰⁷ Especially in the U.S., all forms of energy production, transmission, and distribution have traditionally been centralized through a single electricity provider.¹⁰⁸ The Blockchain can disrupt this foundational set-up as consumers autonomously manage their own electricity purchases, choose the source of their energy, and determine their price point. This then fosters higher efficiency, lower costs, and better distribution of energy resources.¹⁰⁹ Yet, one of the primary concerns that energy regulators face is how to maintain grid stability so as to not overload the system with overcapacity.¹¹⁰ In response, the New York Public Service Commission and economists believed that by having a centralized, market-driven platform that registers and

¹⁰⁵ Ibid.

¹⁰⁶ Andy Gandhi et al, *Big Data And Smarter Know-Your-Customer Compliance* (4 November 2016) Law360 <<https://www.law360.com/articles/859480/big-data-and-smarter-know-your-customer-compliance>>.

¹⁰⁷ Stewart, above n 25.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

¹¹⁰ Caroline Stewart, *How Blockchain Could Change the Energy Industry: Part 2* (22 November 2017) Law360 <<https://www.law360.com/articles/987353/how-blockchain-could-change-the-energy-industry-part-2>>.

unites energy buyers and sellers, these participants could then use the Blockchain to determine individual transaction terms.¹¹¹ This would then ensure that energy resources are appropriately deployed, the energy grid does not overload, energy productions become more predictable, and demands for energy become easier to forecast.¹¹² Thus, by taking a distributed energy resources approach to energy usage, this is one way to demonstrate environmental efficiency.

On humane food sourcing and sustainability, the Blockchain has transformed the way the tuna industry governed its global fishery practices.¹¹³ For instance, the World Wildlife Fund (‘WWF’) in Australia, Fiji, and New Zealand launched a blockchain-based pilot project, in partnership with other companies, to improve tuna traceability.¹¹⁴ Its mission was to stop illegal and unsustainable fishing and to detect corruption, illegal trafficking, and human slavery on tuna fishing boats in the Pacific Islands region.¹¹⁵ To effectively trace tuna, the WWF pilot project used methods such as radio-frequency identification (‘RFID’) tags, quick response (‘QR’) tags, and scanning devices to collect information at various points along the supply chain, recording relevant information on the Blockchain.¹¹⁶ Hence, the combined use of these various methods are extremely important once the whole fish is further processed.¹¹⁷

The Blockchain’s ability to share information in a more accurate, transparent, and immutable way, and in real time, can also enhance climate action and sustainability. In fact, the UN Climate Change

¹¹¹ Ibid.

¹¹² Ibid.

¹¹³ Candice Visser, *How blockchain is strengthening tuna traceability to combat illegal fishing* (21 January 2018) *The Conversation* <<http://theconversation.com/how-blockchain-is-strengthening-tuna-traceability-to-combat-illegal-fishing-89965>>.

¹¹⁴ Ibid.

¹¹⁵ Ibid. Other companies that participated in this pilot project included the U.S.-based technology company, ConsenSys, the Fijian technology company, TraSeable Solutions Ptd Ltd., and the Fijian tuna fishing and processing company, Sea Quest (Fiji) Limited. See generally ConsenSys <<https://new.consensys.net/>>; TraSeable Solutions Private Limited <<https://traseable.com/>>; World Wide Fund for Nature Global <<http://wwf.panda.org/?231571/Transparency-matters-interview-with-Sea-Quest-Fiji-Ltd.>>.

¹¹⁶ Visser, above n 113.

¹¹⁷ Ibid.

Coalition ('UNCCC') was formed to mobilise a broad group of stakeholders to: collaborate and use the Blockchain to verify data regarding the impacts of climate action; save costs associated with the shared information; build trust among different climate actors; and mobilise climate financing.¹¹⁸ However, it can be challenging for climate actors to maintain environmental integrity when the Blockchain also requires a high level of energy consumption and greenhouse gas emissions.¹¹⁹ Nevertheless, the Blockchain's other positive attributes can still help: improving how carbon assets are traded; facilitate clean energy with peer-to-peer renewable energy trade; ensure climate financing properly flows to specific projects; and measure a company's progress to the National Determined Contributions ('NDCs') in accordance with the Paris Agreement.¹²⁰ Indeed, where no one entity can monopolise the Blockchain system, this technology can be a part of the solution for improved climate change governance and sustainability.¹²¹

IV IMPACT ON CORPORATE DECISION-MAKING

While the Blockchain's potential to impact world issues and contribute to companies' triple bottom line are altruistic reasons why companies should adopt this new technology, they are also cautioned to consider new challenges that the Blockchain might pose, especially in the financial, legal, intellectual property, and data privacy fields.

A *Initial Coin Offerings: Implications for Corporate Investors*

Companies that transact with virtual currency using the Blockchain to record these transfers, in lieu of a central bank, are currently subject to fewer restrictions.¹²² For this reason, well over 1,000 virtual currency

¹¹⁸ United Nations Climate Change, *UN Supports Blockchain Technology for Climate Action* (22 January 2018) United Nations Climate Change News <<https://cop23.unfccc.int/news/un-supports-blockchain-technology-for-climate-action>>. As of December 12, 2017, twenty-five organizations working the Blockchain established the UNCCC with the purpose of addressing climate change issues to (1) align with the long-term goals of the Paris Agreement, (2) use advancements of the Blockchain to mitigate and adapt to climate change issues or other fraudulent activities associated with climate change governance, (3) collaborate with coalition members on deployment of shared tools and standardized systems to enhance climate change governance, (4) maintain technology neutrality regarding the blockchain applications, and (5) use the Blockchain to simultaneously contribute to the UN SDGs.

¹¹⁹ Ibid.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Futter, above n 15, 24.

variants entered the market by the end of 2017.¹²³ Increasingly, businesses began using the Blockchain to raise corporate funds by selling virtual currencies marketed as Initial Coin Offerings (‘ICOs’) on stock market exchanges.¹²⁴ As ICO issuers have ‘positioned their offering as “utility tokens” – providing purchasers with future access to the issuer’s product or service,’ these ICOs have not been registered with the U.S. Securities and Exchange Commission (‘SEC’ or ‘Commission’).¹²⁵ For this reason, the SEC began asserting its authority as early as 2017 that certain virtual currencies are subject to U.S. federal securities laws under the Securities Act of 1933 and the Securities Exchange Act of 1934.¹²⁶ Specifically, the SEC relied on the four-part test held by the Supreme Court in *SEC v Howey*, to determine whether the particular ICO transaction is an ‘investment contract’ within the U.S. statutory definition of a ‘security’.¹²⁷

Despite the SEC’s authority to oversee ICO activities, virtual currencies are still in early stages of development and will continue to raise market concerns. This is especially so when companies have been charged with ICO-related security crimes.¹²⁸ Specifically, issuers that simply announced blockchain-related projects or changed their business names to include the word ‘blockchain’ so as to manipulate the stock prices could violate U.S. federal securities laws.¹²⁹ For this reason, the SEC cautioned public companies of the Commission’s aggressive efforts in monitoring those activities.¹³⁰

¹²³ Ibid.

¹²⁴ Ibid. ICOs are similar to Initial Public Offerings (‘IPOs’) where their high level of volatility motivated traders to buy digital coins in hope of raising the cryptocurrencies’ value. See INVESTOPEDIA, *DEFINITION of ‘Initial Coin Offering’* (2018) <<https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp>>.

¹²⁵ Futter, above n 15, 25.

¹²⁶ Ibid; Evelyn Cheng, *The SEC just made it clearer that securities laws apply to most cryptocurrencies and exchanges trading them* (7 March 2018) CNBC <<https://www.cnbc.com/2018/03/07/the-sec-made-it-clearer-that-securities-laws-apply-to-cryptocurrencies.html>>.

¹²⁷ See *SEC v W J Howey Co*, 328 US 293, 302 (Murphy J) (1946). Futter, above n 15, 25. See FindLaw, *What is the Howey Test?* (2018) <<https://consumer.findlaw.com/securities-law/what-is-the-howey-test.html>>.

¹²⁸ Futter, above n 15, 26-7.

¹²⁹ Ibid 29.

¹³⁰ Ibid.

Since the SEC's announcement that ICO 'tokens' are 'securities' under U.S. federal securities laws, regulators from around the world began to review the Blockchain's influence on their own securities laws in their respective jurisdictions, including regulators in Canada, the United Kingdom, Hong Kong, Thailand, Switzerland, Australia, Gibraltar, and Singapore.¹³¹ As a result, corporate leaders considering new products or services using the Blockchain should conduct extensive research for regulatory certainty in this area before launching blockchain-related projects.

B *Anti-Money Laundering Regulations: Implications for Financial Institutions*

When Bitcoin first appeared in January 2009, Congress became increasingly concerned about its use in illegal money transfers and the ability of the Federal Reserve ('Fed') to protect consumers and investors who might use virtual currencies.¹³² Bitcoin can substantially affect the flow of money to the economy. Therefore, the Fed's ability to conduct monetary policy with regards to Bitcoin rests on its ability to accurately measure the rate of circulation of money, influence interest rates, and adjust the reserves of the banking system.¹³³ Moreover, the Department of Treasury ('Treasury Dept') stated that terrorists are now embracing Bitcoin as a financing method to carry out illicit activities.¹³⁴ Even users' earnings of virtual currency are often unreported to the Internal Revenue Services ('IRS') as virtual currency is considered 'property' for federal tax purposes, which allowed them to escape basic tax reporting requirements.¹³⁵ The Bank Secrecy Act ('BSA') strictly binds financial institutions to certain reporting requirements, including disclosures of cash transactions and suspicious activity reports ('SARs') that exceeded

¹³¹ Ibid 30.

¹³² Edward V Murphy et al, Cong. Research Serv. R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues 1 (2015). The Federal Reserve conducts monetary policy to ensure that the economy maintains stable prices, maximizes employment, and reaches financial market stability. See generally Board of Governors of the Federal Reserve System, *About the Fed* (23 July 2018) <<https://www.federalreserve.gov/aboutthefed.htm>>.

¹³³ Edward V Murphy et al, Cong. Research Serv. R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues 1, 4-5 (2015).

¹³⁴ Ibid 12.

¹³⁵ Meghan E Griffiths, 'Virtual Currency Businesses: An Analysis of the Evolving Regulatory Landscape' (2015) 16 *Texas Tech Administrative Law Journal* 303, 323. Murphy et al, above n 133, 20.

a certain monetary threshold. However, Bitcoin exchanges do not have to involve financial institutions.¹³⁶ For this reason, Bitcoin has the potential to engage in money laundering and corruption activities. In response, the Treasury Dept's Financial Crimes and Enforcement Network ('FinCEN') issued an interpretive guidance on 18 March 2013, requiring individuals and businesses of Bitcoin exchanges to register themselves as money services businesses ('MSB').¹³⁷ This made them subject to reporting requirements of any suspicious transactions or money laundering activities under the BSA.¹³⁸ On 28 November 2017, the Senate Judiciary Committee introduced Bill S.1241, which is designed to modernise and tighten anti-money laundering ('AML') laws to cover virtual currency as a 'monetary instrument' under 31 U.S.C. § 5312(a).¹³⁹ This expanded the definition of 'monetary instrument' to now require companies considering the Blockchain as a platform for sending and receiving virtual payments to comply with BSA rules.¹⁴⁰ Therefore, corporate leaders should evaluate their BSA/AML compliance programs to ensure any blockchain-related applications and relevant corporate policies and procedures also include 'virtual currency' as an instrument subject to various financial-related federal laws.

C Smart Contracts: Implications for Lawyers

Lawyers tend to be risk-averse and resistant when it comes to new technology, but it is highly unlikely that the Blockchain will go away.¹⁴¹ In fact, the Blockchain is affecting the day-to-day practices of most major law firms and becoming one of the fastest growing industries. Law firms are joining non-profit organizations, like the Wall Street Blockchain Alliance and Enterprise Ethereum Alliance, to explore the Blockchain along with other member companies.¹⁴² For the legal

¹³⁶ Ibid 21.

¹³⁷ See United States Department of the Treasury, *FinCEN Guidance FIN-2013-G001* (18 March 2013) <<https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>>.

¹³⁸ Ibid.

¹³⁹ Alan Cohn, *Implications of S. 1241, the Combating Money Laundering, Terrorist Financing, and Counterfeiting Act of 2017* (23 June 2017) LEXOLOGY <<https://www.lexology.com/library/detail.aspx?g=c77ee460-b1a6-4335-86cb-a8f7effe579e>>.

¹⁴⁰ Ibid.

¹⁴¹ Jasmine Ye Han, *How Blockchain Technology is Transforming the Legal Industry* (20 February 2018) Bloomberg Law <<https://www.bna.com/blockchain-technology-transforming-n57982088958/>>.

¹⁴² Han, above n 141. See generally Wall Street Blockchain Alliance (2017) <<https://www.wsba.co/>> and Enterprise Ethereum Alliance <<https://entethalliance.org/>>.

industry, the Blockchain can be used to ‘help lawyers draft contracts, record commercial transactions, and verify legal documents’.¹⁴³ This can reduce the time lawyers spend on simple routine tasks and allow them to focus on more complex matters.¹⁴⁴ It can also help law firms build infrastructure to support internal processes like managing time-keeping records, filing deeds, and handling various commercial transactions.¹⁴⁵ For instance, Ethereum’s ‘smart contract,’ can efficiently code a contract into simple ‘if-then’ statements so that a pre-defined event can trigger an automated action once certain conditions are met.¹⁴⁶ OpenLaw and Integra Ledger are two other examples of some of the different ways lawyers have used the Blockchain to achieve company objectives.¹⁴⁷ With OpenLaw, lawyers can embed self-executing smart contracts to generate standardised legal agreements; and with Integra Ledger, the system can establish an immutable record of finalised transactions in real-time so that parties have less room for disputes.¹⁴⁸ Therefore, a lawyer’s ability to analyse and counsel on complex agreements and knowledge of the rules behind smart contract coding will become even more critical to the legal industry today as the Blockchain takes over execution of simple legal contracts.¹⁴⁹

However, even though the Blockchain is a powerful tool for modern day legal practice, current laws have not explicitly stated that smart contracts are legally enforceable.¹⁵⁰ Arguably, the smart contract’s use of a cryptographic key to digitally sign and acknowledge the contract can be qualified as an ‘electronic signature’ within the meaning and intent of UETA and E-SIGN.¹⁵¹ Currently, there is no existing law in the U.S. that explicitly governs the definition of a ‘smart contract’. Corporate lawyers will therefore need to determine how blockchain-

¹⁴³ Han, above n 141.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ Ibid; Cohn et al, above n 9, 281-2.

¹⁴⁷ Han, above n 141. See generally ConsenSys Media, *Introducing OpenLaw* (25 July 2017) <<https://media.consensys.net/introducing-openlaw-7a2ea410138b>> and Integra Ledger (2018) <<http://integraleledger.com/>>.

¹⁴⁸ Ibid.

¹⁴⁹ Ibid.

¹⁵⁰ Cohn et al, above n 9, 285.

¹⁵¹ UETA is the acronym for ‘Uniform Electronic Transactions Act’. Its purpose is to provide model laws for online transactions so as to harmonize and standardize contradictory state laws. See generally Uniform Law Commission: The National Conference of Commissioners on Uniform State Laws, *Electronic Transactions Act*

based smart contracts affect the way legal agreements are structured and transacted between the lawyer and client. More importantly, smart contracts are capable of implementing technically perfect agreements at lower transaction costs, but they still cannot understand the social complexities of contracting.¹⁵² For this reason, it is critical that lawyers capitalise on their social resources and adopt an out-of-the-box analysis of legal doctrines, principles, and concepts as traditional lawyer functions are increasingly being performed by technology.¹⁵³

D Blockchain Technology's Effect on Intellectual Property

The Blockchain has raised important intellectual property ('IP') issues because information stored on the Blockchain are immutable. For example, because the Blockchain provides a digital platform that promises to protect and authenticate the creator's creative work and allow the person to share the work without compromising the creator's authorship claim, a company's Terms of Service that are registered or transferred on the Blockchain risk becoming irreversible.¹⁵⁴ This violates the U.S. Copyright Act of 1976 ('Copyright Act') because, 'just like any other property, part or all of the rights assigned to a copyrighted work are freely transferable by the owner to an assignee'.¹⁵⁵ Moreover, the Blockchain simply cannot replace current laws unless a new legislation is passed to establish the Blockchain's role in protecting copyrights.¹⁵⁶ Therefore, the Blockchain's 'means of proving ownership,' at least in the near future, can only be used as a tool for supplemental protection and not full IP protection.¹⁵⁷

Summary (2018) <<http://www.uniformlaws.org/ActSummary.aspx?title=Electronic%20Transactions%20Act>>.Cohn et al, above n 9, 288. E-SIGN is the acronym for 'Electronic Signature in Global and National Commerce' Act. E-SIGN shared similar provisions as UETA, where it provides rules granting electronic records and signatures the same legal authority as the physical versions.

¹⁵² Karen E C Levy, 'Book-Smart, Not Street-Smart: Blockchain-Based Smart Contracts and the Social Workings of Law' (2017) 3 *Engaging Science, Technology, and Society* 1, 10.

¹⁵³ Mark Fenwick et al, 'Legal Education in the Blockchain Revolution' (2017) 20 *Vanderbilt Journal of Entertainment and Technology Law* 351, 361-62.

¹⁵⁴ Sarah Anderson, 'The Missing Link Between Blockchain and Copyright: How Companies are Using New Technology to Misinform Creators and Violate Federal Law' (2017) 19 *North Carolina Journal of Law and Technology Online* 1, 14.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid* 26.

¹⁵⁷ *Ibid* 27.

As more companies began investing aggressively in Blockchain applications, various industry sectors are beginning to employ differing strategies for patenting the technology.¹⁵⁸

Major financial institutions and corporations like Bank of America, Goldman Sachs, Wells Fargo, Amazon.com, Facebook, IBM, and Dell have begun filing patent applications in the U.S., along with other start-ups like Coinbase and Coinlab.¹⁵⁹ As of October 2017, the U.S. Patent and Trademark Office ('USPTO') has granted twenty-five patents related to the Blockchain, which included applications for 'securities settlements, certifying ownership of files, messaging, managing digital identities, tracking supply chains, user authentication, password management, and robotics'.¹⁶⁰ Yet, the likelihood of a patent being granted on the Blockchain's fundamental concept is highly unlikely. This is because the foundational work describing the Blockchain was already published in a white paper entitled 'Bitcoin: A Peer-to-Peer Electronic Cash System' via a cryptography mailing list nearly a decade ago, in 2008, by a pseudonym Satoshi Nakamoto.¹⁶¹ Since Nakamoto did not file a patent application for his white paper within one year after the technology was first made public, the Blockchain is considered a public domain technology and no longer eligible for patenting.¹⁶² Therefore, even though most of the patent applications made a claim to the Blockchain's core algorithm, which is already 'well known in the art', important additions and variations that are 'designed to solve a technological problem in conventional industry practice' can still be patented.¹⁶³ From a business perspective, it may be problematic for companies because they will have less interoperability, which leads to less innovation, as the number of patent applications, being filed relating to the Blockchain, rise.¹⁶⁴ Therefore, companies are cautioned against capitalising on the

¹⁵⁸ Leslie Spencer, *Defensive Patenting Strategies for Blockchain Innovators* (10 October 2017) Law 360 <<https://www.law360.com/articles/968628/defensive-patenting-strategies-for-blockchain-innovators>>.

¹⁵⁹ Ibid.

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

¹⁶² Inayat Chaudhry, 'The Patentability of Blockchain Technology and the Future of Innovation' (2018) 10(4) *American Bar Association Section of Intellectual Property Law* 1, 1.

¹⁶³ Ibid 3.

¹⁶⁴ Ibid 4–5.

Blockchain's new technological developments that current U.S. laws have yet to allow for establishing full IP protection.¹⁶⁵

E *Digital Identity and Know-Your-Customer: Data Privacy Considerations*

The Blockchain's use of digital signatures protects and authenticates the identity of the parties involved in a transaction. This reduces the likelihood of any error occurring when chain transactions are strenuously verified and validated before execution.¹⁶⁶ However, while the Blockchain does not require a third-party intermediary to complete a transaction, it is still a public ledger.¹⁶⁷ For instance, Bitcoin transactions are not truly anonymous, so fully compliant Bitcoin exchanges might still risk customers' personal data being leaked, especially with the use of sophisticated computer analysis to track the transaction's movement.¹⁶⁸ While Bitcoin users might enjoy the heightened privacy that comes with the Blockchain, and the risk of identity theft may be less, encrypted identities for all transactions are still potentially traceable.¹⁶⁹ Especially in the banking industry, the increased data burdened on financial institutions to collect 'know-your-customer' ('KYC') information make the Blockchain a viable utility solution for managing such information via digital customer profiles.¹⁷⁰ However, while this system allows financial institutions to proactively manage data risk with higher accuracy and increased transparency, the Blockchain's centralized repository database of KYC information still raises practical concerns about data privacy and customer rights.¹⁷¹ Yet,

¹⁶⁵ Anderson, above n 154, 3.

¹⁶⁶ Fenwick et al, above n 153, 366.

¹⁶⁷ Murphy et al, above n 133, 3.

¹⁶⁸ Ibid.

¹⁶⁹ Ibid 6.

¹⁷⁰ The process of obtaining KYC information, for customer identification purposes, is at the center of an effective BSA/AML compliance program. The USA Patriot Act amended the BSA to include a customer identification program so as to address money laundering and other illicit activities that might occur in financial institutions. See Office of the Comptroller of the Currency, *Bank Secrecy Act* <<https://www.occ.treas.gov/topics/compliance-bsa/bsa/index-bsa.html>>. Gandhi et al, above n 106.

¹⁷¹ Gandhi et al, above n 106. See generally David Shrier et al, 'Blockchain and Infrastructure (Identity, Data Security)' (May 2016) *Massachusetts Institute of Technology* 6 <https://www.getsmarter.com/career-advice/wp-content/uploads/2017/07/mit_blockchain_and_infrastructure_report.pdf>.

despite some of its shortcomings, the Blockchain is still a viable platform for enabling financial institutions to authenticate their customers during the KYC process, comply with BSA/AML requirements, and prevent fraudulent activities.¹⁷²

When discussing data privacy, it is also important to note the distinction between public and private blockchains. For instance, Bitcoin operates on a public blockchain, which allows anyone with Internet access to obtain its entire transactional history and poses a threat to privacy more generally.¹⁷³ A public blockchain's 'append-only' data process makes it difficult to remove information because an entire node network would have to agree on any changes to the information prior to removal.¹⁷⁴ Indeed, the Blockchain is more restrictive at controlling information than with a centralized system because users do not have the ability to correct mistakes or reverse transactions.¹⁷⁵

Even with permissioned blockchains, where companies layer their infrastructure with additional identity and privacy protections above the Blockchain, the identity network could still be vulnerable to some form of privacy issue.¹⁷⁶ On the one hand, the Blockchain offers 'a greater degree of personal ownership, control, and monetisation of personal data', which can be a valuable tool for public good and for private companies.¹⁷⁷ On the other hand, the Blockchain's 'ability to see details of so many interactions is also so immensely powerful [that it] can be used for good or for ill'.¹⁷⁸ Therefore, companies need to continuously improve their corporate practices to protect the personal privacy of individuals and, at the same time, to not compromise transparency and data sharing for the public good.

¹⁷² Ibid 5–6.

¹⁷³ Garry Gabison, 'Policy Considerations for the Blockchain Technology Public and Private Applications' (2016) 19 *SMU Science and Technology Law Review* 327, 330.

¹⁷⁴ Ibid 330–1.

¹⁷⁵ Ibid 334, 343.

¹⁷⁶ Shrier et al, above n 171, 6.

¹⁷⁷ Ibid 10.

¹⁷⁸ Ibid.

V LACKING A REGULATORY FRAMEWORK

A *Current U.S. Laws Regulating Virtual Currency*

As the Blockchain revolutionises the way people conduct businesses, governments, regulators, and various policymakers have become increasingly concerned whether the benefits of developing technologies in commerce will outweigh the bad actors' potential exploitation of the Blockchain for illicit purposes (i.e., money laundering, terrorist financing).¹⁷⁹ The classic challenge with new technologies is determining the right moment to regulate, balancing the need for protecting the public's interests, and providing policy direction without inhibiting innovation and stifling new jobs.¹⁸⁰

Those who are proponents of technology typically advocate for self-regulation; however, a self-regulatory approach to the Blockchain is unlikely to address illicit and fraudulent activities associated with the technology.¹⁸¹ The Blockchain is prone to hacks, unforeseen occurrences, and other technical bugs; yet, regulators at both the federal and state levels have been slow to implement any firm set of rules and most have adopted a 'wait-and-see' approach.¹⁸²

In March 2013, FinCEN released the Virtual Currency Guidance ('VC Guidance') as a mechanism to regulate virtual currency transactions.¹⁸³ This was in response to Bitcoin running on the Blockchain being increasingly used as a vehicle for bad actors to commit money laundering and other criminal activities. The VC Guidance specifically stated administrators and exchangers of de-centralized virtual currencies are subject to AML requirements 'to the extent that they transmit decentralized virtual currency or legal tender from one user to another,

¹⁷⁹ Reyes, above n 11, 193.

¹⁸⁰ Angela Walch, 'The Path of the Blockchain Lexicon (and the Law)' (2017) 36 *Review of Banking and Financial Law* 713, 717.

¹⁸¹ Reyes, above n 11, 194.

¹⁸² Brian Scarbrough and Justin Steffen, *Insurance and Regulatory Hurdles to Blockchain Adoption* (13 September 2017) Law360 <<https://www.law360.com/articles/963267/insurance-and-regulatory-hurdles-to-blockchain-adoption>>.

¹⁸³ The formal name for FinCEN's guidance on virtual currencies is entitled, 'Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies.' See United States Department of the Treasury, *FinCEN Guidance FIN-2013-G001* (18 March 2013) <<https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>>.

or from one location to another'.¹⁸⁴ Other regulators followed suit and began targeting companies with traditional centralized structures that also offered products and services linked to the Blockchain because those companies maintained large-scale virtual currency operations.¹⁸⁵ For example, following large negative publicity, the Federal Bureau Investigations Unit ('FBI') shut down Silk Road in 2013.¹⁸⁶ The site used Bitcoin as payment for illicit services such as narcotics and provided purchasers with relative anonymity.¹⁸⁷ This further prompted Congress to hold public hearings and other regulatory agencies, including the IRS, Fed, SEC, and Commodity Futures Trading Commission ('CFTC'), to also weigh in on the matter.¹⁸⁸ However, compliance requirements to address AML, terrorist financing, and identity verification issues continued to have their own practical difficulties because these agencies' regulations over virtual currencies were often disjointed.¹⁸⁹ For example, 'virtual currency' is defined as 'property' according to the IRS, 'currency' according to [FinCEN] and 'commodity' according to the CFTC.¹⁹⁰ It appears that current federal regulations on the Blockchain primarily address payments law issues relating to Bitcoin and other virtual currencies rather than issues specifically presented by the Blockchain.¹⁹¹ Thus, federal agencies should seek a solution on how to regulate the Blockchain and come up with a regulatory toolbox that addresses payment-related issues more comprehensively, including other issues like privacy and security, tax compliance, and the potential use of unfair and deceptive business practices.¹⁹²

¹⁸⁴ Reyes, above n 11, 204.

¹⁸⁵ Ibid.

¹⁸⁶ Steven Nelson, *Buying Drugs Online Remains Easy, 2 Years After FBI Killed Silk Road* (2 October 2015) United States News and World Report <<https://www.usnews.com/news/articles/2015/10/02/buying-drugs-online-remains-easy-2-years-after-fbi-killed-silk-road>>.

¹⁸⁷ Stephanie A. Lemchuk, 'Virtual Whats?: Defining Virtual Currencies in the Face of Conflicting Regulatory Guidances' (2017) 15 *Cardozo Public Law, Policy, and Ethics Journal* 319, 320. See Griffiths, above n 135, 305.

¹⁸⁸ Reyes, above n 11, 205, 207, 209. See Scarbrough et al, above n 202. For general information on federal and state agencies authorities regulating blockchain transactions, see Kiviat, above n 17, 588–602.

¹⁸⁹ Kiviat, above no 17, 589.

¹⁹⁰ Scarbrough et al, above n 182.

¹⁹¹ Reyes, above n 11, 211, 213.

¹⁹² Ibid 211.

At the U.S. state level, several states took interest in regulating decentralized virtual currencies.¹⁹³ For example, California and New York sent letters to industry participants to solicit their comments and evaluate how to implement regulatory guidelines for virtual currencies.¹⁹⁴ In fact, New York became the first state to require any persons or businesses engaging in virtual currency services to obtain a ‘BitLicense’, excluding ‘merchants and consumers that utilize virtual currency solely for the purchase or sale of goods or services’.¹⁹⁵ Additionally, the Uniform Law Commission recently established a regulatory framework on 19 July 2017 known as the Uniform Regulation of Virtual Currency Business Act (‘URVCBA’) to assist state legislatures with a model template for regulating virtual currency that could be implemented across all states.¹⁹⁶ Even Arizona, Nevada, and Vermont have pursued Blockchain initiatives, but the most notable state legislation came from Delaware when it legalized blockchain-based stock trades.¹⁹⁷ Delaware’s new Blockchain law was enacted after the Court of Chancery determined in a class action litigation involving Dole Food Co. that the Blockchain might be the technological solution to reconcile stock ownerships.¹⁹⁸ Under the Dole decision, corporations can now use the Blockchain to utilise a host of different functions including:

1. issuing and tracking shares electronically on a real-time basis to prevent any delay or uncertainty from manual recording;
2. eradicating the distinction between record holder and beneficial holder to eliminate any inefficiencies caused by the nominee system;

¹⁹³ Ibid 205. See Dario de Martino and Spencer Klein, *Don’t Want to be the Next Kodak? Embrace Blockchain*, (6 September 2017) Law360 <<https://www.law360.com/articles/960825/don-t-want-to-be-the-next-kodak-embrace-blockchain>>.

¹⁹⁴ Reyes, above n 11, 205–6.

¹⁹⁵ Griffiths, above n 135, 321.

¹⁹⁶ de Martino et al, above no 193. See generally Uniform Law Commission: The National Conference of Commissioners on Uniform State Laws <<http://www.uniformlaws.org/>>.

¹⁹⁷ Scarbrough et al, above n 182.

¹⁹⁸ Joshua A Klayman et al, *Why the Delaware Blockchain Initiative Matters to All Dealmakers* (20 September 2017) Forbes <<https://www.forbes.com/sites/grouphink/2017/09/20/why-the-delaware-blockchain-initiative-matters-to-all-dealmakers/2/#4db2ad3c5f77>>; See generally *Re Dole Food Co* (Del. Ch., C.A. No. 8703-VCL, 15 February 2017) (order granting modification on the stock distributions as originally stipulated in the Plan of Allocation of the Settlement Fund). de Martino et al, above n 193.

3. settling transactions instantaneously so as to reduce the transaction costs; and
4. allowing shareholders and issuers to communicate directly with each other without third-party intermediaries.¹⁹⁹

However, despite attempts by several U.S. States to regulate virtual currency, they are just as divided as federal regulators to offer any real guidance.²⁰⁰ Therefore, if regulators are serious about wanting to deter financial crimes and increase security for the public, both federal and state governments need to collaborate on a comprehensive guidance to effectively monitor virtual currency activities.²⁰¹

B Growing Trends in Blockchain Technology

The Blockchain's disruptive potential to revolutionise almost everything beyond the Internet has received a lot of buzz from technologists to investors in recent years.²⁰² The World Economic Forum estimated the Blockchain is likely to store about 10 percent of the global domestic product within the next decade.²⁰³ For this reason, companies may be at a commercial or economic disadvantage if they do embrace the Blockchain.²⁰⁴ While there are mixed reviews about whether blockchain-based currencies are more efficient and effective alternatives to the traditional forms of payment, there is almost universal consensus that the Blockchain is a great tool for facilitating electronic value transfers.²⁰⁵ Before corporate leaders decide to implement the Blockchain into their businesses, leaders need to clearly understand the Blockchain and various regulations behind the technology.

Regulators need to understand the different types of Blockchain technologies so that they can craft precise language to achieve more favourable regulatory outcomes.²⁰⁶ Without a clear understanding

¹⁹⁹ de Martino et al, above n 193.

²⁰⁰ Stephanie A. Lemchuk, 'Virtual Whats?: Defining Virtual Currencies in the Face of Conflicting Regulatory Guidances' (2017) 15 *Cardozo Public Law, Policy, and Ethics Journal* 319, 322.

²⁰¹ Ibid 323.

²⁰² de Martino et al, above n 193.

²⁰³ Ibid.

²⁰⁴ Ibid.

²⁰⁵ Kiviat, above n 17, 587–8.

²⁰⁶ Walch, above n 180, 731.

of the Blockchain lexicon, regulators will likely resort to industry experts to provide them with an explanation.²⁰⁷ This could lead to a heightened risk of under-regulation if regulators take everything they were told from the industry experts at face value.²⁰⁸ Moreover, a failure to have a consistent meaning for the term ‘blockchain’ across different jurisdictions will inhibit policy objectives and effective regulation.²⁰⁹ Lastly, if the ‘blockchain’ takes on different meanings so frequently, regulators can potentially adjust the technology or terminology to avoid any regulatory burdens.²¹⁰ Accordingly, companies might want to wait until regulators have cultivated expertise and proficient knowledge in the Blockchain before any useful, stable regulations get adopted.²¹¹

Currently, the U.S. does not have a central authority to control the direction of virtual currency nor any specific blockchain regulations. For this reason, companies should continue to monitor the evolving regulatory landscape in this area because the Blockchain’s effect on businesses is no longer a matter of ‘if’; rather, it is now a matter of ‘when’. Moreover, companies’ early self-regulation of the Blockchain is recommended as more blockchain-related projects are trending and becoming the inevitable technology of the future for many businesses across all sectors, both domestically and globally.

VI RECOMMENDATIONS FOR LAWMAKERS AND CORPORATIONS

A *For Lawmakers*

1 *Various Domestic Laws and International Standards*

Where much of the Internet has penetrated global civilian society in the 1990s, the Blockchain is similarly moving in that direction at an increasingly rapid speed. This can be problematic for regulators if there is an absence of any comprehensive law.²¹² For example, when the Internet became widespread and resulted in global accessibility, most users only knew of its basic features, like surfing the web or sending e-mails.

²⁰⁷ Ibid 731–2.

²⁰⁸ Ibid.

²⁰⁹ Ibid 734.

²¹⁰ Ibid 735.

²¹¹ Ibid 746, 751.

²¹² Piazza, above n 49, 523.

They did not know the Internet's mechanisms, underlying structure, or operation.²¹³ Even though the Internet 'has become easy to access,' it was still 'hard to grasp', so comprehensive regulation over the Internet became extremely difficult.²¹⁴ Like the Internet before it, the Blockchain is 'only as secure as its entry points', so it is still prone to unforeseen risks and exposures.²¹⁵ Since it has the capability to handle high volume transactions, the Blockchain is likely vulnerable to computer hacks as criminals invent new ways to circumvent the technology for fraudulent purposes.²¹⁶ Therefore, slow adoption of blockchain-related frameworks ahead of these technical trends combined with accelerated investments in blockchain-related projects and/or start-up companies can lead to inconsistent standards and practices over time.

To date, the U.S. has not established any comprehensive legislation to regulate the Blockchain. In fact, any efforts by Congress to regulate the Blockchain have been offered more as 'guidance' for the financial services industry to address Bitcoin and other virtual currencies.²¹⁷ While these technological advances raise serious concerns about privacy, security, and job disruption issues, they can also improve the way people connect and do businesses around the world, redefine global trade, alleviate poverty, remove corrupt regimes, and transform people's everyday lives.²¹⁸ Therefore, the U.S. legislature should consider adopting domestic laws that incorporate international minimum standards so as to prevent possible widespread abuses caused by de-centralized applications on the Blockchain. Moreover, if the U.S. becomes the first country to lead the way on such legislation, it will likely influence other countries to adopt similar blockchain laws in their

²¹³ Ibid 523–4.

²¹⁴ Ibid 523.

²¹⁵ Lorelie S Masters et al, 'Blockchain: Tapping Its Potential and Insuring against Its Risks' (2017) 2017 *Business Law Today* 1, 1.

²¹⁶ Ibid.

²¹⁷ Kiviat, above n 17, 589.

²¹⁸ Global Agenda Council on the Future of Software and Society, 'Deep Shift: Technology Tipping Points and Societal Impact' (9 September 2015) *World Economic Forum* 3 <http://www3.weforum.org/docs/WEF_GAC15_Technological_Tipping_Points_report_2015.pdf>.

domestic jurisdictions.²¹⁹ Indeed, the Blockchain is the ideal technology to help build a more efficient, transparent, and conscientious business society that also addresses global environmental, social, and human rights issues.

(a) International Compliance

For the purpose of supply chain management, chain of title, and traceability in an increasingly global marketplace, lawmakers should consider how having disparate blockchain regulations between different jurisdictions could affect the way records are kept. For instance, as Bitcoin emerges as an acceptable form of payment in jurisdictions like Canada and Germany, other jurisdictions, such as Thailand and China, remain doubtful about using Bitcoin as a legitimate medium for exchange.²²⁰ If Bitcoin becomes the preferred method for payment around the world, the ‘myriad of different policies [and] varying degrees of control’ in different jurisdictions will likely raise enforcement and economic problems.²²¹ More specifically, in order for any Bitcoin regulations to be effective within a global financial system, all countries need to agree on a single classification of what ‘Bitcoin’ actually means. Is Bitcoin a currency or money, commodity, investment vehicle, or digital asset?²²²

Similarly, if the U.S. chooses to regulate the Blockchain, lawmakers should incorporate some of the key principles from international guidelines, such as: the UN Guiding Principles for Business and Human

²¹⁹ If Congress creates blockchain laws that align with the international community’s compliance standards, then the U.S. can introduce these ‘domestic laws’ into their trade policies to galvanize their trading partners to do the same for their home countries. For example, when the U.S. became the first country to adopt a domestic legislation in 2010, under the Dodd Frank Act Section 1502, the rule that required publicly-traded companies to file annual non-financial disclosures for any linkage to conflict minerals within their supply chains, the EU also responded with their version of the conflict minerals regulation in 2017. See Pam Ly ‘TARGETING THE CONFLICT MINERALS TRADE: Corporate Social Responsibility Governance and the Multilateral System’ (2017) 25 *Willamette Journal of International Law and Dispute Resolution* 25, 27; Dynda A Thomas, ‘EU Conflict Minerals Regulation – Finally Published in the Official Journal’ on *Squire Patton Boggs: Conflict Minerals Law* (19 May 2017) <<https://www.conflictmineralslaw.com/2017/05/19/eu-conflict-minerals-regulation-finally-published-in-the-official-journal/>>.

²²⁰ Ed Howden, ‘The Crypto-Currency Conundrum: Regulating an Uncertain Future’ (2015) 29 *Emory International Law Review* 741, 743, 752, 758.

²²¹ *Ibid* 744–5.

²²² *Ibid* 760–6.

Rights, OECD Guidelines for Multinational Enterprises, OECD Due Diligence Guidance for Responsible Supply Chains, and Reference Guide to AML and Terrorist Financing.²²³ This will ensure that Blockchain regulations do not compromise the U.S. pledge to comply with international social, economic, and environmental guidelines as uniform standards develop for this newly de-centralized system. It will also protect the record's integrity and ensure its continuity of information as each transaction moves between multiple borders.

(b) International Trade

As the Blockchain becomes the preferred technology for tracing and recording products and services moving through global supply chains, it is critical that developed countries aid developing and less-developed countries so as to maintain pace in the Blockchain revolution. Domestically, this will benefit the U.S. economy as businesses and consumers gain more trust and confidence that emerging markets in less developed countries will have the infrastructure to maintain continuity of records across a supply chain. Therefore, with clear guidance and effective regulations on the Blockchain, the U.S. can compile accurate documentation of the statuses at each step along the process, thereby facilitating a more transparent and legitimate movement of goods and services.

²²³ (1) The UN Guiding Principles for Business and Human Rights provides States and companies with a set of international standards to prevent human rights abuses linked to business activities. See generally United Nations Global Compact, *Guiding Principles for Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework* (2011) <<https://www.unglobalcompact.org/library/2>>. (2) Member States of the Organisation for Economic Co-operation and Development ('OECD') collaborated on a set of voluntary principles and standards to ensure that multinational enterprises are conducting responsible business under applicable laws. See generally, Organisation for Economic Co-operation, *OECD Guidelines for Multinational Enterprises* (2008) <<https://www.oecd.org/corporate/mne/1922428.pdf>>. (3) Member States of the OECD collaborated with multi-stakeholders to establish guidelines for supply chain management of minerals mined in conflict-affected and high-risk areas. See generally Organisation for Economic Co-operation, *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* (2013) <<https://www.oecd.org/corporate/mne/GuidanceEdition2.pdf>>. (4) The World Bank and International Monetary Fund developed a reference guide to help countries prevent AML and terrorist financing and improve their domestic laws in accordance with international standards and best practices. See generally Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism* (The World Bank and International Monetary Fund 2nd ed, 2006) 1, 1.

(c) *International Cooperation*

Currently, the U.S. does not have any specific legislation or any one source to address CSR. However, various federal and state legislations such as: the Foreign Corrupt Practices Act ('FCPA'), BSA/AML, the Dodd-Frank Wall Street Reform and Consumer Protection Act ('DFA') § 1502, and other state-specific laws on human trafficking, modern slavery, and supply chain transparency demonstrated the U.S. interests in addressing global human rights concerns.²²⁴ Moreover, governments across multiple borders can use the Blockchain to foster information sharing and collaborate on a global response to social, economic, and environmental issues. Especially with the UN's public support for the Blockchain to be used to advance international development programs,²²⁵ other international organisations and civil society will likely place increasing demands on lawmakers to examine how the Blockchain can be a valuable tool to address global human rights.

In the EU, the Blockchain Observatory Initiative was designed to make Europe the benchmark for the Blockchain. Furthermore, the government's recent financing of blockchain-related projects for FinTech companies hinted at a possible EU blockchain law that may have a global legislative reach beyond its domestic legislation.²²⁶ For example,

²²⁴ The Department of Justice ('DOJ') and the SEC are the U.S. federal agencies authorized to pursue criminal and civil actions against corporations and individuals under the FCPA. See generally Criminal Division of the United States Department of Justice and Enforcement Division of the United States Securities and Exchange Commission, *FCPA: A Resource Guide to the US Foreign Corrupt Practices Act* (2012). See generally Business and Human Rights Resource Centre, *Implementation of US Dodd-Frank Act rule on conflict minerals: Commentaries, guidance, company actions* (2013) <<https://www.business-humanrights.org/en/conflict-peace/conflict-minerals/implementation-of-us-dodd-frank-act-rule-on-conflict-minerals-commentaries-guidance-company-actions>> and Kamala D Harris, California Department of Justice, *The California Transparency in Supply Chains Act: A Resource Guide* (2015).

²²⁵ UNICEF Innovation, *Blockchain at UNICEF* (12 January 2017) <<http://unicefstories.org/blockchain/>>.

²²⁶ Banco Bilbao Vizcaya Argentaria, *The European Commission commits to blockchain for promoting fintech companies* (22 February 2018) <<https://www.bbva.com/en/european-commission-commits-blockchain-promoting-fintech-companies/>>.

the UK Modern Slavery Act, EU Non-Financial Disclosure Directive, and Conflict Minerals Regulation were some of the regulations that ultimately bound U.S. companies to various disclosure rules and due diligence practices.²²⁷ Currently, it is still unclear how future foreign blockchain laws might impact U.S. corporations. However, U.S. lawmakers should begin with a legislative framework that also considers how blockchain laws in foreign jurisdictions may affect companies doing business outside of the U.S. in order to prevent complex standards or an inability to cooperate with international laws.

2 Legislative Framework to Advance UN Sustainable Development Goals

If the U.S. adopts a legislative framework that guides individuals, businesses, and governments to advance the UN SDGs, then the Blockchain can be a very useful tool to: measure the efficient use of global environmental resources, improve transparency and traceability throughout global supply chains, empower impoverished communities to improve living conditions through access to international payment transfers, and facilitate developing countries' access to the global marketplace through safe business transactions.

To date, the only type of U.S. federal legislation that is remotely related to the Blockchain has strictly been in the Bitcoin and virtual currency space. Several federal agencies have tried to regulate virtual currency, but to no avail because they failed to clearly define the meaning of virtual currency. Since the Blockchain does not fall neatly under any single regulatory agency's authority, U.S. lawmakers should consider forming a 'Blockchain Technology Unit', similar to FinCEN. By designating relevant federal agencies to a separate unit, each agency can more effectively monitor and research activities of products and services recorded on the Blockchain.

²²⁷ See generally *Modern Slavery Act 2015* (UK) c 30; European Commission, Non-financial reporting <https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en>; *European Commission, Combatting Conflict Minerals* <<http://ec.europa.eu/trade/policy/in-focus/conflict-minerals-regulation/>>.

Michael R Littenberg et al, *Corporate Social Responsibility Compliance in 2018, and Beyond – An Overview for In-House Legal Counsel* (12 March 2018) Ropes and Gray LLP <<https://www.ropesgray.com/en/newsroom/alerts/2018/03/Corporate-Social-Responsibility-Compliance-in-2018-and-Beyond-An-Overview-for-In-House-Legal-Counsel>>.

It can also: collect and analyse information relating to possible financial, privacy, intellectual property, and other human rights-related crimes; act as an interagency arm for all federal agencies to collaborate on investigative inquiries; and cooperate with foreign jurisdictions to foster information sharing. More importantly, the Blockchain Technology Unit can rely on existing domestic laws and international standards to refer enforcement actions to the appropriate federal agency that has oversight authority over a particular product, service, or other crimes recorded on the Blockchain. Under this framework, the U.S. legislature can protect the public's trust that investments in blockchain-related businesses are legitimate, foster company growths without stifling innovation, establish clearer guidelines to prevent illicit activities, and ensure that blockchain-related innovations do not compromise the U.S. pledge to advance its UN SDGs.

B For Corporations

1 Call for Corporations to Think Global, Act Global

In 2006, the UNEP Finance Initiative, UN Global Compact, and a network of international investors launched the Principles of Responsible Investment ('PRI') initiative. This established a voluntary framework that provides guidance on how investors can integrate environmental, social, and governance ('ESG') issues into decision-making and ownership practices so as to foster a more sustainable global financial system.²²⁸ The UN's 'Making Global Goals Local Business' campaign sets a new era of responsible businesses to become more aware and active in achieving the UN SDGs.²²⁹ With increasing pressure from stakeholders for companies to align themselves and their practices with societal goals, and similar pressures placed on responsible investors, companies are becoming more incentivized to engage in CSR.²³⁰ With the Blockchain, U.S. companies can now efficiently record their CSR performance

²²⁸ See generally United Nations Global Compact, *Integrate the Principles for Responsible Investment* (2018) <<https://www.unglobalcompact.org/take-action/action/responsible-investment>>.

²²⁹ Lise Kingo, 'Making Global Goals Local Business: A New Era for Responsible Business' (September 2017) *United Nations Global Compact 3* <<https://www.unglobalcompact.org/docs/publications/MGGLB-2017-UNGA.pdf>>.

²³⁰ Kingo, above n 229. PRI Association, *What is responsible investment?*, PRI: Principles for Responsible Investment <<https://www.unpri.org/pri/what-is-responsible-investment>>. PRI stands for 'Principles for Responsible Investment.' The PRI was born out of an investor initiative in partnership with the UNEP Finance Initiative and UN Global Compact to collaborate on a platform that measures companies' ESG performance.

by tracking environmental data (i.e., climate change, greenhouse gas emissions, waste and pollution), social conditions (i.e., slavery and child labour, conflicts, health and safety), and governance issues (i.e., bribery and corruption, tax strategies, executive compensation, donations).²³¹ Additionally, as more CSR-related regulations emerged in recent years, corporate legal departments have increased responsibility to build out their CSR compliance functions.²³² These pressures have led a growing number of companies, both domestically and internationally, to pay attention and engage in CSR practices.²³³ For example, Australia, China, France, EU, Hong Kong, Switzerland, and the Netherlands have initiated their own legislations to address common CSR issues relating to conflict minerals, bribery, corruption, human and labour trafficking, and modern-day slavery.²³⁴ Even in the U.S., the federal government has given wide deference to state legislatures to enact blockchain legislations rather than exercising its own right to impose federal blockchain laws.²³⁵ In fact, Delaware is home to about 64% of Fortune 500 companies who have made the state their place of incorporation.²³⁶ So when Delaware established the Delaware Blockchain Initiative to benefit its corporate clients, this prompted corporate leaders in other states and jurisdictions around the world to also engage in dialogues about the Blockchain ecosystem.²³⁷ Delaware envisioned corporations and other business entities would benefit from blockchain-based ‘smart’ applications that can help achieve administrative efficiencies, reduce risks, and lower costs associated with certain corporate activities.²³⁸ Thus, corporations can now determine whether their corporate practices are ‘responsible business’ with the use of the Blockchain to track their CSR performance.

²³¹ Ibid.

²³² Littenberg et al, above n 227.

²³³ Ibid.

²³⁴ Ibid.

²³⁵ Ian Murphy, *More US States move to legalise blockchain* (15 January 2018) Enterprise Times <<https://www.enterprisetimes.co.uk/2018/01/15/us-states-move-legalise-blockchain/>>.

²³⁶ Christopher Wink, *64% of Fortune 500 firms are Delaware incorporations: here's why* (23 September 2014) Technical.ly <<https://technical.ly/delaware/2014/09/23/why-delaware-incorporation/>>.

²³⁷ Caitlin Long and Andrew Tinianow, With Blockchain, *The Early Lawyer Gets the Worm* (4 October 2017) Law360 <<https://www.law360.com/articles/970948/with-blockchain-the-early-lawyer-gets-the-worm>>.

²³⁸ Ibid.

VII CONCLUSION

In recent years, corporations are increasingly being challenged to develop effective CSR compliance programs in response to numerous domestic and international legislations which address global environmental, social, and human rights concerns. Corporations' traditional approach to recordkeeping resulted in duplicative records, human errors, and inefficiencies. With the Blockchain, corporations now have a more secure method of confirming that products are free of human rights abuses, supply chains are not tainted by terrorist financing, and data can be recorded in real-time in an automated, de-centralized, and neutral way. Blockchain-based platforms can be used to carry out CSR initiatives that: contribute to companies' triple bottom line, influence corporate governance decisions, and impact the way corporations address their financial, legal, intellectual property, and data privacy issues. However, existing domestic legislation does not adequately address these business concerns because Blockchain-based technologies are growing faster than what regulators can do to keep up. Therefore, as the public expects corporations to exercise CSR, U.S. lawmakers may have to rely on existing international guidelines and incorporate those principles into domestic law. U.S. lawmakers will likely be more successful at regaining the trust of the public if a legislative framework is established to help guide companies in using the Blockchain's de-centralized, borderless system to conduct responsible business in accordance with the principles as set forth in the UN SDGs. Accordingly, corporations now have the Blockchain's technological capability to build effective CSR-compliance programs, thereby transforming the way they govern corporate practices and address international issues around the world.

**AN EXAMINATION OF THE LIMITS ON
TREATY SHOPPING AND NATIONALITY
PLANNING THROUGH ARBITRAL
JURISPRUDENCE – HOW THE *PHILIP
MORRIS V AUSTRALIA* AWARD REPRESENTS
A CONSOLIDATION OF THE APPROACH OF
PREVIOUS TRIBUNALS**

SELENA LIU*

ABSTRACT

***International Investment Law – International Arbitration – Australia –
Alternative Dispute Resolution – Treaty Shopping – Nationality Planning –
Bilateral Investment Treaty***

This article examines arbitral jurisprudence on the practice of nationality planning and treaty planning in the context of international investment law and arbitral proceedings under bilateral investment treaties. The first part of the article examines the limits on the practice of nationality planning and treaty shopping. The awards of arbitral tribunals are analysed to identify the main limits on the practice of nationality planning and treaty shopping. The article, through the comparative analysis of arbitral awards, suggests that the latest comprehensive award of the tribunal in Philip Morris v Australia¹ represents a consolidation of the approach of previous tribunals to some of the main limitations to the practice of nationality planning and treaty shopping.

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¹ *Philip Morris Asia Ltd v The Commonwealth of Australia (Award on Jurisdiction and Admissibility)* (UNCITRAL, PCA Case No 2012-12, 17 December 2015) (*Philip Morris Asia v Australia (Award)*).

I INTRODUCTION

There is no single definition of ‘treaty-shopping’ in international investment law.² The Organisation for Economic Cooperation and Development posit ‘treaty shopping’ to comprehensively encompass instances ‘... when an investor structures an investment (through incorporation and possibly by restructuring certain business operations) in order to seek to qualify for protections conferred by particular investment treaties’.³ The terms – ‘nationality planning’ and ‘corporate restructuring’ are generally understood to be different forms of ‘treaty-shopping’.⁴ Although the practice of treaty-shopping carries negative connotations, current trends in the international investment law area illustrate that nationality planning and corporate restructuring are generally permitted when completed prior to the emergence of a dispute.⁵ The timing of an action is therefore crucial to the admissibility of a dispute to arbitration and the determination on the legitimacy of the treaty-shopping practice. With globalisation and increased corporate sophistication, arbitral tribunals have had to make determinations on the difference between legitimate nationality planning and abusive treaty-shopping. The most recent guidance on the distinction between legitimate nationality planning and abusive treaty-shopping is found in *Philip Morris v Australia*.⁶

This article will begin with a critical discussion of treaty-shopping and nationality planning by corporations with international reach. The latter parts of this article then move on to survey the limits on the practice through the examination of demonstrative arbitral jurisprudence, various international investment instruments, and

² Baumgartner Baumgartner, *Treaty shopping in international investment law* (Oxford University Press, 2017), 1.

³ David Gaukrodger and Kathryn Gordon, ‘Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community’ (Working Papers on International Investment No 2012/3, OECD, 2012) 55 <http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf>

⁴ Baumgartner, above n 2, 8; John Lee, ‘Resolving Concerns of Treaty Shopping in International Investment Arbitration’ (2015) 6 *Journal of International Dispute Settlement*, 355, 355.

⁵ Baumgartner, above n 2, 8–11.

⁶ *Philip Morris Asia Ltd v The Commonwealth of Australia (Award on Jurisdiction and Admissibility)* (UNCITRAL, PCA Case No 2012-12, 17 December 2015) (*Philip Morris Asia v Australia (Award)*).

principles of international law. A conclusion on whether the Award of the *Philip Morris v Australia* tribunal represents a consolidation or new development in international investment law will close the discussion on each of the main limitations.

II TREATY-SHOPPING AND NATIONALITY PLANNING

Since the signing of the first bilateral investment treaty ('BIT') between Germany and Pakistan in 1959,⁷ over 3000 international investment agreements have come into existence.⁸ Countries enter into BITs to facilitate investment by creating a reciprocal set of rights and obligations between them.⁹ Many BITs include direct investment by natural persons and often also indirect investments by legal persons.¹⁰ This qualifier allows corporations to change their nationality with relative ease¹¹ and therefore gain access to the most favourable BIT. As a result, resourceful corporations with international reach often undertake treaty-shopping for the purposes of bringing claims against the host state¹² and to bring claims within the jurisdiction of the International Centre for Settlement of Investment Disputes ('ICSID').¹³

Treaty-shopping occurs because the international investment system is decentralised. The boundaries of the contemporary international investment framework are set in a myriad of multilateral treaties, BITs, and 'specialised' international investment instruments such as the Convention establishing the International Centre for Settlement of

⁷ *Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments*, signed 25 November 1959, 33 Bundesgesetzblatt II, 793 (entered into force 6 July 1961).

⁸ Baumgartner, above n 2, 204.

⁹ Roos van Os and Roeline Knottnerus, 'Dutch Bilateral Investment Treaties: A Gateway to "Treaty Shopping" for Investment Protection by Multinational Companies' (SOMO, October 2011) 11; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2nd ed, 2012) 19–20.

¹⁰ Stephan W. Schill, 'Multilateralization: An Ordering Paradigm for International Investment Law' in Marc Bungenbery, Jorn Briebel, Stephan Hobe, August Reinisch (eds); Yun-I Kim (ass. ed), *International Investment Law: A Handbook* (C.H. Beck, 2015) 1817, 1828.

¹¹ Ibid 1828.

¹² Baumgartner, above n 2, 204 [1.2.1].

¹³ Utku Topcan, 'Abuse of the Right to Access ICSID Arbitration' (2014) 29(3) *ICSID Review* 627, 628.

Investment Disputes ('ICSID Convention').¹⁴ This provides investors with the incentive to 'pick and choose' the most favourable system for their purpose. As a result, nationality planning undermines contractual reciprocity expressed by BITs as corporations are able to opt in and out of the most favourable BIT through treaty-shopping.¹⁵

Treaty-shopping is generally observed in two broad situations. The first situation describes a company's incorporation in a country other than the investor's home State for the purposes of bringing itself under a more favourable BIT with the intended host State. This form of 'shopping' is known as nationality planning.¹⁶ Corporate nationality planning occurs because nationality is often a condition precedent to accessing the standards of protection conferred under a BIT.¹⁷ The practice of treaty-shopping and nationality planning is especially prevalent in multinational corporations.¹⁸ International trends have shown that many multinational corporations incorporate subsidiaries in a State with a favourable BIT with the intended host State to 'maximise' standards of protection for its foreign investment.¹⁹

The second form of treaty-shopping usually occurs after the dispute is foreseeable or has arisen. This is done by the sale of disputed assets from the corporation in dispute to its related entity based in a country with a more favourable BIT for the purpose of bringing its claims. The first situation – nationality planning – denotes a pre-emptive action whilst practices in this second scenario are made with the benefit of foresight. As such, where a corporation has sold its assets to a subsidiary incorporated in a state with a more favourable BIT, arbitral tribunals are more likely to hold the practice to be treaty abuse and decline jurisdiction on the matter. These types of practices are referred to as 'corporate restructuring' in arbitral jurisprudence and have been

¹⁴ Dolzer and Schreuer above n 9, 12; *Convention of the Settlement of Investment Disputes Between States and Nationals of Other States (as Amended and Effective April 10, 2006)*, opened for signature 18 March 1965, 4 ILM 524 (entered into force 14 October 1966) ('ICSID Convention').

¹⁵ Schill, above n 10, 1828–1829.

¹⁶ Dolzer and Schreuer, above n 9, 52–54.

¹⁷ Christoph Schreuer, 'Nationality of Investors: Legitimate Restrictions vs. Business Interests' (2009) 23(2) *ICSID Review – Foreign Investment Law Journal* 521, 521.

¹⁸ Baumgartner, above n 2, 2.

¹⁹ *Ibid.*

used as the main method for changing the corporate nationality to bring claims within the jurisdiction of arbitral tribunals.²⁰

Treaty-shopping, by way of nationality planning or corporate (re) structuring are not prohibited per se and have been recognised as valid methods of accessing international arbitration.²¹ It is now expected that a prudent investor will undertake treaty-shopping as a part of diligent corporate planning.²²

The rise in the practice of treaty shopping can be attributed to the realisation that direct access to international arbitration is subject to less limitations than seeking diplomatic protection.²³ Under diplomatic protection, the home State has discretion as to whether to bring a claim on behalf of the aggrieved investor.²⁴ By electing into a BIT that provides direct access to arbitration at the ICSID, investors can bring disputes independently of, and commence arbitration proceedings directly with the host State.²⁵ Many investors favour ICSID arbitration over domestic litigation and ad hoc arbitration because decisions of ICSID tribunals are binding and confer greater enforceability through the operation of the ICSID Convention.²⁶ Moreover, compared to ad hoc arbitral tribunal proceedings and decisions, ICSID decisions are public and therefore may incentivise host states to reach settlement in the interests of reducing adverse publicity.²⁷

The favourable BIT may also allow an investor to access more favourable provisions or processes through a most favoured nation ('MFN') clause.²⁸ MFN clauses seek to eliminate discriminatory treatment by extending any favourable treatment one nation might

²⁰ Baumgartner, above n 2, 13 [1.1.2.2].

²¹ Christoph Schreuer, 'Nationality Planning' in Arthur Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2012* (Brill 2012) 17, 18; Dolzer and Schreuer, above n 9, 52.

²² Schreuer, above n 21, 19; Schill, above n 10, 1828.

²³ Baumgartner, above n 2, 205.

²⁴ Ibid.

²⁵ van Os and Knottnerus, above n 9, 9; Matthew Skinner, Cameron Miles, and Sam Luttrell, 'Access and Advantage in Investor-State Arbitration: The Law and Practice of Treaty Shopping' (2010) 3(2) *Journal of World Energy Law & Business* 260, 261.

²⁶ Skinner, Miles and Luttrell, above n 25, 266; Dolzer and Schreuer, above n 9, 239.

²⁷ Ibid 267.

²⁸ Baumgartner, above n 2, 11.

have conferred on another to other third states.²⁹ However, access to a more favourable dispute resolution procedure via the MFN clause will be limited by the wording of the BIT. The *Maffezini* tribunal held that the wording of the BIT permitted access to a more favourable dispute resolution procedure.³⁰ By contrast, the Salini tribunal held that the wording of the relevant BIT did not extend the MFN clause to apply to procedural matters.³¹ These contrasting rulings provide another insight into why investors opt into BITs that unambiguously provide for direct access to ICSID arbitration.

With the increase in nationality planning and corporate restructuring practices, it has been recognised that treaty-shopping is vulnerable to manipulation and abuse.³² Arbitral tribunals have expressed a number of limitations to demarcate the fine line between legitimate nationality planning and exploitative treaty shopping. The next section critically discusses the main limitations by reference to demonstrative arbitral decisions and international law principles.

III LIMITATIONS ON TREATY-SHOPPING AND NATIONALITY PLANNING

Arbitral tribunals have recognised that the practice of treaty-shopping and nationality planning can occur for a vast array of reasons. To screen the permissible from the prohibited, there are four main limitations. The first three relate to the jurisdiction of a tribunal: *ratione personae*, *ratione materiae*, and *ratione temporis*. Under these limitations, claims cannot be brought within the jurisdiction of arbitral tribunals if the identity, material,³³ and temporal³⁴ requirements are not met. The

²⁹ Dolzer and Schreuer, above n 9, 206–208.

³⁰ *Emilio Augustín Maffezini v The Kingdom of Spain (Decision of the Tribunal on Objections to Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/97/7, 25 January 2000), [52]-[56]. (*Maffezini v Spain*’).

³¹ *Salini Costruttori S.p.A. and Italstrade S.p.A. v The Hashemite Kingdom of Jordan (Decision on Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/02/13, 29 November 2004), [117]-[119].

³² Suzy Nikiéma, ‘Best Practices Definition of Investor’ (Best Practice Series, The International Institute for Sustainable Development, March 2012) 16-17. Jorun Baumgartner, ‘The Significance of the Notion of Dispute and Its Foreseeability in an Investment Claim Involving a Corporate Restructuring, (2017) 18 *Journal of World Investment & Trade* 201, 202.

³³ Schreuer, above n 21, 19-20.

³⁴ Baumgartner, above n 2, ch 6.

last main limitation to the practice of treaty-shopping and nationality planning considers the principle of abuse of right/process.³⁵

The next sections will discuss the jurisdictional limitations before placing focus on the abuse of right/process limitation.

A *Jurisdictional limitations: *ratione personae* and *ratione materiae**

These two jurisdictional limitations to treaty-shopping and nationality planning stem from the definition of ‘investor’ and ‘investment’. Even though the place of incorporation is the most common definition of corporate nationality,³⁶ when the ‘investor’ and/or ‘investment’ lacks a genuine connection to the home State as required, arbitral tribunals lack *ratione personae* and *ratione materiae*. This is because the investor is not an eligible national and the investment is not within the scope of protection as defined by the BIT.³⁷

‘Round-tripping’ and the use of shell or mailbox companies are the two common methods to shift corporate nationality. ‘Round-tripping’ describes when a national of a State sets up an entity in another State in order to qualify its investment under the protection of an international investment instrument, thereby effectively bringing an international investment claim against its own State under the guise of an international BIT.³⁸ Shell or mailbox companies are the companies incorporated for the purpose of bringing a multinational’s investment within the protection of a favourable BIT, but otherwise carries out no significant business activities in its claimed home State.³⁹ In response, many BITs contain denial of benefit provisions in an attempt to curtail abusive treaty shopping and to look through the corporate veil to the nationality of the controlling shareholders and the source of the investment capital.⁴⁰

³⁵ Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’ (2012) 27(2) *ICSID Review* 281, 289.

³⁶ Schreuer, above n 21, 18.

³⁷ Baumgartner, above n 2, 67; Feldman, above n 35, 282–283. Stephen Schill, *The Multilateralization of International Investment Law* (Cambridge University press, 2009) 199.

³⁸ Baumgartner, above n 2, [4.3.1.1].

³⁹ van Os and Knottnerus, above n 9, 4.

⁴⁰ Feldman, above n 35, 302. Dolzer and Schreuer, above n 9, 55-56; Schill, above n 37, 223.

Denial of benefit provisions define the circumstances in which an investor's connection to the home State is lacking.⁴¹ This is usually qualified on a finding that the investor does not have substantial business activity in the claimed home State or that the investment is controlled by other nationals.⁴² In contrast to the abuse of right/process limitation from customary international law, denial of benefit provisions are contractual, with their interpretation reliant on express text, not jurisprudence or legal principles and thus serve to make outcomes more predictable.⁴³ Due to their contractual nature, denial of benefit clauses are suggested to be 'the best approach for establishing clear, predictable limits on ... nationality planning'.⁴⁴ It has also been suggested that the abuse of right/process limitation will be limited due to the increasing use of denial of benefits provisions in modern investment instruments.⁴⁵ Clear, well-drafted denial of benefit clauses eliminate uncertainties over considerations such as policy, objective intent, and the origin of investment capital.⁴⁶

The tribunals in *Tokios v Ukraine*⁴⁷ and *Saluka*⁴⁸ considered that in the absence of denial of benefit provisions, the investor criterion is satisfied when the corporation was incorporated in the asserted home State. The BIT concerned should be the definitive guide, and tribunals are barred from imposing any other criteria into the definition of an investor as agreed to by the contracting states.⁴⁹

The Tribunal in *ADC Affiliate*⁵⁰ also looked to the wording of the BIT and concluded that the applicable BIT did not require a genuine link

⁴¹ Feldman, above n 35, 282.

⁴² Baumgartner, above n 2, [4.3.3]

⁴³ Feldman, above n 35, 283.

⁴⁴ Ibid 293.

⁴⁵ Ibid 302.

⁴⁶ Ibid.

⁴⁷ *Tokios Tokelès v Ukraine (Decision on Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/02/18, 29 April 2004) [29], [38], [56] ('*Tokios v Ukraine (Decision on Jurisdiction)*').

⁴⁸ *Saluka Investments B.V. v The Czech Republic (Partial Award)* (UNCITRAL, Permanent Court of Arbitration, 17 March 2006) [197], [241].

⁴⁹ Ibid [241].

⁵⁰ *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary (Award)* (ICSID Arbitral Tribunal, Case No ARB/03/16, 2 Oct 2006) ('*ADC Affiliate v Hungary (Award)*').

between the capital and the nationality of the investor.⁵¹ The concept of piercing the corporate veil was also considered in *Tokios* and *ADC Affiliate* to tease apart the relationship and the connection required between a valid investor and investment. The Tribunal expressed that the use of veil piercing should be rare and only be used where ‘the real beneficiary of the business misused corporate formalities in order to disguise its true identity and therefore to avoid liability’.⁵² Professor Prosper Weil, as the President of the *Tokios* tribunal, provided the dissent on the relationship between nationality and investment. In contrast to the majority, Professor Weil considered the origin of the capital to be the crucial qualifier in determining the legitimacy of the asserted nationality of an investor.⁵³ Proceeding tribunals have not sided with this sentiment and have concentrated on the timing of the structuring rather than tracing the origin of the investor and capital.

The jurisdictional limitations of *ratione personae* and *ratione materiae* are now largely well-defined. The rulings of *Tokios* and *Saluka* express that the jurisdiction *ratione personae* and *jurisdiction ratione materiae* of arbitral tribunals are dictated by the wording of the BIT. This is likely to be due to principles of customary international law, where discrimination on the basis of nationality is prohibited and is a violation of the fair and equitable treatment standard.⁵⁴ As a result, tribunals are barred from looking beyond the definition contained in the investment treaty. Contractually, the existence of a MFN clause in most treaties also prohibits distinction on the basis of nationality.⁵⁵

⁵¹ Ibid [345], [359].

⁵² Ibid [358].

⁵³ *Tokios v Ukraine (Decision on Jurisdiction)*, [23] (President Weil).

⁵⁴ Christoph Schreuer, ‘Nationality of Investors: Legitimate Restrictions vs. Business Interests’ (2009) 23(2) *ICSID Review – Foreign Investment Law Journal* 521, 527.

⁵⁵ Christoph Schreuer, ‘Nationality Planning’ in Arthur Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2012* (Brill 2012) 17, 17.

B Philip Morris: Consolidation or Development within *ratione personae* and *ratione materiae*?

The *Philip Morris* Tribunal followed prior jurisprudence by looking to the wording of the BIT.⁵⁶ The Tribunal placed emphasis on the ‘substantial interest’ requirement for investors and their investments as expressed in Article 1(e) of the Hong Kong–Australia BIT.⁵⁷ The Tribunal concluded that Philip Morris Asia Ltd lacked substantial interest and control over its Australian investments.⁵⁸ The lack of control was evidenced by the fact that its manager mostly acted for the parent company and that the parent company dictated major decisions.⁵⁹

Even though the Award of *Philip Morris* did not consider the investor/investment limitation in length, the decision represents a consolidation of previous tribunals’ approaches on the analysis of these limitations. The Hong Kong–Australia BIT does not contain a denial of benefits provision. It has been noted that where the applicable BIT does not contain a denial of benefit clause and when a meaningful connection between the investor and their (chosen) home State appears to be lacking, tribunals will focus on the abuse of rights/process limitation.⁶⁰ Consistent with this sentiment, the *Philip Morris* Tribunal then concentrated its judgement on the next two limitations: jurisdiction *ratione temporis* and abuse of right/process.

⁵⁶ *Philip Morris Asia Ltd v Commonwealth (Award on Jurisdiction and Admissibility)* (UNCITRAL, PCA Case No 2012–12, 17 December 2015) (*Philip Morris Asia v Australia (Award)*).

⁵⁷ *Agreement between the Government of Australia and the Government of Hong Kong for the Promotion and Protection of Investments*, signed 15 September 1993, 30 Australian Treaty Series 1993 (entered into force 15 October 1993) art 1(e); *Philip Morris Asia v Australia (Award)*, [498]–[500].

⁵⁸ *Philip Morris Asia v Australia (Award)*, [508]–[509].

⁵⁹ *Ibid* [508].

⁶⁰ Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’ (2012) 27(2) ICSID Review 281, 301.

C *Jurisdictional limitation: ratione temporis*

The third jurisdictional limitation concerns the temporal scope of arbitral jurisdiction – *ratione temporis*. When a dispute has already occurred or has come into existence prior to the corporate restructuring, arbitral tribunals will dismiss the claim based on lack of temporal jurisdiction (*'ratione temporis'*)⁶¹ or on ground of abuse of right/process when the dispute was foreseeable.⁶² The *ratione temporis* limitation relates to the admissibility of a dispute and does not assess the merits of the claim. The merits of the claim are assessed against the principle of abuse of right/process limitation which will be discussed in detail in the next section.⁶³ Jurisdiction *ratione temporis* is a crucial qualifier for the validity of the arbitral decision as wrongful admission/dismissal constitute an excess of power and gives grounds for annulment under the ICSID Convention.⁶⁴

The first element to this assessment is to determine the point at which the investor obtained the nationality of the claimed home State.⁶⁵ Under the ICSID Convention, used in the majority of international investment arbitration cases, the nationality criterion requires a company to have had the nationality of the home State 'on the date on which the parties consented to submit such dispute to ... arbitration'.⁶⁶ As such, the majority of tribunal decisions in this area seek to identify the difference in time between the starting point of the dispute and the change in nationality through corporate restructuring.

In customary international law, 'dispute' has been defined via reference to jurisprudence from the Permanent Court of International Justice and the International Court of Justice.⁶⁷ Generally, a dispute is

⁶¹ Jorun Baumgartner, *Treaty shopping in international investment law* (Oxford University Press, 2017), 315 [6.4]; Michael Waibel, 'Investment Arbitration: Jurisdiction and Admissibility' (Research Paper No 9, Legal Studies Research Paper Series, the University of Cambridge Faculty of Law, February 2014) 46.

⁶² Baumgartner, above n 61, [6.4].

⁶³ Ibid 182 [6.4.1.2].

⁶⁴ ICSID Convention, art 52(1)(b); R Doak Bishop and Silvia Marchili, *Annulment under the ICSID Convention* (Oxford University Press 2012) [6.46ff].

⁶⁵ Baumgartner, above n 61, [6.2].

⁶⁶ ICSID Convention, art 25(2)(b).

⁶⁷ Baumgartner, above n 61, 188 [6.4.2.3.1].

said to exist when parties' positions are in opposition, which later gives basis to the claim.⁶⁸

This limitation is a practical example of the principle of non-retroactivity under customary international law.⁶⁹ Obtaining protection via corporate restructuring after a dispute comes into existence is usually impossible because many treaties do not apply retroactively via specific exclusionary clauses.⁷⁰ In the absence of exclusion clauses, arbitral tribunals have limited their jurisdiction to disputes that arose after a corporate restructure.⁷¹ The Tribunal in *Phoenix Action*⁷² gave a general statement of principles on this topic. The Tribunal noted that its temporal jurisdiction was limited to 'judging only those acts and omissions occurring after the date of the ... investment'⁷³ and had 'no jurisdiction *ratione temporis* over any alleged claims' that predated the restructuring.⁷⁴ This ruling equated the timing of the claim with the 'birth' of the dispute, demonstrating that the use of the principle of non-retroactivity equated to the exclusion of pre-existing disputes.⁷⁵

At the beginning of the century, the *Maffezini* Tribunal noted that a dispute is often the product of a sequence of events.⁷⁶ This statement recognises that corporate restructurings occur in deteriorating business climates, often after the start of a series of events but before the final act that leads to the dispute. Arbitral jurisprudence has shown that the starting point of a dispute that resulted from a sequence of events is hard to determine.⁷⁷ The following discussion will examine these inconsistencies by reference to demonstrative arbitral decisions.

⁶⁸ Jorun Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability in an Investment Claim Involving a Corporate Restructuring' (2017) 18 *Journal of World Investment & Trade* 201, 222; *Emilio Augustín Maffezini v The Kingdom of Spain (Decision of the Tribunal on Objections to Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/97/7, 25 January 2000) [96] ('*Maffezini v Spain (Decision of the Tribunal on Objections to Jurisdiction)*').

⁶⁹ Baumgartner, above n 61, [6.1].

⁷⁰ Christoph Schreuer, 'Nationality of Investors: Legitimate Restrictions vs. Business Interests' (2009) 23(2) *ICSID Review – Foreign Investment Law Journal* 521, 527

⁷¹ Baumgartner, above n 61, [6.4.1.2]; Waibel, above n 61, 46-47.

⁷² *Phoenix Action Ltd. v The Czech Republic (Award)* (ICSID Arbitral Tribunal, Case No ARB/06/5, 15 April 2009) ('*Phoenix v Czech Republic (Award)*').

⁷³ *Ibid* [68].

⁷⁴ *Ibid* [71].

⁷⁵ Baumgartner, above n 61, 182 [6.4.2.1]

⁷⁶ *Maffezini v Spain (Decision of the Tribunal on Objections to Jurisdiction)*, [96].

⁷⁷ Baumgartner, above n 61, [6.1].

In *Pac Rim*,⁷⁸ the Claimant was an US entity owned by a Canadian parent company. Disputes over the issuing of mining permits stretched from 2005 to 2008. In March 2008, the President of El Salvador made a public statement against mining.⁷⁹ In December 2007 the ownership in the investments in El Salvador were transferred to the US company. The Tribunal determined that a dispute arises when the claimant ‘can see an actual dispute or can foresee a specific future dispute as a very high probability and not merely as a possible controversy’.⁸⁰ However, unhelpful to providing guidance on which types of events can be considered to evidence the beginning of a dispute, the Tribunal then noted that there is a ‘significant grey area’ between emerging disputes and actual ones.⁸¹ This grey area allowed for importation of a claimant’s subjective intentions into the test. Allowing for subjective interpretations make findings vulnerable to selective pleadings.⁸²

As a result, the *Pac Rim* Tribunal eventually held that it had temporal jurisdiction as the issues faced by the company over the mining permits was a continuous act and only became apparent by the President’s public announcement in March 2008,⁸³ after the change in nationality.

In contrast to *Pac Rim*, the Tribunal in *Laos Holdings v Laos*⁸⁴ shifted towards the use of objective assessments. In *Laos Holdings*, the Claimant was a company incorporated under the laws of the Netherlands Antilles which in January 2012, acquired 100% of the shares in Macao-incorporated Sanum. Sanum operated casinos in Laos and in March 2011 began negotiations on a flat tax agreement which divided Government authorities over whether to extend it. The Lao Ministry of Finance eventually issued a negative decision in Nov 2011, and in December 2011, a new tax code for a higher taxation of casino revenue was passed.

⁷⁸ *Pac Rim Cayman LLC v Republic of El Salvador (Decision on the Respondent’s Jurisdictional Objections)* (ICSID Arbitral Tribunal, Case No ARB/09/12, 1 June 2012) (*Pac Rim v El Salvador (Decision on the Respondent’s Jurisdictional Objections)*’).

⁷⁹ *Ibid* [2.24]-[2.25].

⁸⁰ *Ibid* [2.99].

⁸¹ *Ibid* [2.99].

⁸² Baumgartner, above n 61, 193 [6.4.2.3.2].

⁸³ *Pac Rim v El Salvador (Decision on the Respondent’s Jurisdictional Objections)*, [3.37].

⁸⁴ *Lao Holdings N.V. v Lao People’s Democratic Republic (Decision on Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB(AF)12/6, 21 February 2014) (*Lao Holdings v Laos (Decision on Jurisdiction)*’).

The decision to withhold the extension of the flat tax agreement was later affirmed by the Prime Minister of Laos in March 2012.⁸⁵

The Tribunal had to determine whether the restructuring happened at a time when the dispute with the Lao government had already existed. In doing so, the Tribunal first noted that ‘the test for determining the critical date is objective and that the relevant question is not ... whether the Claimant subjectively believed it had not, the question is whether the facts, objectively analysed, establish the existence of a dispute and if so at what time did it arise, and was it resolved ... before the Treaty came into force as between the Respondent and the Claimant?’⁸⁶

The Tribunal held that the actual dispute arose in March 2012 when the Prime Minister confirmed the Finance Minister’s decision.⁸⁷ The Tribunal had temporal jurisdiction as the restructuring in January 2012 occurred before the dispute came into existence and that the company had ‘a reasonable expectation that the decision of the Minister of Finance was just a stepping stone in a longer process’.⁸⁸ Even though the Tribunal called for an objective test, it imported subjective interpretation of facts to determine temporal jurisdiction.

Both *Pac Rim* and *Laos Holdings* demonstrate that for continuous disputes, the starting point of the dispute is the date of the final act that gave rise to the claim. The tribunals equated the start of a dispute with the occurrence of an alleged breach which has allowed for jurisdiction *ratione temporis* when the restructuring occurred before the occurrence of the alleged breach.⁸⁹ However, these cases have been criticised to have placed too much emphasis on the claimants’ subjective interpretation of events.⁹⁰

D Philip Morris: Consolidation or Development within *ratione temporis*?

The latest comprehensive expression on jurisdiction *ratione temporis* is found in *Philip Morris v Australia*.⁹¹ The Claimant was a Hong Kong–incorporated company (‘Philip Morris Asia’) that sought

⁸⁵ Ibid [60].

⁸⁶ Ibid [124].

⁸⁷ Ibid [146], [158].

⁸⁸ Ibid [139], [146].

⁸⁹ Baumgartner, above n 68, 222.

⁹⁰ Baumgartner, above n 61, [6.4.2.3.2].

⁹¹ *Philip Morris Asia v Australia (Award)*.

damages against Australia for imposing plain packaging measures on tobacco. In February 2011 Philip Morris Asia acquired shares of Philip Morris Australia and its subsidiary Philip Morris Limited. Plans for plain packaging measures started in 2008/2009.⁹² On 29 April 2010 the Australian Government then publicly announced its intention to introduce legislation and publish a timetable on 7 July 2010.⁹³ Legislation was enacted on 21 Nov 2011. Procedural history shows that Philip Morris Australia opposed the process. In response, Australia submitted that the Tribunal lacked jurisdiction *ratione temporis* because the dispute had already come into existence at the time Philip Morris undertook the restructuring.⁹⁴

The Tribunal based its determination on the principle of non-retroactivity⁹⁵ by concluding that the test for a *ratione temporis* objection is ‘whether a claimant made a protected investment before the moment when the alleged breach occurred’.⁹⁶ The Tribunal held that it had jurisdiction because ‘for purposes of the *ratione temporis* objection, the critical date is the date when the State adopts the disputed measure, which in this case is the date of *enactment* of the TPP [i.e. the plain packaging] Act, as before that moment the Claimant’s right could not be affected’.⁹⁷ As such, the November 2011 implementation of plain packaging laws which led to the alleged breach did not exist at the time of the restructuring (in February 2011).⁹⁸ The Tribunal then turned its attention to assess whether the restructuring was an abuse of process, the details of which are discussed in the next section.

The Tribunal of *Philip Morris* held that the starting point of the dispute is the time of the alleged breach.⁹⁹ The approach of the Tribunal meant that the Award of the *Philip Morris* Tribunal is a consolidation of the approaches taken by previous tribunals. The Tribunal’s statement

⁹² Ibid [103]-[106].

⁹³ Ibid [130].

⁹⁴ Ibid [354]-[360].

⁹⁵ Baumgartner, above n 61, 195 [6.4.2.3.3].

⁹⁶ *Philip Morris Asia v Australia (Award)*, [529].

⁹⁷ *Philip Morris Asia v Australia (Award)*, [533].

⁹⁸ Ibid [534].

⁹⁹ Ibid [532].

that ‘the date of the dispute is not necessarily identical to that of the alleged breach’¹⁰⁰ hinted at a possible development or clarification in this area. However, the Tribunal did not contemplate the circumstances under which the date of the dispute and the alleged breach would be different. This hint of development might have been stifled by the fact that the *ratione temporis* and abuse of right/process limitations are linked. A finding of lack of temporal jurisdiction would also bar a tribunal from assessing the merits of the claim against the principle of abuse of right/process.¹⁰¹

E Abuse of right/process

The abuse of right/process principle has become the main limitation to the practice of treaty-shopping and nationality planning.¹⁰² As international investment instruments such as the ICSID Convention and BITs are in the international arena, it has been suggested that these instruments are to be interpreted by reference to the Vienna Convention on the Law of Treaties (‘the Vienna Convention’).¹⁰³ Under the Vienna Convention, treaties are to be interpreted with reference to the principle of good faith and any other relevant rules from international law.¹⁰⁴ The principles of good faith, abuse of right, and abuse of process are used interchangeably in this context.¹⁰⁵

The application of this limitation to the facts of a claim serves to distinguish between legitimate nationality planning and abusive treaty-shopping.¹⁰⁶ The interface between nationality planning, foreseeability, and abuse of rights/process has been one of the most contentious areas of international investment law. Perhaps unsurprisingly, the application of

¹⁰⁰ Ibid.

¹⁰¹ *Renée Rose Levy and Gremcitel S.A. v. Republic of Peru (Award)* (ICSID Arbitral Tribunal, Case No ARB/11/17, 9 January 2015) [182] (‘*Gremcitel v Peru (Award)*’).

¹⁰² Feldman, above n 60, 288; Paul Michael Blyschak, ‘Access and advantage expanded: *Mobil Corporation v Venezuela* and other recent arbitration awards on treaty shopping’ (2011) 4(1) *Journal of World Energy Law and Business* 32, 33.

¹⁰³ *Vienna Convention on the Law of Treaties* (opened for signature 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 (‘*Vienna Convention*’). Utku Topcan, ‘Abuse of the Right to Access ICSID Arbitration’ (2014) 29(3) *ICSID Review* 627, 628.

¹⁰⁴ *Vienna Convention*, art 31(1)(a), 31(3)(c).

¹⁰⁵ Baumgartner, above n 61, 202 [7.2].

¹⁰⁶ Ibid 226 [7.3.2.2].

this principle to corporate restructuring has been subject to inconsistent interpretations. One of the first substantial cases that considered the interface between treaty shopping and abuse of right/process rested upon the Tribunal in *Phoenix Action v Czech Republic* ('Phoenix').¹⁰⁷

Phoenix concerned the restructuring of investments from the Czech Republic to Israel and subsequent claim for breach of standards of protection under the Israel–Czech Republic BIT.¹⁰⁸ The Claimant was a Czech national who transferred assets from his two Czech companies to an Israeli company.¹⁰⁹ In assessing the treaty abuse element, the Tribunal noted that the principle of good faith 'has long been recognised in public international law, as it is also in all national legal systems'.¹¹⁰ The use of the good faith principle prevented the abuse of rights contained in treaties.¹¹¹ Treaty protections therefore must not extend to investments made through misuse of the ICSID system.¹¹² The Tribunal found that the Israeli company also did not carry out any substantial economic activity and that the assets were transferred between family.¹¹³ The timing and substance of the investment suggested that the true nature of the restructuring was to disguise a domestic investment as an international investment, done for the purpose of bringing a claim which amounted to an abuse of rights.¹¹⁴ Another 2009 case, *Cementownia v Turkey* considered a similar set of facts as those in *Phoenix*. The *Cementownia* Tribunal connected the principle of good faith with treaty abuse by adding that restructuring cannot be used 'to fabricate international jurisdiction where none should exist'.¹¹⁵

¹⁰⁷ *Phoenix v Czech Republic* (Award).

¹⁰⁸ Ibid [93]; *Agreement between the Government of the Czech Republic and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments*, signed 23 September 1997, (entered into force 19 March 1999).

¹⁰⁹ Ibid [22], [65], [137].

¹¹⁰ Ibid [107].

¹¹¹ Ibid.

¹¹² Ibid [106], [113].

¹¹³ Ibid [139]-[140].

¹¹⁴ Ibid [143]-[144].

¹¹⁵ *Cementownia "Nowa Huta" S.A. v Republic of Turkey* (Award) (ISDIC Arbitral Tribunal, Case No RB(AF)/06/2, 17 September 2009) ('*Cementownia v Turkey* (Award)'), [117].

The next case in this line of jurisprudence – *Mobil v Venezuela*,¹¹⁶ concerned the restructuring of assets within subsidiaries. Mobil, a US company made investments in Venezuela through two layers of subsidiaries. In June 2005, disputes arose on the imposition of higher royalty payment and income tax requirements. (‘the 2005 disputes’).¹¹⁷ The 2005 disputes expanded in 2007 when the President of Venezuela announced the nationalisation of oil production projects, including the two projects Mobil held (the nationalisation claim).¹¹⁸ From October 2005 to November 2006, Mobil restructured its investments in two projects in Venezuela through to a company incorporated in the Netherlands.¹¹⁹

The Tribunal in *Mobil v Venezuela* began its decision on the abuse of right limitation by noting that an abuse of right should be judged by taking account of all the circumstances of the case.¹²⁰ This statement, whilst instructive, does not give a clear contemplation of the range of practices that would be deemed to be abusive. Having weighted the circumstances before it, the Tribunal considered that ‘the main, if not sole purpose of restructuring was to protect Mobil investments from adverse Venezuelan measures’.¹²¹ The Tribunal also held that restructures to gain access to ICSID arbitration through the BIT are legitimate when undertaken for the purposes of obtaining protection for future disputes.¹²² This has been recognised as a bright line statement that expresses permission for ex ante treaty-shopping.¹²³

Citing *Phoenix Action*,¹²⁴ the *Mobil* Tribunal reiterated that abuse will be found when a restructure is done for the sole purpose of bringing a pre-existing claim under a favourable BIT.¹²⁵ The author submits that

¹¹⁶ *Mobil Corporation, Venezuela Holdings BV, Mobil Cerro Negro Holding, Ltd, Mobil Venezolana de Petroleos Holdings, Inc, Mobil Cerro Negro, Ltd, and Mobil Venezolana de Petroleos, Inc v Bolivarian Republic of Venezuela (Decision on Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/07/27, 10 June 2010) (‘*Mobil v Venezuela (Decision on Jurisdiction)*’).

¹¹⁷ *Ibid* [202].

¹¹⁸ *Ibid* [19].

¹¹⁹ *Ibid* [32], [203].

¹²⁰ *Ibid* [177].

¹²¹ *Ibid* [190].

¹²² *Ibid* [204].

¹²³ Blyschak, above n 102, 35.

¹²⁴ *Phoenix v Czech Republic (Award)* [144].

¹²⁵ *Mobil v Venezuela (Decision on Jurisdiction)* [205].

the *Mobil* Tribunal placed great emphasis on timing and decided the legitimacy of nationality planning by reference to the starting point of the dispute. The Tribunal found that Mobil's restructure was completed before nationalisation in 2007 but after the 2005 disputes.¹²⁶ Therefore Mobil's restructure for the purpose of seeking protection for the 2007 nationalisation breach was not held to be an abuse of right/process.¹²⁷ The Tribunal's distinction of pre-existing and future disputes expresses that an abuse of right/process will be found when corporate restructuring was undertaken for the main or sole purpose of bringing a pre-existing dispute within ICSID jurisdiction.

This limitation was considered again in *Pac Rim*.¹²⁸ In *Pac Rim*, restructuring took place in December 2007, perhaps in response to a series of mining permit disputes which arose in 2005. The Claimant sought to claim damages for the events which arose after March 2008, when it considered that the ban on mining became apparent as a result of the President of El Salvador's public announcement.¹²⁹ Even though it can be argued that the existence of the dispute was foreseeable with a very high probability, the Tribunal accepted the Claimant's submission that it believed that mining permits would be granted due to representations made by state officials prior to March 2008.¹³⁰

The *Pac Rim* Tribunal also distinguished pre-existing disputes from future ones. To find a conduct to be an abuse of process, the restructuring must be done when the 'birth' of a dispute can be foreseen with a 'very high probability, not merely as a possible controversy'.¹³¹ The divide between legitimate nationality planning and treaty abuse is to be determined by the existence or the very high probability of a specific dispute.¹³² This is a very fine distinction which has to be made by consideration to the circumstances of each case.¹³³ The Tribunal stated that the use of a shell company for the purposes of bringing the dispute

¹²⁶ Ibid [203].

¹²⁷ Ibid [204].

¹²⁸ *Pac Rim v El Salvador (Decision on the Respondent's Jurisdictional Objections)*.

¹²⁹ Ibid [2.54], [2.78].

¹³⁰ Ibid [2.83]-[2.84].

¹³¹ Ibid [2.99].

¹³² Ibid.

¹³³ Ibid.

within the protection of a BIT after the dispute had come into existence was an abuse of process.¹³⁴ On determination, the restructuring was held to be legitimate because the actual dispute only became foreseeable as a consequence of the President's speech in March 2008.¹³⁵ Further, consistent with the approach of the Tribunal in *Mobil v Venezuela*, the Tribunal for *Pac Rim* also noted that restructures for the sole purpose of gaining access to ICSID arbitration are legitimate so long as the restructure was instigated before the inception of a dispute.¹³⁶

The principle of abuse of right/process was considered again in *Tidewater v Venezuela*.¹³⁷ Taking guidance from *Mobil*¹³⁸ and *Phoenix*¹³⁹, the Tribunal placed emphasis on the timing of the restructuring. The tribunal held that timing was a crucial factor in determining whether the restructuring amounted to an abuse of rights.¹⁴⁰ The Tribunal agreed with the approach of the Tribunal in *Mobil* by noting that a change in nationality in itself does not amount to abuse of process; restructures for the purposes of seeking protection from future disputes are legitimate.¹⁴¹ The restructuring in this case began in December 2008 and was concluded in March 2009, at around the same time as financial disagreements began.¹⁴² The government then enacted laws that amounted to expropriation in May 2009.¹⁴³ The Tribunal considered the financial disagreements to be an 'ordinary commercial dispute',¹⁴⁴ and that the government's actions in May 2009 were not reasonably foreseeable during the course of the corporate restructuring (December 2008-March 2009).¹⁴⁵ As such, the corporate restructuring did not amount to an abuse of right.¹⁴⁶

¹³⁴ Ibid [2.100].

¹³⁵ Ibid [2.109]- [2.110].

¹³⁶ Ibid [2.42], [2.47].

¹³⁷ *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v The Bolivarian Republic of Venezuela (Decision on Jurisdiction)* (ICSID Arbitral Tribunal, Case No ARB/10/5, 8 February 2013) ('*Tidewater v Venezuela (Decision on Jurisdiction)*').

¹³⁸ *Mobil v Venezuela (Decision on Jurisdiction)*.

¹³⁹ *Phoenix v Czech Republic (Award)*.

¹⁴⁰ *Tidewater v Venezuela (Decision on Jurisdiction)* [145]-[146].

¹⁴¹ Ibid [184].

¹⁴² Ibid [163], [197].

¹⁴³ Ibid [6].

¹⁴⁴ Ibid [190].

¹⁴⁵ Ibid [197].

¹⁴⁶ Ibid [198].

Even though the tribunals in *Tidewater* and *Pac Rim* were both guided by *Mobil v Venezuela* in its consideration to whether the timing of a restructure constituted an abuse of right/process, the *Tidewater* tribunal lowered the foreseeability aspect from ‘a very high probability’ as expressed by *Pac Rim*¹⁴⁷, to ‘reasonably foreseeable’.¹⁴⁸

Seven months after *Tidewater*, the abuse of right limitation was considered again by the Tribunal in *ConocoPhilips v Venezuela*.¹⁴⁹ Agreeing with previous arbitral jurisprudence, the Tribunal noted that there was a high correlation between the timing, the restructuring and the foreseeability of the dispute.¹⁵⁰ Abuse of right will be found when a dispute was ‘in prospect’ at the time the corporate restructuring took place.¹⁵¹ The author notes that the Tribunal did not make a final determination on the timing of the restructure because the main argument concerned the validity of the investment company. It was alleged that the companies were mailbox companies, incorporated under Dutch law for the sole purpose of achieving access to arbitration.¹⁵² Echoing *Phoenix*¹⁵³, the Tribunal held that treaty abuse will be found where a claim is brought in bad faith, even where the corporate nationality met the definition of ‘investor’ in the applicable BIT.¹⁵⁴ On the definition of investor, the Tribunal did not find abuse of right because evidence suggested that the Claimant intended to hold ongoing business interests after the restructuring.¹⁵⁵ The approach of the Tribunal in *ConocoPhilips* suggests that the use of mailbox companies, which abrogates the *ratione personae* limitation, is likely to be considered to be an act in bad faith and therefore constitutes an abuse of right/process.

¹⁴⁷ *Pac Rim v El Salvador (Decision on the Respondent’s Jurisdictional Objections)* [2.99].

¹⁴⁸ *Tidewater v Venezuela (Decision on Jurisdiction)* [184], [197].

¹⁴⁹ *ConocoPhilips Petrozuata BV, ConocoPhilips Hamaca BV and ConocoPhilips Gulf of Paria BV v Bolivarian Republic of Venezuela (Decision on Jurisdiction and the Merits)* (ICSID Arbitral Tribunal, Case No ARB/07/30, 3 September 2013) (*‘ConocoPhilips v Venezuela (Decision on Jurisdiction and Merits)’*).

¹⁵⁰ *Ibid* [275].

¹⁵¹ *Ibid* [279].

¹⁵² *Ibid* [267]-[268].

¹⁵³ *Phoenix v Czech Republic (Award)*.

¹⁵⁴ *ConocoPhilips v Venezuela (Decision on Jurisdiction and Merits)* [273].

¹⁵⁵ *Ibid* [280].

The next demonstrative case, *Laos Holdings v Laos* agreed with earlier jurisprudence that a change in nationality on its own does not constitute abuse by stating that ‘the time frame corresponding to a finding of abuse of process is not the same as the time frame corresponding to an objection *ratione temporis*’.¹⁵⁶ The Tribunal also stated that abuse will be found when corporate restructuring occurs at a time when the existence of a dispute becomes ‘highly probable’.¹⁵⁷

At the beginning of 2015, *Gremcitel v Peru*¹⁵⁸ increased the foreseeability threshold by referring back to *Pac Rim*’s finding that a dispute must be foreseeable with a very high probability.¹⁵⁹ In respect to the timing element, this Tribunal noted that the closer the timing of the restructuring is to the dispute, the higher the degree of foreseeability.¹⁶⁰

F *Philip Morris: Consolidation or Development as an abuse of right?*

A recent comprehensive interpretation of the abuse of right limitation was expressed in *Philip Morris*.¹⁶¹ Having decided that it had temporal jurisdiction, the Tribunal started their analysis by noting that ‘the threshold for finding an abusive initiation of an investment claim is high ... the notion of abuse does not imply a showing of bad faith. Under the case law, the abuse is subject to an objective test’.¹⁶²

The *Philip Morris* Tribunal considered the arbitral jurisprudence set out by previous tribunals and concluded that the legal tests for abuse of right revolved around the concept of foreseeability.¹⁶³ The Tribunal considered that the threshold for foreseeability was between the ‘very high probability’ standard expressed in *Pac Rim* and the ‘reasonable prospect’ standard expressed in *Tidewater*.¹⁶⁴ The Tribunal lowered the

¹⁵⁶ *Lao Holdings v Laos (Decision on Jurisdiction)* [76].

¹⁵⁷ *Ibid.*

¹⁵⁸ *Gremcitel v Peru (Award)*.

¹⁵⁹ *Ibid* [185].

¹⁶⁰ *Ibid* [187].

¹⁶¹ *Philip Morris Asia v Australia (Award)* (UNCITRAL, PCA Case No 2012-12, 17 December 2015).

¹⁶² *Ibid* [539].

¹⁶³ *Ibid* [554].

¹⁶⁴ *Ibid.*

standard expressed by the early 2015 case *Gremcitel* by siding with *Tidewater's* threshold of 'reasonable prospect'.¹⁶⁵

The *Philip Morris* Tribunal applied its interpretation of the approach of previous Tribunals to the facts and concluded that the government's intention to implement plain packaging laws was definite and it was reasonable to expect that some form of the Plain Packaging Measure would be enacted. By 29 April 2010, the dispute was foreseeable.¹⁶⁶ Commenting on foreseeability generally, the Tribunal noted that 'the length of time it takes to legislate is not a decisive factor in determining whether the legislation is foreseeable'.¹⁶⁷ The facts in *Pac Rim* also involved a series of disputes that began before the restructuring. The Tribunal in *Pac Rim* held that the dispute was not foreseeable because of representations made to the company that permits would be issued.¹⁶⁸ Philip Morris could not rely on a similar defence because it was held that at the time of its corporate restructuring, even though the exact date of enactment of the plain packaging laws might have been uncertain, the eventual enactment of plain packaging measure laws were certain as despite change in leadership, the Australian Government never retracted from this intention.¹⁶⁹

The Award of the *Philip Morris* tribunal represents a consolidation to the abuse of right limitation. It consolidated considerations to the timing of the restructuring as echoed by previous tribunals in *Mobil*, *Pac Rim*, and *Tidewater*. Several treaty-shopping practices and motivations have been considered to be an abuse of right/process. Tribunals prior to *Philip Morris* concluded that ex post restructuring for the sole purpose of bringing an arbitration proceeding, actions brought in bad faith,¹⁷⁰ and the use of mailbox companies¹⁷¹ all constituted an abuse

¹⁶⁵ Ibid.

¹⁶⁶ Ibid [566].

¹⁶⁷ Ibid [567].

¹⁶⁸ *Pac Rim v El Salvador (Decision on the Respondent's Jurisdictional Objections)* [2.83] [2.84].

¹⁶⁹ *Philip Morris Asia v Australia (Award)* [566]-[569].

¹⁷⁰ *Phoenix v Czech Republic (Award)* [107], [143-144]; *Cementownia v Turkey (Award)* [117].

¹⁷¹ *ConocoPhillips v Venezuela (Decision on Jurisdiction and Merits)* [273]

of right. By asserting that abuse will be found when the restructuring is done when the dispute became 'foreseeable',¹⁷² the approach of the Tribunal in *Philip Morris* may be argued to have reduced considerations of international law principles such as bad faith and enquiries into corporate motivations. By stating that 'a dispute is foreseeable when there is a reasonable prospect that a measure that may give rise to a treaty claim will materialise',¹⁷³ the Award of the *Philip Morris* tribunal represents a further consolidation of the polar standards of 'very high probability' and 'reasonable prospect' expressed by previous tribunals.

IV CONCLUSION

The practice of treaty-shopping and nationality planning has been accepted by international investment law. The increasing use of these practices may be interpreted as a by-product of increasing multinationalism and commercial sophistication. A change of corporate nationality by nationality planning is an attractive strategy to modern, prudent investors as it allows for investments to be made under a more favourable international investment instrument and/or BIT. The distinction between legitimate nationality planning and treaty abuse has been blurred by its pervasiveness. In response, arbitral tribunals have expressed limitations which touch upon aspects of commercial contractual relationships in the modern economy and customary international law.

The main limitations to the practice of treaty-shopping and nationality planning fall into two categories: jurisdictional and customary. The *ratione personae* and *ratione materiae* limitations focus on the definitions of 'investor' and 'investment' contained in the evoked investment instrument.

Out of the four main limitations to the practice of treaty-shopping and nationality planning, *Philip Morris'* Tribunal considered the jurisdiction *ratione temporis* and abuse of right/process limitations in detail. This

¹⁷² *Philip Morris Asia v Australia (Award)* [585].

¹⁷³ *Ibid.*

is also a representation of the shift towards assessing the legitimacy of treaty-shopping practice(s) by reference to the circumstances of each case.

For the *ratione temporis* and abuse of rights/process limitations, the timing between the commencement of perceived treaty-shopping practices and the inception of a dispute is crucial as it can dictate the scope of a tribunal jurisdiction and the legitimacy of the claim. By stating that nationality planning by way of corporate restructuring that occurred after the dispute became reasonably foreseeable constitutes an abuse of right and/or process and therefore must be dismissed,¹⁷⁴ the Award of the *Philip Morris* tribunal represents a consolidation of the *ratione temporis* and abuse of right/process limitations.

Even though *Philip Morris* has consolidated the approach of previous tribunals on *ratione temporis* and abuse of right limitations, jurisprudence has shown that the divide between legitimate nationality planning and abusive treaty-shopping is factually and temporally sensitive. With increasing commercial complexity, the current consolidations may be challenged by future decisions.

¹⁷⁴ *Philip Morris Asia v Australia (Award)* [585].

TRACING THE HISTORICAL ROOTS OF SHARE PRICE MANIPULATION IN AUSTRALIA: *RERUM COGNOSCERE CAUSAS*¹

PAUL CONSTABLE*

ABSTRACT

Share Price Manipulation – Australian Capital Markets – Securities Markets – Market Misconduct – Historical Roots – Literature Review

A review of the literature relating to share price manipulation would lead one to reasonably conclude that the historical roots of this particular form of market misconduct in Australia only really commenced in the late 1960s following the mining and mineral boom and consequent changes to the domestic securities regulation paradigm. Yet, there is information available to suggest that share prices were being manipulated in local markets as far back as the latter part of the 1800s.

This article reviews the literature relating to the historical roots of share price manipulation in Australia and argues that despite the growing body of academic and non-academic work in this area, it remains largely incomplete due to the absence of literature that traces the historical roots of this illicit activity back beyond the late 1960s.

I INTRODUCTION

One reads frequently of the ‘ramps’ of the period, of shady tricks by stock brokers, swindled clients, murky ancient scandals, sometimes true, sometimes neither verified nor verifiable.²

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¹ ‘To learn the causes of things’ – the full quote from Virgil’s poem is ‘*felix qui potuit rerum cognoscere causas*’, translated from Latin to mean ‘happy he who was able to understand the causes of things’: Alessandro Schiesaro, ‘The Boundaries of Knowledge in Virgil’s *Georgics*’ in Thomas Habinek and Alessandro Schiesaro (eds), *The Roman Cultural Revolution* (Cambridge University Press, 2000), 81.

² J.B. Were & Son, *The House of Were, 1839–1954: The history of J.B. Were & Son, and its founder, Jonathan Binns Were* (J.B. Were & Son, 1954), 85.

Reports of misconduct in financial markets have been an almost daily occurrence in the media both internationally and locally over recent times, with ‘new scandals emerging with monotonous regularity’.³ Interest rate rigging, fraud by rogue traders, manipulation of key foreign exchange (‘FX’) benchmarks and insider trading are but a few examples of the types of misconduct perpetrated on global capital markets that seem to recur time after time. Whilst misconduct in financial markets is not a recent phenomenon, the financial penalties now imposed on recalcitrant banks and other financial service organisations just keep on increasing into the hundreds of millions and, in some cases, billions of dollars – amounts that not so long ago would not have been thought possible. Indeed, it is claimed that misconduct in financial markets by banks globally has cost them collectively in the region of almost half a trillion dollars.⁴ This figure would, presumably, be accounted for by not only the financial sanctions imposed by global regulators, but also the legal, management and remediation costs associated with responding to regulatory enforcement actions and litigation.

Yet, criminal breaches, bad behaviour, misconduct and sharp practices appear to be endemic in an industry that is supposedly built on trust, epitomised in the motto of the London Stock Exchange, *Dictum meum pactum*, my word is my bond.⁵ It is an industry that Platt characterises as a:

sick patient whose symptoms range from excessive risk taking, rate fixing, and mis-selling financial products to breaching sanctions laws, laundering money and facilitating crime.⁶

³ Stephen Platt, *Criminal Capital: How the Finance Industry Facilitates Crime* (Palgrave Macmillan, 2015), 188. Whilst the issues being publicly aired at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry are acknowledged, this article will focus on activities in the equity capital markets.

⁴ ‘One fund manager’s running tally scores the banks’ collective malfeasance as costing them about \$460 billion so far’: Michael Pascoe, ‘ASIC, ANZ and Reckless Brinkmanship’, *The Sydney Morning Herald*, 19-20 March 2016, Business Day, 6. Given the myriad of regulatory enforcement actions that have been completed in the last two years, this figure is likely to be considerably larger.

⁵ The motto on the Coat of Arms given to the London Stock Exchange in 1923 was *Dictum Meum Pactum* (my word is my bond): London Stock Exchange, *Our History*, <<http://www.londonstockexchange.com/about-the-exchange/company-overview/our-history/our-history.htm>>; Stuart Fraser, ‘Reform banking by putting capitalism back at the heart of capitalism’, *The Guardian* (online), 5 July 2012 <<http://www.theguardian.com/commentisfree/2012/jul/05/reform-banking-culture>>.

⁶ Platt, above n 3, 2.

Following the global financial crisis, the target of regulatory enforcement action has to a large extent been financial markets, instruments and activities that have traditionally operated or occurred outside, or on the fringes, of the ‘regulatory perimeter’.⁷ Examples include spot FX trading and financial benchmark submissions, such as the London Interbank Offered Rate (‘LIBOR’),⁸ the 4pm London ‘fix’, a key reference rate in the spot FX market published by WM/Reuters,⁹ and, closer to home, the Bank Bill Swap Reference Rate (‘BBSW’).¹⁰ The manipulation of BBSW by two of Australia’s largest domestic banks resulted in Australia and New Zealand Banking Group (‘ANZ’) and National Australia Bank (‘NAB’) receiving what has been described as a ‘savaging’¹¹ from Jagot J in the Federal Court of Australia:

- ⁷ This is essentially the division between ‘which activities are regulated and which are not’: HM Treasury, ‘A New Approach to Financial Regulation: Building a Stronger System’, February 2011, Presented to Parliament by the Financial Secretary to the Treasury by Command of Her Majesty, 22 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/81411/consult_newfinancial_regulation170211.pdf>. An example is given by Schooling Latter: ‘... spot FX sits in an interesting place on what we call our regulatory perimeter. Spot FX trading is only within the perimeter in certain circumstances, for example where a spot trade is ancillary to a transaction in a regulated ‘financial instrument’ (for example, when buying currency to purchase a bond), or where manipulation of prices on spot FX markets impacts the prices on regulated markets such as those for FX derivatives, or impacts on a benchmark. Most other FX trading is, in formal terms, outside our perimeter’: Schooling Latter, Edwin, ‘Conduct Risk in FX Markets’ (Speech delivered at FX Week Europe, London, 30 November 2016) <<https://www.fca.org.uk/news/>
- ⁸ The LIBOR ‘scandal’ has been described as, inter alia, the ‘greatest banking scandal in history’: Alexis Stenfors, *Barometer of Fear An Insider’s Account of Rogue Trading and the Greatest Banking Scandal in History* (Zed Books Ltd, 2017). The fallout from the LIBOR scandal included Deutsche Bank being fined a record \$2.5 billion for rigging this key financial benchmark: Jill Treanor, ‘Deutsche Bank hit by record \$2.5bn Libor-rigging fine’, *The Guardian* (online), 23 April 2015 <<http://www.theguardian.com/business/2015/apr/23/deutsche-bank-hit-by-record-25bn-libor-rigging-fine>>.
- ⁹ Guy Debelle, ‘FX Benchmarks’, (Address to the FX Week Australia Conference, Sydney, 12 February 2015) <<https://www.rba.gov.au/speeches/2015/sp-ag-2015-02-12.html>>.
- ¹⁰ According to Jagot J in *Australian Securities and Investments Commission v National Australia Bank Ltd*; *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Ltd* [2017] FCA 1338, BBSW is ‘the central benchmark interest reference rate which AFMA publishes each Sydney business day. It is widely used as a reference rate in financial agreements in Australia’: [17].
- ¹¹ Stephen Letts, ‘ANZ, NAB agree to \$100 million settlement of swap rate rigging case’, ABC News (online), 10 November 2017, <[http://www.abc.net.au/news/2017-11-10/anz-nab-agree-to-\\$100m-settlement-of-swap-rate-fixing-case/9138796](http://www.abc.net.au/news/2017-11-10/anz-nab-agree-to-$100m-settlement-of-swap-rate-fixing-case/9138796)>.

That any employee performing these kinds of functions within a bank, let alone two pillars of Australia's banking system, could have conceived of manipulating the BBSW, and in fact attempted to do so repeatedly over such periods of time bespeaks fundamental failings in the culture, training, governance and regulatory systems of both NAB and ANZ. The public should be shocked, dismayed and indeed disgusted that conduct of this kind could have occurred. The conduct involved attempts to corrupt a fundamental component of the entire Australian financial system for mere short term commercial advantage. The conduct involved a repeated failure to fulfil what would generally be perceived as the most basic standards of honesty, fairness and commercial decency, let alone the standards that would properly be expected of these two banks. The conduct tends to undermine public confidence in the entirety of the Australian financial system.¹²

Historically, however, financial market regulators globally, including the Australian Securities and Investments Commission ('ASIC'), have tended to focus their efforts on misconduct on stock markets, where corporations raise capital and the shares of publicly-listed companies are traded by institutional and professional investors, as well as retail, or 'Mum and Dad', investors.¹³ Insider trading, market manipulation or rigging, false or misleading statements, dishonest conduct and other abuses have been the traditional fare of those responsible for the supervision and regulation of stock exchanges across the globe.

The history of share price manipulation¹⁴ and the various means and devices used by malefactors to illegally manipulate the price of shares to benefit themselves at the expense of others are well documented in relation to some of the key global financial centres, such as the United Kingdom and the United States. However, this does not appear to be the case for Australia. This article will review the literature relating to the historical roots of share price manipulation in Australia and

¹² *Australian Securities and Investments Commission v National Australia Bank Ltd; Australian Securities and Investments Commission v Australia and New Zealand Banking Group Ltd* [2017] FCA 1338, [115] (Jagot J).

¹³ Retail investors have also been referred to as 'Mum and Dad' investors in: Paul Constable, 'Ferocious Beast or Toothless Tiger? The Regulation of Stock Market Manipulation in Australia' (2011) 8 *Macquarie Journal of Business Law* 54, 80. See also McClellan, P, 'White Collar Crime: Perpetrators and Penalties' (Speech delivered at the Fraud and Corruption in Government Seminar, University of New South Wales, 24 November 2011), 25.

¹⁴ For the purposes of this paper, the more generic term 'share price manipulation' has been used instead of 'stock market manipulation' to cover a broader range of manipulative activities, including those that occurred before the establishment of formal stock exchanges in Australia.

argue that whilst there has been a growing body of excellent academic and non-academic work completed on this particular form of market misconduct in the domestic context, it is largely incomplete. This is mainly due to an apparent failure to look back beyond the 1970s when share price manipulation was first criminalised under the *Securities Industry Acts* introduced in four Australian States – New South Wales, Victoria, Queensland and Western Australia.¹⁵ In addition, this article will highlight a further apparent gap in the literature relating to the role that domestic stock exchanges have played in combating this pernicious activity since the formation of the first stock exchange in Australia around 157 years ago.¹⁶

¹⁵ Robert Baxt, HAJ Ford and GJ Samuel, *An Introduction to the Securities Industry Acts* (Butterworths, 1977), 26. For commentary on this text, see CJH Thomson, 'An Introduction to the Securities Industry Act' (1978) 9(2) *Federal Law Review* 248, 251–256.

¹⁶ The information available on the establishment of the first stock exchange in Australia is fragmented and appears to be inconsistent. The 'History' page on ASX's website accessed on 18 June 2018 states the following: 'In Victoria, the gold-rush of the 1850s resulted in the formation of stock exchanges in at least three cities: Melbourne, Ballarat and Bendigo. Early exchanges included Khull's Stock Exchange, the Victorian Stock Exchange and the St Kilda Stock Exchange'. In April 1861, ten specialist brokerages in Melbourne 'formed the Brokers' Association and went on to publish 63 rules outlining the procedures for admission to the Stock Exchange of Melbourne. All of these exchanges were short-lived': Australian Securities Exchange, 'History', <<https://www.asx.com.au/about/history.htm>> (accessed 18 June 2018). An earlier version of what appears to be the same page on ASX's website seems to be more definitive: '1861 Ten years after the official advent of the Gold Rush, Australia's first stock exchange was formed in Melbourne': ASX Group, 'History', <<https://web.archive.org/web/20120423052515/http://www.asxgroup.com.au/history.htm>> (accessed 18 June 2018), although it does not state the name of that exchange. In the 'Chronology of Key Events' in Edna Carew's history behind the creation of a national stock exchange (the Australian Stock Exchange), the first mention of a stock exchange being formed in Australia occurs in the year 1861 – 'Melbourne's first stock exchange formed': Carew, Edna, *National Market National Interest: The Drive to Unify Australia's Securities Markets* (Allen & Unwin, 2007), xxi. Again, however, the name of the stock exchange is not recorded. In chapter one where she discusses the six capital city stock exchanges that 'came to dominate Australia's securities markets', Carew states the following in relation to Melbourne: 'Melbourne's first official stock exchange was formed in 1857 at a meeting of stockbrokers in the city's Criterion Hotel. This exchange competed with groups of brokers calling their premises the 'Gold Fields Stock Exchange', the 'Victorian Stock Exchange' and the 'St Kilda Stock Exchange'. The Stock Exchange of Melbourne was officially established in 1884: *ibid.*, 26. The National Museum of Australia's 'Defining Moments in Australia's History' web page, under the title 'First Stock Exchange, 1859: Establishment of Australia's First Stock Exchange, in Melbourne', states that the Melbourne Brokers Association, which traded from rented space in the Hall of Commerce on Collins Street from 1859, was

II SETTING THE SCENE

From the spreading of false rumours to manipulate share prices by the brokers, speculators, city merchants and moneylenders who frequented the Amsterdam Stock Exchange in the 1680s – the leading financial centre of the world at the time¹⁷ – to the alleged nefarious activities of high frequency and algorithmic traders on today's stock markets who are the subject of Michael Lewis' book *Flash Boys*,¹⁸ history is littered with numerous examples of manipulative practices perpetrated on share markets around the world, including those in Australia.

Share price manipulation essentially arises from an intentional interference with the forces of genuine supply and demand in the market for the sale and purchase of securities to obtain a benefit for the perpetrator at the expense of other investors.¹⁹ It is widely documented

Australia's first stock exchange': National Museum of Australia, "Defining Moments in Australia's History: First Stock Exchange", <http://www.nma.gov.au/online_features/defining_moments/featured/first-stock-exchange> (accessed 18 June 2018). Whilst there may have been other exchanges formed prior to the establishment of the Stock Exchange of Melbourne in 1861, given the apparent ambiguity in this area the formation of the Stock Exchange of Melbourne in 1861 has been used as the reference point for the formation of the first stock exchange in Australia for the purposes of this paper: see AR Hall, *The Stock Exchange of Melbourne and the Victorian Economy 1852–1900* (Australian National University Press, 1968), 23, 31–34; Graeme Adamson, *A Century of Change: The First Hundred Years of the Stock Exchange of Melbourne* (Currey O'Neil Ross, 1984), 7.

¹⁷ Arthur H Cole, 'Foreword' in Josef de La Vega, *Confusion De Confusiones* (Martino Publishing, first published 1688, 2013 ed). According to Petram, de La Vega's book is 'the world's earliest book on the stock market' and Amsterdam is the 'world's oldest stock exchange': Lodewijk Petram, *The World's First Stock Exchange* (Columbia University Press, 2014), 2-3.

¹⁸ Michael Lewis, *Flash Boys: Cracking the Money Code* (Allen Lane, 2014). See also: Tom CW Lin, 'The New Market Manipulation' (2017) 66 *Emory Law Journal* 1253.

¹⁹ According to Mason J in *North v Marra Developments Ltd* (1981) 37 ALR 341 at 351 when discussing s 70 of the *Securities Industry Act 1970* (NSW), which contained a prohibition on creating, or causing to be created, or doing anything which is calculated to create, a false or misleading appearance of active trading in any securities on any stock market in the State, or a false or misleading appearance with respect to the market for, or price of, any securities, '... the object of the section is to protect the market for securities against activities which will result in artificial or managed manipulation. The section seeks to ensure that the market reflects the forces of genuine supply and demand. By 'genuine supply and demand' I exclude buyers and sellers whose transactions are undertaken for the sole or primary purpose of setting or maintaining the market price'. Thel asserts that the term 'securities manipulation' means 'conduct intended to induce people to trade a security or force its price to an artificial level': Steve Thel, 'The Original Conception of Section 10(b) of the Securities Exchange Act' (1990) 42 *Stanford Law Review* 385, 393.

that the artificial distortion of prices through manipulative activities harms innocent investors, the reputation, fairness and integrity of a country's financial markets and, ultimately, can adversely impact the health and wellbeing of a nation's economy.²⁰ This was acknowledged by Ipp J in *R v Lloyd*²¹ when His Honour stated the following:

I take it to be an essential feature of a system of trading in securities in listed corporations by bidding for stock at centralised stock exchanges that the system does reflect the interplay of the market forces of supply and demand. So much would seem to be essential to the health of the market and, at least to a degree, to the wider economic health of the business community which utilises it and which by that means invests in listed corporations which are to a substantial degree the vehicles of commercial life and its capacity to generate wealth in our community. Investor confidence is the quality which the market must be able to maintain. If investors become suspicious that the values of securities which the market reflects do not provide a measure of the worth of the stock then it seems obvious that they will be reluctant to invest.²²

Share price manipulation has been described as 'an art form which strikes at the heart of the pricing system on which all investors rely'.²³ Its 'insidious and widespread effects' have for a long time 'been thought to strike at the heart of the integrity of security markets'.²⁴ Indeed, as long ago as 1872, Malins VC in *Rubery v Grant*²⁵ described 'market rigging' as one of 'the most dishonest practices to which men can possibly resort' and little more than an 'abominable fraud'.²⁶ There can be little doubt

²⁰ See, eg, *Brown v R* [2006] WASCA 145 where Wheeler JA stated (at [12]) that it is 'vital for the economy that the community has confidence in the share market and in institutions such as the ASX' and that market manipulation 'undermines that confidence'; *Joffe v R*; *Stromer v R* [2012] NSWCCA 277 at [34] per Allsop P; Janet Austin, *Insider Trading and Market Manipulation: Investigating and Prosecuting Across Borders* (Edward Elgar Publishing, 2017), 2.1.

²¹ *R v Lloyd* (1996) 19 ACSR 528.

²² *R v Lloyd* (1996) 19 ACSR 528, 548 (Ipp J).

²³ Vivien Goldwasser, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales' (1999) 5 *Australian Journal of Legal History* 149, 149.

²⁴ Vivien Goldwasser, *Stock Market Manipulation and Short Selling* (CCH Australia Limited and Centre for Corporate Law and Securities Regulation, 1999), 44.

²⁵ (1872) 13 LR Eq 443.

²⁶ *Rubery v Grant* (1872) 13 LR Eq 443, 448 (Malins VC).

that stock market manipulation, like its ‘evil twin’ insider trading,²⁷ has ‘utterly no place in any fair minded law-abiding economy’.²⁸

It is no surprise then that this particular form of financial market misconduct²⁹ constitutes a criminal offence in most developed countries, including Australia where it has been the subject of specific criminal sanction since the 1970s.³⁰ However, unlike the manipulation of key financial benchmarks, such as LIBOR, the 4pm London fix and BBSW, which are relative newcomers to the rogues’ gallery of scandals, the manipulation of share prices has a much longer history. Yet, it appears that the history of this particular form of market misconduct in Australia is incomplete.

Whilst there is a considerable body of published and unpublished literature on share price manipulation, both in Australia and overseas, a review of the domestic and international literature would lead one to reasonably conclude that the history of share price manipulation in Australia only really commenced in the late 1960s following the mining and mineral boom that saw the volume of shares traded in Sydney increase to three times the amount being handled by the New York Stock Exchange.³¹ In fact, much of the literature on stock market misconduct

²⁷ Louis Loss, ‘Disclosure as Preventive Enforcement’ in Hopt, Klaus J and Teubner, Gunther (eds), *Corporate Governance and Directors’ Liabilities: Legal, Economic and Sociological Analyses on Corporate and Social Responsibility* (Walter de Gruyter, 1985), 330.

²⁸ Arthur Levitt, ‘A question of investor integrity: Promoting investor confidence by fighting insider trading’ (Speech delivered at the ‘SEC Speaks Conference’, Washington DC, 27 February 1998).

²⁹ The terms ‘market misconduct’ and ‘market abuse’ will be used interchangeably in this paper. The former is used more widely in the Australian context to refer to financial market offences such as market manipulation and insider trading (for example, it is the name of the chapter in the *Corporations Act* that deals with the key market offences, such as market manipulation – Part 7.10 of Chapter 7), whereas the latter is a term that tends to be more apposite in the United Kingdom and European context: see eg, Financial Conduct Authority, *Market Abuse*, (20 December 2017) <<https://www.fca.org.uk/markets/market-abuse>>; Karen Harrison and Nicholas Ryder, *The Law Relating to Financial Crime in the United Kingdom* (Routledge, 2nd ed, 2017), Chapter 6.

³⁰ See, eg, Division 2 of Part 7.10 of the *Corporations Act 2001* (Cth) (‘Market Misconduct and Other Prohibited Conduct Relating to Financial Products and Financial Services’), which contains prohibitions on, inter alia, market manipulation and false trading and market rigging.

³¹ Trevor Sykes, *Two Centuries of Panic: A History of Corporate Collapses in Australia* (Allen & Unwin, 2003), 398.

in Australia typically commences with a discussion of the introduction of the *Securities Industry Acts* in the 1970s in New South Wales, Victoria, Queensland and Western Australia³² and the establishment of the Rae Committee,³³ which investigated a broad range of misconduct perpetrated across the local securities industry, including stock market manipulation.³⁴ The contents of the Rae Committee's report have been described as 'sensational' and having 'shamed the industry and the market'.³⁵ Even where there is no substantive discussion of these events, they are still often used as the starting point for situating market misconduct generally, and market manipulation more specifically, in a historical context in Australia.³⁶ It is rare for commentators to venture further back in time to consider what may have occurred over the prior 100 years when share trading was being conducted across Australia, albeit in a more primitive form.³⁷ This is by no means a criticism and, indeed, these events, as well as the consequent changes to the securities regulation paradigm in Australia, are the most logical places to

³² Ford and Samuel, above n 15, 26. New South Wales (*Securities Industry Act 1970* (NSW)), Queensland (*Securities Industry Act 1971* (QLD)), Victoria (*Securities Industry Act 1970* (VIC)) and Western Australia (*Securities Industry Act 1970* (WA)): Goldwasser, *Stock Market Manipulation*, above n 24, 41; Paul Latimer, 'Legal Enforcement of Stock Exchange Rules' (1995) 7(2) *Bond Law Review* 1, 1–2.

³³ See, eg, Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (Federation Press, 2nd ed, 2002), ch1, 20; Goldwasser, *Stock Market Manipulation and Short Selling*, above n 24, 39–40; Robert Baxt, HAJ Ford and Ashley Black, *Securities Industry Law* (Butterworths, 4th ed, 1993), ch 11.

³⁴ Senate Select Committee on Securities and Exchange, Parliament of Australia, *Australian Securities Markets and Their Regulation* (1974). The Senate Committee was named the Rae Committee, after its Chair, Senator Peter Rae and its report is commonly referred to as the Rae Report.

³⁵ Bernard Mees and Ian M Ramsay, *Corporate Regulators in Australia (1961-2000): From Companies' Registrars to the Australian Securities and Investments Commission*, Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne, Melbourne, 2008, 15.

³⁶ See, eg, Vivien Goldwasser, 'The Regulation of Stock Market Manipulation and Short Selling in Australia' in Gordon Walker and Brent Fisse (eds), *Securities Regulation in Australia and New Zealand* (LBC Information Services, 1998), 516.

³⁷ One of the few, if not the only located to date, is Dr Howard Chitimira, whose work will be discussed below: Howard Chitimira, 'The Regulation of Market Manipulation in Australia: A Historical Comparative Perspective' (2015) 8(2) *Potchefstroom Electronic Law Journal* 111, 113.

commence documenting a local history of financial market misconduct and securities regulation.³⁸

However, as will be discussed below, there is evidence available to suggest that the manipulation of share prices was being perpetrated on Australia's formal and informal securities markets as long ago as the 1870s, and possibly earlier.³⁹ Indeed, it would seem that for as long as people have been able to buy and sell shares in Australia, whether jostling shoulder to shoulder around a 'pavement stock-broker' on the footpath of a small gold mining town in the gold fields of Western Australia in the late 1800s,⁴⁰ gathered in a 'ramshackle, dark stuffy room' at the rear of a 'tumble-down building' to participate in one of the Stock Exchange sessions held in Melbourne in the late 1880s⁴¹ or using the very latest technology to send orders to exchanges around the world, there have been those seeking nefarious ways to tip the scales in their favour,⁴² including through the artificial distortion of the prices at which those shares are bought and sold.

³⁸ The decade that followed the minerals boom could fairly be described as a seminal period in the history of securities market regulation in Australia. Legislation was finally passed in 1970 that specifically outlawed market misconduct, including share price manipulation, in a number of Australian states and the Senate Select Committee on Securities and Exchange, known as the Rae Committee, was established, which investigated a broad range of misconduct perpetrated across the local securities industry, including stock market manipulation: Senate Select Committee on Securities and Exchange, *Australian Securities Markets*, above n 34. The Senate Committee was named the Rae Committee, after its Chair, Senator Peter Rae and its report is widely referred to as the Rae Report.

³⁹ Paul Constable, 'Psst ... Want to Hear a Rumour? Rumourage May Have Been Occurring in Australia For Longer Than We Thought' (2016) 19 *International Trade and Business Law Review* 48. A review of the many contemporary newspaper articles that describe the activities of malefactors associated with share trading in the 1800s across Australia tends to lend support to this view.

⁴⁰ Albert F Calvert, *My fourth tour in Western Australia* (Forgotten Books, first published by William Heinemann, 1897, 2015 ed), 126.

⁴¹ George Meudell, *The Pleasant Career of a Spendthrift* (George Routledge & Sons, 1929), 82-83.

⁴² As Loss notes, 'It is the essence of the economic function of a securities exchange that it be a free market – free of the artificiality of manipulation (the laying of hands on the scales) as it is free of the unfairness of insider trading (playing cards with a marked deck)': L Loss, *Fundamentals of Securities Regulation* (Little, Brown & Company, 1983), 984.

III SUMMARY OF THE RESULTS OF THE LITERATURE REVIEW

A review of the published and unpublished literature relating to the historical roots of share price manipulation in Australia suggests that there are several research gaps, which have not yet been explored or which require further exploration. Firstly, there appears to be no single book, journal article or other resource that seeks to comprehensively document the history of share price manipulation in Australia, from the very early days of share trading through to the present day.⁴³ Secondly, there is a distinct paucity of literature on this particular species of market misconduct and its occurrence in Australia in the period prior to the late 1960s and early 1970s. Lastly, once share trading moved from the footpaths of regional mining towns across Australia in the 1800s onto organised stock exchanges, the history of share price manipulation became intrinsically linked with the development and operation of share trading on local stock exchanges across the decades. The local stock exchanges should, therefore, have played a key role in efforts to combat the manipulation of the prices of shares listed and traded on their respective markets. Yet, there appears to be a dearth of literature in Australia on the role that domestic exchanges have played in dealing with manipulative activities over the course of the last 157 years, notwithstanding they were primarily responsible for the supervision of the activities on their respective markets for a very considerable period of time.⁴⁴ This suggests that there is presently little known about the historical roots in Australia of an activity that

⁴³ Interestingly, this appears to be the case for other forms of market misconduct, such as insider trading. Generally speaking, the key forms of market misconduct are often considered together in the literature, particularly in text books, and a similar approach is used when considering their historical roots, which is discussed below.

⁴⁴ ASIC took over responsibility for the supervision of real-time trading on Australia's domestic licensed markets on 1 August 2010, including the Australian Securities Exchange: Australian Securities and Investments Commission, Supervision <<http://asic.gov.au/regulatory-resources/markets/supervision/>>; The Treasury (Cth), 'Reforms to the Supervision of Australia's Financial Markets' (Media Release, No. 013, 24 August 2009), <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/013.htm&pageID=003&min=ceba&Year=2009&DocType=0>>.

has been referred to as a ‘suspect form of human ingenuity’⁴⁵ and which appears to have been occurring for considerably longer than a review of the traditional local and international legal literature would otherwise suggest.⁴⁶

IV THE LITERATURE REVIEW – THE OVERSEAS EXPERIENCE

It appears that the position in Australia is quite different from that in other countries, where there is a relatively rich documented history on the operation of the very early securities markets and the misconduct that was perpetrated by participants, including the manipulation of share prices. Before discussing the legal and non-legal literature on share price manipulation from a domestic perspective, consideration will be given briefly to some of the literature available that considers the historical roots of this nefarious activity in the Netherlands, England and the United States (‘US’), for broad comparative purposes. England and the US were chosen on the basis that they have for many decades been, and remain today, key global financial centres, whereas Amsterdam (the capital of the Netherlands) is not but is claimed to have been the world’s leading financial centre in the seventeenth century.⁴⁷

A *The Netherlands*

One of the earliest and perhaps most famous examples of literature relating to the historical roots of share price manipulation is that of Joseph de la Vega, who, in his book *Confusion de Confusiones*,⁴⁸ recounts the practices of the stock exchange in Amsterdam in the 1680s, which, at the

⁴⁵ Tim Smith and Rodger Wallis, *Market Manipulation – A Suspect Form of Human Ingenuity* (7 August 2013) Chapman Tripp: Brief Counsel <<http://www.chapmantripp.com/publications/Documents/2013%20PUB%20BC%20Market%20manipulation%20%20a%20suspect%20form%20of%20human%20ingenuity%20-%207%20august.pdf>>.

⁴⁶ See, eg, Constable, above n 39.

⁴⁷ ‘By the seventeenth century Amsterdam had become the principal centre for securities trading, with considerable activity in both domestic and foreign stocks’: Michie, Randal C, *The Global Securities Market: A History* (Oxford University Press, 2006), 9. According to Cole, in his Foreword to *Confusion de Confusiones*, Amsterdam ‘was still the leading financial center of the world’ in 1688: Cole, Arthur H, ‘Foreword’ in de la Vega, above n 17, v.

⁴⁸ de la Vega, above n 17.

time, is claimed to have been home to the world's first stock exchange.⁴⁹ According to Corzo, Prat and Vaquero, de la Vega's book:

is not a work on stock exchanges or economics, nor is it a legal analysis. It acts more as a description of the beginning of the activities and games of the stock exchange. Nobody by that time had tried to understand and describe this activity. Even in Amsterdam, there was no technical work about this frantic activity.⁵⁰

Around 100 years before Australia was established as a British colony in New South Wales, 172 years before Australia had its first stock exchange, and 282 years before Australia had specific laws criminalising share price manipulation, de la Vega describes the 'gambling hell' frequented by brokers, speculators, city merchants and money lenders and the techniques they employed to unjustly enrich themselves at the expense of other investors.⁵¹ One such technique involved the spreading of rumours to manipulate the price of shares traded on the exchange:

The bulls spread a thousand rumors about the stocks, of which one would be enough to force up the prices. A thousand stratagems of the Contremine are launched in an effort to cause ill-temper on the exchange.⁵²

The bears, on the other hand:

crowded together and, in order not to let the bulls take breath, spread the rumor that a war would break out. [They said that] they knew of so many secret preparatory measures that no doubt could be entertained. Then the taxes would increase like an avalanche, the burdens would grow immeasurably, the whole of Europe would be set ablaze, and misery, terror and ruin would be found everywhere ... [Consequently], the bears were able exclusively to control the market prices.⁵³

Yet, it appears that the manipulation of share prices on the Amsterdam Stock Exchange by the spreading of false rumours was occurring

⁴⁹ See, eg, Petram, above n 17, 3, 6; cf Michie, above n 47, 9 where Michie asserts that instead of Amsterdam 'it was in Paris in 1724 that a formal stock exchange was first established'. Cole asserts that de la Vega's book is 'the first that describes the practices of any stock exchange': Arthur H Cole, 'Foreword' in de la Vega, above n 17, v. Petram agrees and states that *Confusion de Confusiones* is 'the world's earliest book on the stock market': Petram, above n 17, 2.

⁵⁰ Teresa Corzo, Margarita Pratand Esther Vaquero, 'Behavioral Finance in Joseph de la Vega's *Confusion de Confusiones*' (2014) 15(4) *Journal of Behavioral Finance* 341, 341.

⁵¹ de la Vega, above n 17, 12.

⁵² Ibid 37. See also Constable, above n 39.

⁵³ de la Vega, above n 17, 40. See also Constable, above n 39.

much earlier than de la Vega's account in *Confusion de Confusiones*. According to Hellenbenz, in 1608 a group of speculators led by Isaac Le Maire sought to manipulate the price of Dutch East India Company (Vereenigde Oost-Indische Compagnie ('VOC'))⁵⁴ shares traded on the Amsterdam Stock Exchange through a combination of 'short' selling large blocks of shares and 'spreading rumours that were unfavourable to the Dutch Company'.⁵⁵ As a consequence of the 'grave damage and harm' visited upon widows, orphans and other investors in the company, as well as the company itself, an 'edict banning naked short selling was promulgated' on 27 February 1610, which Petram asserts was 'the first in the history of the world'.⁵⁶ As de la Vega had done over 320 years earlier, Petram, in *The World's First Stock Exchange*, not only highlights the important contribution that events in seventeenth-century Amsterdam made to the development of securities markets globally, he also describes the 'tricks and deceptions' that participants had to 'watch out for if they enter the fray',⁵⁷ including the manipulation of share prices through spreading false rumours.

B *England*

There is a considerable volume of literature that traces the history of market misconduct generally, and share price manipulation specifically, back to the very early days of securities trading in England. Indeed, there is contemporary literature that documents efforts to artificially interfere with the forces of genuine supply and demand in the English securities markets in the late 1600s. Defoe, for example, in *An Essay Upon Projects*, recounts the spreading of false information to illicitly affect share prices thus: 'so have I seen shares in joint-stocks, patents, engines, and undertakings, blown up by the air of great words ...'⁵⁸

⁵⁴ Petram, above n 17, 1.

⁵⁵ Hermann Kellenbenz, 'Introduction' in de la Vega, above n 17, xiii; Petram, above n 17, ch 4. See also Constable, above n 39.

⁵⁶ Petram, above n 17, 65–66.

⁵⁷ Ibid 3.

⁵⁸ Daniel Defoe, *An Essay Upon Projects* (CreateSpace Independent Publishing Platform, first published 1697, 2015 ed), 12–13. For secondary source commentary see eg, Stuart Banner, *Anglo-American Securities Regulation: Cultural and Political Roots, 1690–1980* (Cambridge University Press, 1998), Chapter 1.

Defoe argued that ‘stock-jobbing brokers’ could not only determine the number of buyers and sellers in the market, which was ‘in their power to make and manage at will’, but also make the prices of stock ‘... dance attendance on their designs, and rise and fall as they please, without any regard to the Intrinsick (sic) worth of the Stock’.⁵⁹

Similarly, according to Houghton in *Collection for improvement of Husbandry and Trade*, published in 1694: ‘in small Stocks ’tis possible to have Shares rise or fall by the Contrivances of a few Men in Confederacy’.⁶⁰

In *The Anatomy of Exchange Alley*, Defoe provides his contemporary observations on those who used the financial markets in the late seventeenth and early eighteenth century as being engaged in ‘... a Trade found in Fraud, born of Deceit, and nourished by Trick, Cheat, Wheedle, Forgeries, Falshoods and all sorts of Delusions’.⁶¹

Over the years, there has been an ever-increasing amount of literature on the history of illicit activities perpetrated on the earliest securities markets in England, including share price manipulation, as well as the associated legislative and regulatory developments that have taken place over almost three centuries to combat them. This includes Banner’s *Anglo–American Securities Regulation: Cultural and Political Roots, 1690–1980*, which, in examining the regulation of England’s and America’s earliest securities markets, provides plenty of evidence to suggest that the manipulation of the price of securities was common during the period covered by his review.⁶²

Through an analysis of a considerably broad range of contemporary material, including poetry, ballads, letters and plays, as well as the more

⁵⁹ Daniel Defoe, *The Villainy of Stock-Jobbers Detected, and the Causes of the Late Run Upon the Bank and Bankers Discovered and Considered* (Gale Ecco, Print Editions, first published 1701, 2010 ed), 5.

⁶⁰ John Houghton, *Collection for improvement of Husbandry and Trade*, 6 July 1694, quoted in Banner, *Anglo-American Securities Regulation*, above n 58, 30.

⁶¹ Daniel Defoe, *The Anatomy of Exchange Alley: or, a system of stock-jobbing. Proving that scandalous trade, as it is now carry’d on, to be knavish in its private ... and treason in its publick ... By a jobber* (Gale ECCO, Print Editions, first published 1719, 2010 ed), 3. See also Daniel Defoe, *The Villainy of Stock-Jobbers Detected*, above n 59.

⁶² Banner, *Anglo-American Securities Regulation*, above n 58. See also, Anne L Murphy, Society, *Knowledge and the Behaviour of English Investors, 1688–1702* (PhD Thesis, University of Leicester, 2005); Rawlings, ‘Folk Devils, Moral Panics and the Origins of Financial Regulation’ (2008) 61(1) *Current Legal Problems* 325.

traditional legal material, such as statutes, case law and legal treatises, Banner highlights how the spreading of false rumours was used to artificially push the price of securities up or down to benefit the person spreading the rumours at the expense of other investors. According to Banner, speculation ‘caused men to be deceitful, as they discovered they could profit from spreading misinformation about market conditions’⁶³ and that by:

spreading false news as to the value of a stock, speculators discovered that they could shift demand for the stock dramatically in either direction. Although lying was nothing new, the stock market opened up unprecedented opportunities to gain from it.⁶⁴

In *The Origins of English Financial Markets: Investment and Speculation Before the South Sea Bubble*, Murphy provides a comprehensive account of the activities of speculators and investors in the securities markets in England from the late seventeenth century, including stock-jobbers, who manipulated the prices of securities for their own advantage.⁶⁵

Evidence of market manipulation and attempted market manipulation will be presented below. Indeed, the limited capitalisation of many of the smaller companies of the period meant that they were dangerously exposed to concerted attacks on their share prices.⁶⁶

Although acknowledging the argument that stock jobbers may have benefited the market by adding liquidity and serving as a ‘rudimentary market-making function’,⁶⁷ Murphy goes on to provide a number of examples of where they and other market actors interfered with the forces of genuine supply and demand in the securities markets that operated from the 1690s to the early part of the 1700s.⁶⁸

⁶³ Stuart Banner, *Anglo-American Securities Regulation*, above n 58, 16.

⁶⁴ *Ibid.* Notwithstanding the considerable number of examples of manipulative practices littered throughout Banner’s account of share trading over a two hundred year period in England, he is circumspect in estimating the prevalence of this illicit activity: ‘How often this sort of manipulation actually occurred is another question, but the fact that contemporaries thought it happened frequently suggests that it happened at least occasionally’: at 56.

⁶⁵ Anne L Murphy, *The Origins of English Financial Markets: Investment and Speculation Before the South Sea Bubble* (Cambridge University Press, 2012).

⁶⁶ *Ibid.* 71.

⁶⁷ *Ibid.* 172.

⁶⁸ Other actors in the contemporary securities markets referred to by Murphy include investors, brokers and groups of speculators. But, whatever their ilk, it was ‘insiders’ who ‘had regular access to the places where news circulated, gained superior information and were in the best position to take advantage of that information’: *ibid.* 221.

Yet, whilst Murphy concedes that stock-jobbers in particular ‘did not always deserve’ their contemporary reputation as abusing their privileged position ‘to manipulate share prices and dupe inexperienced investors’,⁶⁹ she asserts that they could use their superior knowledge to manipulate the market and ‘it is clear that in some cases they did so’.⁷⁰ Moreover, insiders also reaped the rewards from pushing around the prices of smaller stocks, which, according to Murphy were ‘certainly manipulated’.⁷¹

Other authors have also included coverage of the history of share price manipulation in their work, although often not to the same extent as the likes of Banner and Murphy. For example, in his work on the history of financial speculation, *Devil Take the Hindmost*, Chancellor provides a brief account of some of the early instances of share price manipulation, and he spends a chapter discussing the shenanigans that occurred in Exchange Alley in the City of London in the 1690s.⁷²

In the stock market of the 1690s, the line between commendable self-interest and arrant fraud was frequently crossed: sham companies were launched for the enrichment of projectors, share prices were manipulated, and false rumours were circulated.⁷³

Avgouleas’ *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, provides a comprehensive interdisciplinary account of market abuse, including market manipulation, in the UK and Europe from an economic and legal perspective.⁷⁴ Unlike Banner and Murphy, however, Avgouleas does not dwell on the historical roots of market abuse and its regulation. Nonetheless, he does provide

⁶⁹ Ibid 178.

⁷⁰ Ibid 222.

⁷¹ Ibid. Like Banner, Murphy is circumspect in her view of the pervasiveness of market manipulation during the period of her analysis: ‘Whether or not manipulation was widespread, this did come to be the dominant perception of the financial market at this time’: at 223.

⁷² Chapter 2, ‘Stockjobbing in ‘Change Alley: The Projecting Age of the 1690s’: Edward Chancellor, *Devil Take the Hindmost: A History of Financial Speculation* (Plume, 2000), 48.

⁷³ Ibid.

⁷⁴ Avgouleas, above n 29. Avgouleas’ text has been referred to by the Full Court of the High Court in its judgment in *Director of Public Prosecutions (Cth) v JM* [2013] HCA 30, fn 69, 74; *Australian Securities and Investments Commission v Westpac Banking Corporation* (No 2) [2018] FCA 751 (24 May 2018), [1892], [1895], [1897], [1899], [1901] (Beach J).

a brief account of its prohibition and punishment in the UK by way of general historical context.⁷⁵ Like many other authors before and since, including many Australian authors and academics,⁷⁶ Avgouleas includes reference in his work to *R v De Berenger* (1814) 3 M&S 67 (KB), 105 Eng Rep 536, which is typically the starting point for many authors when considering how manipulative activity on financial markets was dealt with by the common law. This is, arguably, the most famous case in the history of securities market manipulation,⁷⁷ a case variously described as ‘a classic case’,⁷⁸ ‘a landmark’⁷⁹ and ‘[t]he classic illustration of stock market manipulation’,⁸⁰ the underlying circumstances of which have been characterised as a ‘spectacular early stock exchange scam’.⁸¹ In that case, the common law offence of conspiracy to defraud was relied upon to prosecute the joint perpetrators of an elaborate hoax that was designed and effected to artificially distort the price of Government debt securities to benefit themselves at the expense of other investors.⁸² Whilst described by Loss as the ‘first English manipulation case’,⁸³ as Banner, Murphy and others have highlighted, the history of this type of misconduct being perpetrated on England’s financial markets can be traced back considerably further than the prosecution of the conspirators in *R v De Berenger*.

⁷⁵ See, eg, Avgouleas, above n 29, ch 4 and 7.

⁷⁶ Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis Butterworths, 9th ed, 2017), 16.4.

⁷⁷ Avgouleas, above n 29, 328.

⁷⁸ Roman Tomasic, James Jackson, Brendan Pentony and Robin Woellner, *Corporation Law: Principles, Policy and Process* (Butterworths, 1990), 486.

⁷⁹ Avgouleas, above n 29, 113.

⁸⁰ Vivien Goldwasser, ‘The Regulation of Stock Market Manipulation in Australia’ in Walker and Fisse (eds), above n 36, 535. Tomasic, Bottomley and McQueen use the same terminology when referring to this case (‘A classic illustration of stock market manipulation ...’): Tomasic, Bottomley, and McQueen, above n 33, 621.

⁸¹ Richard Dale, *Napoleon is Dead: Lord Cochrane and the Great Stock Exchange Scandal* (Sutton Publishing, 2006).

⁸² Avgouleas, above n 29, 328.

⁸³ Loss, *Fundamentals of Securities Regulation*, above n 42, 845. According to Loke, this case ‘did not establish the crime of market manipulation’: Alexander FH Loke, ‘The Investors’ Protected Interest Against Market Manipulation in the United Kingdom, Australia and Singapore’ (2007) 21 *Australian Journal of Corporate Law* 22, 24.

C United States

Given it was not even founded for almost another 80 years after the writing of Defoe's observations, the history of share price manipulation in the US commenced much later than in England.⁸⁴ According to Markham in *Law Enforcement and the History of Financial Market Manipulation*,⁸⁵ an early attempt to deal with abusive and manipulative practices on the New York Stock Exchange involved the prohibition of 'fictitious' sales in 1817,⁸⁶ and he goes on to outline the role that the courts and governments have played in trying to combat share price manipulation in the US over the 200 years that have followed.⁸⁷

Both Markham⁸⁸ and Banner⁸⁹ provide numerous examples of the methods used by those engaged in the manipulation of share prices in the years prior to the enactment of the *Securities Act* of 1933 and the *Securities Exchange Act* of 1934,⁹⁰ which specifically outlawed share price manipulation at the Federal level and constituted part of President Franklin D Roosevelt's response to the Great Depression, excessive speculation and the stock market crash of 1929.⁹¹ Examples

⁸⁴ For an account of the development of securities trading in America prior to its founding in 1776, see Banner, *Anglo-American Securities Regulation*, above n 58, ch 4.

⁸⁵ Jerry W Markham, *Law Enforcement and the History of Financial Market Manipulation* (ME Sharpe, 2014).

⁸⁶ *Ibid* 14.

⁸⁷ *Ibid* 66.

⁸⁸ *Ibid*; Jerry W Markham, *A Financial History of the United States, Volume 1: From Christopher Columbus to the Robber Barons* (1492–1900) (ME Sharp, 2002).

⁸⁹ Banner, *Anglo-American Securities Regulation*, above n 58; Stuart Banner, 'The Origins of the New York Stock Exchange, 1791–1860' (1998) 27(1) *Journal of Legal Studies* 113.

⁹⁰ According to Galbraith, in 'the wake of the 1929 crash, and with a view to preventing another runaway boom and the associated abuse, the Congress passed some tolerably astringent legislation' that included the *Securities Exchange Act of 1934*: John Kenneth Galbraith, *The Great Crash 1929* (Penguin Books, 2009), 9.

⁹¹ See, eg, Markham, *Law Enforcement*, above n 85, Chapter two; Franklin Allen and Douglas Gale, 'Stock-Price Manipulation' (1992) 5(3) *Review of Financial Studies* 503, 503-505; 'Regulation of Stock Market Manipulation' (1947) 56(3) *Yale Law Journal* 509. According to Fischel and Ross, '[m]uch of the regulation of financial markets seeks to prevent manipulation. The drafters of the Securities Act of 1933 and the Securities Exchange of 1934, for example, were convinced that there was a direct link between excessive speculation, the stock market crash of 1929, and the Great Depression of the 1920s': Daniel R Fischel and David J Ross, 'Should the Law Prohibit "Manipulation" in Financial Markets?' (1991) 105(2) *Harvard Law Review* 503, 503. This article is famous

include ‘corners’,⁹² ‘matched trades’,⁹³ ‘pools’,⁹⁴ ‘wash sales’ or ‘fictitious sales’,⁹⁵ artificially raising or lowering share prices ‘through the concentration of buying or selling orders’⁹⁶ and spreading ‘rumours and fictitious stories’ in order to induce people to buy or sell certain shares.⁹⁷ According to Banner, quoting from contemporary material from 1791:

[s]tockjobbers preyed on the public by manipulating stock prices. Although price fluctuations were “injurious to the people in general”, a correspondent to the *Gazette of the United States* charged, “[s]peculators will aim to keep up a fluctuation, as their trade depends on *ups* and *downs*.” The New York lawyer Robert Troup admitted as much. “The truth” he informed the Secretary of the Treasury, “is that the fluctuations are principally owing to the arts & contrivances of mere jobbers”.⁹⁸

Nearly 140 years later, John Kenneth Galbraith in his ‘classic’ account of the US stock market crash of 1929, *The Great Crash 1929*,⁹⁹ recounts the ‘period of exceedingly active pool and syndicate operations – in short, of manipulation’.¹⁰⁰

During 1928 more than a hundred issues on the New York Stock Exchange were subject to manipulative operations, in which members of the Exchange or their partners had participated.¹⁰¹

(or infamous) for its ‘sharp departure from current law and commentary’ in concluding that ‘the concept of manipulation should be abandoned altogether’, ‘[f]ictitious trades should be analysed as a species of fraud’ and ‘[a]ctual trades should not be prohibited as manipulative regardless of the intent of the trader’: at 507. cf Steve Thel, ‘\$850,000 in Six Minutes – the Mechanics of Securities Manipulation’ (1994) 74 *Cornell Law Review* 219.

⁹² Markham, *Law Enforcement*, above n 85, 14–15, 27–28; Banner, *Anglo-American Securities Regulation*, above n 58, 142–143, 265. See also Loss, *Fundamentals of Securities Regulation*, above n 42, 849.

⁹³ Markham, *Law Enforcement*, above n 85, 31.

⁹⁴ *Ibid* 31–32, 62–63. See also Loss, *Fundamentals of Securities*, above n 42, 844–845.

⁹⁵ Markham, *Law Enforcement*, above n 85, 34; Banner, *Anglo-American Securities Regulation*, above n 58, 278–279. See also Loss, *Fundamentals of Securities Regulation*, above n 42 849.

⁹⁶ Markham, *Law Enforcement*, above n 85, 34.

⁹⁷ Banner, *Anglo-American Securities Regulation*, above n 58, 148, 202.

⁹⁸ *Ibid* 148.

⁹⁹ Galbraith, above n 90.

¹⁰⁰ *Ibid* 103.

¹⁰¹ *Ibid*. See also Loss, *Fundamentals of Securities Regulation*, above n 42, 844–845.

Over the years, there has been a very significant amount of literature published on share price manipulation in the US,¹⁰² particularly at around the time of the lead up to, and following, the enactment of the *Securities Act* and *Securities Exchange Act* in the 1930s.¹⁰³ Eminent legal authors such as Professor Louis Loss,¹⁰⁴ ‘widely viewed as the father of [US] securities law’,¹⁰⁵ Professor Adolf A Berle¹⁰⁶ and Professor Steve Thel,¹⁰⁷ amongst many others, have made a significant and valuable contribution to the considerable body of knowledge relating to share price manipulation in the US, including its historical roots. Unlike the Netherlands, the US and England, where there is literature available that traces the historical roots of share price manipulation, the position in Australia appears to be different.

¹⁰² See, eg, Markham, *Law Enforcement*, above n 85; Loss, *Fundamentals of Securities Regulation*, above n 42; Norman S Poser, ‘Stock Market Manipulation and Corporate Control Transactions’ (1986) 40(3) *University of Miami Law Review* 671; Lawrence Damian McCabe, ‘Puppet Masters or Marionettes: Is Program Trading Manipulative as Defined by the Securities Exchange Act of 1934?’ (1993) 61 *Fordham Law Review* s 207; Lewis D Lowenfels, ‘Sections 9(a)(1) and 9(a)(2) of the Securities Exchange Act of 1934: An Analysis of Two Important Anti-Manipulative Provisions Under the Federal Securities Laws’ (1991) 85 *Northwestern University Law Review* 698; Paul L Porterfield, ‘Securities: Stock Market Manipulation at Common Law and Under Recent Federal Securities Legislation’ (1940) 28(3) *California Law Review* 378; WJS, ‘Corporations: Stock Market Manipulation: Rescission for Fraud’ (1935) 34(2) *Michigan Law Review* 268; Robert J Hutcheon, ‘Speculation, Legitimate and Illegitimate’ (1922) 32(3) *International Journal of Ethics* 289; James William Moore and Frank M Wiseman, ‘Market Manipulation and the Exchange Act’ (1934) 2 *University of Chicago Law Review* 46, and many others.

¹⁰³ According to Loss, writing in 1988, ‘there is a substantial literature on the classic manipulation techniques’: Loss, *Fundamentals of Securities Regulation*, above 42, 844.

¹⁰⁴ Ibid; Louis Loss, *Securities Regulation* (Little, Brown and Company, 2nd ed, 1961–1969).

¹⁰⁵ Floyd Norris, ‘Louis Loss, 83, Dies; Harvard Professor Defined and Interpreted Field of Securities Law’, *The New York Times* (online), 16 December 1997, <<https://www.nytimes.com/1997/12/16/business/louis-loss-83-dies-harvard-professor-defined-interpreted-field-securities-law.html>>.

¹⁰⁶ AA Berle, ‘Liability for Stock Market Manipulation’ (1931) 31(2) *Columbia Law Review* 264; Berle, AA ‘Stock Market Manipulation’ (1938) 38(3) *Columbia Law Review* 393.

¹⁰⁷ Steve Thel, ‘Taking Section 10(B) Seriously: Criminal Enforcement of SEC Rules’ (2014) 1 *Columbia Business Law Review* 1; Thel, ‘\$850,000 in Six Minutes’, above n 91; Thel, ‘The Original Conception of Section 10(b) of the Securities Exchange Act’ above n 19; Steve Thel, ‘Regulation of Manipulation under Section 10(b): Security Prices and the Text of the Securities Exchange Act of 1934’ (1988) 2 *Columbia Business Law Review* 359.

IV THE LITERATURE REVIEW – THE AUSTRALIAN EXPERIENCE

The apparent disparity between the low volume of literature documenting the history of share price manipulation in Australia as compared to other countries, including the Netherlands, the UK and the US, is, of course, a product of, inter alia, social and economic history. According to Rae, for example, the development of the Australian securities industry has been:

later in point of time for when the 24 brokers met under the buttonwood tree in Manhattan in 1792 to found what has become the New York Stock Exchange, Australia was a four-year old new settlement struggling to survive.¹⁰⁸

Indeed, Australia did not even have its first stock exchange until the 1860s,¹⁰⁹ whereas Amsterdam had one in the 1600s,¹¹⁰ London had one in 1773¹¹¹ and the US followed in 1790.¹¹²

However, this does not account for what appears to be a significant gap in the literature on the local history of share price manipulation, particularly given that share trading is claimed to have begun in Sydney in the late 1820s,¹¹³ around 150 years before the manipulation of share prices was first criminalised in four States in Australia. It would seem strange that domestic share trading, whether on the streets of provincial gold mining towns prior to the establishment of the stock exchanges or on the early stock exchanges themselves, was untouched by those intent on artificially distorting share prices to benefit themselves at the expense of others. Why would Australia be immune from this type of activity, which had been taking place in the ‘mother country’ and elsewhere for well over 100 years earlier?

¹⁰⁸ Peter Rae, ‘Moulding the Securities Industry for Tomorrow’, *Australian Accountant*, December 1971, 484.

¹⁰⁹ Above n 16.

¹¹⁰ Petram, above n 17, ch 6. Note, however, that notwithstanding the title of Petram’s book, Michie has identified Paris as having the first ‘formal’ stock exchange, which was established in 1724: Michie, above n 47, 9. According to Michie, there were permanent markets established much earlier across Europe within which securities could be traded, with Bourses or exchanges built in Cologne in 1553, Paris in 1563 and London in 1571: Michie, above n 47, 23.

¹¹¹ Michie, above n 47, 45–46.

¹¹² Domenic Vitiello and George E Thomas, *The Philadelphia Stock Exchange and the City It Made* (University of Pennsylvania Press, 2010), 26. According to the authors, this was America’s first stock exchange.

¹¹³ Tomasic, Bottomley, and McQueen, above n 33, 555.

A *Domestic Legal Literature – The 1970s*

As Redmond observed in 1994, concern with ‘abusive trading activities’ that became apparent in the aftermath of the mining boom that occurred in Australia in the late 1960s ‘provided the impetus for the introduction of legislation to regulate Australian securities markets’.¹¹⁴ As such, it is easy to understand why many authors, including Goldwasser,¹¹⁵ Hart¹¹⁶ and Meyer,¹¹⁷ use the post-mining boom developments in domestic securities regulation as the starting point for their consideration of the history of share price manipulation in Australia.¹¹⁸ It is most certainly the logical starting point for any consideration of the history of market misconduct in Australia, but what about the 150 years before, particularly during the early years of the mining booms and gold rushes where fraudulent activities in relation to mining shares appear to have been rampant?¹¹⁹ Although there may not have been legislation specifically outlawing share price manipulation prior to the 1970s, that does not necessarily mean it was not occurring.

One of the early pieces of literature on securities regulation in Australia is Sawyer’s article, ‘Australian Securities Markets and Their Regulation’, published in 1975.¹²⁰ Whilst there is a specific, albeit very brief, reference to the manipulative practice of ‘cornering a market’

¹¹⁴ Paul Redmond, ‘A Short History of Securities Regulation in Australia’ in Walker, and Fisse, (eds), above n 36, 98. Redmond elsewhere refers to September 1969 as being the beginning of ‘the most spectacular stock market boom in Australian history’: Redmond, Paul, Harding, Don and Cameron, Ian, *Companies and Securities Law: Commentary and Materials* (The Law Book Company Limited, 1988), 33. Moreover, according to Redmond, the ‘dramatic events of 1969–1975’ were a ‘watershed period in Australian company law’: Redmond, Paul, *Corporations and Financial Markets Law* (Lawbook Co, 7th ed, 2017), 43.

¹¹⁵ Goldwasser, *Stock Market Manipulation*, above n 24.

¹¹⁶ Geoffrey Hart, ‘The Regulation of Stock Market Manipulation’ (1979) 7 *Australian Business Law Review* 139.

¹¹⁷ Peter W R Meyer, ‘Fraud and Manipulation in Securities Markets: A Critical Analysis of Sections 123 to 127 of the Securities Industry Codes’ (1986) *Company and Securities Law Journal* 92.

¹¹⁸ This is sometimes the case with non-legal literature also: see, for example, PJ Drake, ‘Stock exchange reforms in Australia’ (1985) 294 *The Round Table* 114, 114.

¹¹⁹ See, eg, Geoffrey Blainey, *The Rush That Never Ended: A History of Australian Mining* (Melbourne University Press, 2003), 98, 99, 202–203, 205, 223, 236,

¹²⁰ Geoffrey Sawyer, ‘Australian Securities Markets and Their Regulation’ (1975) 51(3) *Economic Record* 379.

being one of the ‘principal forms of undesirable activity’¹²¹ identified by the Rae Committee in its report *Australian Securities Markets and their Regulation*,¹²² the article does not dwell specifically on share price manipulation.¹²³ Rather, like Bell in his article, ‘The Securities Market – National Control or Self-Regulation?’¹²⁴ published in the same edition of *The Economic Record*, Sawyer provides some general observations on the Rae Report.¹²⁵ However, Sawyer’s specific observations on the Committee’s recommendation that a Securities and Exchange Commission be appointed and empowered by the Commonwealth are, relevantly, informative in terms of the apparent lack of a comprehensive historical account of the functions and operations of the stock exchanges in Australia.¹²⁶ Whilst criticising the Committee for recommending ‘so momentous a change in the legal and political structure of and regulatory policy for the securities industry’ based merely on an ‘examination of the stock exchanges at a particular phase of a particular investment and speculative boom, that occurring from 1962 to 1972’, Sawyer notes that:

¹²¹ Ibid 383.

¹²² Senate Select Committee on Securities and Exchange, *Australian Securities Markets*, above n 34.

¹²³ Whilst *The Economic Record* is not a legal journal and, therefore, not strictly ‘legal literature’, this article has been included in this section as Professor Geoffrey Sawyer was a Professor of Law at the Australian National University (the first Professor of Law at the ANU College of Law) at the time he wrote it: Australian National University, *Annual Geoffrey Sawyer Lecture* <<https://law.anu.edu.au/news-and-events/event-series/annual-geoffrey-sawyer-lecture>>. It is also one of the earliest articles located on the regulation of securities markets in Australia. Moreover, given Sawyer’s article is a review of the Rae Report and purports to consider regulation, a very liberal interpretation of ‘legal literature’ has been adopted for the purposes of this section of this paper and it has been included in the legal literature section. See also n 125 below.

¹²⁴ Harold F Bell, ‘The Securities Market – National Control or Self-Regulation?’ (1975) 51(3) *Economic Record* 372.

¹²⁵ Whilst this article is not contained in a legal journal, it has been included in the legal literature section for the same reasons outlined in above n 123. Note that in the footnote attached to the main heading of Bell’s article and Sawyer’s article, each author refers to the other’s article.

¹²⁶ Sawyer, above n 120.

no thorough long-term examination of the investment and exchange of securities in Australia had previously been made; a few detailed cases had been investigated and still fewer reports of such inquiries published ...¹²⁷

Hart appears to agree and although acknowledging in his 1979 commentary that there had been ‘a number of articles published in Anglo Australian law journals on the law with respect to insider trading’, he states the following:

Apart from the commentary in Professor Baxt’s works there has been almost no treatment of the law with respect to other aspects of the securities industry. No doubt this is partially attributable to the fact that there is a dearth of decided cases in the area which makes academic treatment of the Australian law quite difficult ...¹²⁸

In his Masters of Financial Management thesis, titled ‘Regulation of Stock Market Manipulation in Australia’, published in 1979,¹²⁹ Thomas argues the same point. In discussing the legal position in Australia with respect to stock market manipulation, Thomas points to the ‘[n]umerous articles on insider trading’ that had appeared ‘in the literature’ and, by comparison, notes that: ‘[a]part from the works of Baxt, Ford and Samuel (1977) and Hart (1979) there has been little treatment of the law relating to other areas of market manipulation’.¹³⁰

Like Hart, Thomas ‘partially’ attributes this to ‘the lack of decided cases in this area’.¹³¹ Both Thomas and Hart’s reference to the ‘dearth

¹²⁷ Ibid 380. Sawyer notes, however, that a ‘thorough long-term survey would have involved a much larger staff and taken an even longer time than this inquiry did’. Tomasic et al made a similar observation two decades later: ‘Despite its importance to the overall structure of Australian capitalism, there is relatively little formal legal analysis of the operation of securities laws in Australia’: *Tomasic, Jackson, Pentony, and Woellner*, above n 78, 445.

¹²⁸ Hart, above n 116, 139.

¹²⁹ As with n 123 and n 125 above, given that Thomas purports to consider the regulation of share price manipulation, a very liberal interpretation of ‘legal literature’ has been adopted for the purposes of this section of this paper and it has been included in the legal literature section.

¹³⁰ Anthony Thomas, ‘Regulation of Stock Market Manipulation in Australia’ (Masters Thesis, University of Queensland, 1979), 31.

¹³¹ Ibid. See also *Tomasic, Jackson, Pentony and Woellner*, above n 78, 445–446, where similar comments on the lack of legal analysis on the operation of securities laws are made more generally and where the following comments are made: ‘Despite its importance to the overall structure of Australian capitalism, there is relatively little formal legal analysis of the operation of securities laws in Australia ... just as there is relatively little academic analysis of the operation and effect of Australian securities laws, it could be said that one reason for this is that there is also relatively little judicial analysis or case law dealing with this legislation’.

of decided cases in this area' is consistent with the following comments made in the Rae Report, which was published in 1974:

... we cannot point to any successful prosecutions of individuals concerned in these practices, and the rare attempts which have been made to initiate legal proceedings in this area have been abortive. The Committee is aware that several cases of apparent manipulation of the markets have been referred to State authorities, but although periods of about three years have passed in each of these instances, nothing has been heard in public about what the authorities discovered, either in the form of a report on the specific dealings or in the form of a general statement on the kind of practices involved.¹³²

Against this backdrop, it is perhaps easier to understand why there is an apparent paucity of literature in Australia concerning the misconduct associated with trading on local stock exchanges, including share price manipulation, prior to the 1970s.

Bell's 1975 article does little to further an understanding of share price manipulation in Australia, including the tracing of its historical roots. The closest he comes to explicitly recognising this particular form of market misconduct is by way of the following observation, which appears to be an oblique reference to the manipulation of share prices through the spreading of false rumours:

Every boom brings out its pundits and booms and boomlets have over the centuries been puffed up on the basis of 'information' found later to be less than justified by the facts.¹³³

Hart, on the other hand, provides a comparatively comprehensive account of stock market manipulation in his article 'The Regulation of Stock Market Manipulation', which appears to be one of the earliest local journal articles that focuses specifically on this topic.¹³⁴ This article considers a number of aspects of stock market manipulation, including the objectives of securities legislation in this area, the different types of manipulative activities, the legislative position in Australia and its nexus with the securities laws in the US, as well as the civil and common law remedies then available to those adversely impacted by manipulative activities. However, other than a brief summary of the events that led to the publication of the Rae Report and the enactment of the *Securities*

¹³² Senate Select Committee on Securities and Exchange, *Australian Securities Markets*, above n 34, 8.14-8.15.

¹³³ Bell, above n 124, 375.

¹³⁴ Hart, above n 116.

Industry Act in four Australian States,¹³⁵ there is no mention of the legal position prior to 1970 or even whether or not the manipulation of share prices was occurring in the period leading up to the minerals boom that precipitated the significant changes to the regulation of local securities markets.

Although Hart is clear on the scope of his article when he states that his purpose is to ‘examine the market manipulation provisions as they have evolved since 1970’,¹³⁶ as with other authors of the time he does little to elucidate whether or not share price manipulation on local markets was merely a product of the minerals boom in Australia in the late 1960s or whether it was occurring previously, how it was perpetrated, for how long and what action had been taken to combat identified instances, including how the law had dealt with it. Moreover, given that share price manipulation was intrinsically linked with share trading on Australia’s stock exchanges, there is no information provided on what action, if any, the exchanges were taking to deal with identified instances. Was it being perpetrated on the nation’s stock markets, how often was it occurring, what impact was this activity having on the market and what action were the exchanges taking to prevent, detect and punish malefactors engaging in this type of misconduct?

Whilst Professor Baxt’s commentary is specifically referred to by Hart and Thomas, unfortunately, the texts that he authored and co-authored during the 1970s do little to help in answering these questions. For example, whilst Baxt’s 1971 text *The Rae Report – Quo Vadis?* provides a good analysis of the key areas covered by the Rae Committee’s report, including two chapters dedicated to manipulative practices identified by the Committee,¹³⁷ there is no information on how these practices had developed in the domestic context in the years preceding the events that were the subject of his analysis. Instead, Baxt makes passing reference to ‘pools’ in the US having been one of the ‘major abuses uncovered by the Senate Committee on Banking and

¹³⁵ Ibid, 139–141.

¹³⁶ Ibid 140.

¹³⁷ Chapter 8 ‘Some Examples of Manipulative Practices – Another Failure of Self-Regulation’ and Chapter 16 ‘Manipulative and Other Practices Banned by the Existing Securities Industry Legislation’: Robert Baxt, *The Rae Report – Quo Vadis?* (Butterworths, 1974), 43, 114.

Currency appointed in 1932' and, like many local and overseas authors since,¹³⁸ he makes brief references to the seminal English authorities in this area, *R v De Berenger*¹³⁹ and *Scott v Brown Doering MacNab and Co.*¹⁴⁰ Similarly, Baxt and Afterman's *Casebook on Companies and Securities*, published in 1976, provides comprehensive commentary on trading in shares and other securities and the law that governed those activities.¹⁴¹ However, other than brief comments on the offences provided for in the *Securities Industry Acts* of the four Australian states, there is little in the way of a historical analysis of the genesis of the legislation or the manipulative activities it specifically proscribed.¹⁴²

In *An Introduction to the Securities Industry Acts*, published in 1977, Baxt, Ford and Samuel once again use the *Securities Industry Acts* of the four States and the Rae Report as the starting points for their consideration of domestic securities regulation generally, and share price manipulation in particular. Disappointingly, discussion of the former commences with the following, which does little to shine a light on the history prior to 1970:

In 1970, as a result of a period of discussion and co-operative research by the various States, legislation was introduced in four Australian jurisdictions – New South Wales, Victoria, Queensland and Western Australia – to regulate the affairs of the securities markets.¹⁴³

The provision of additional detail on the 'discussion and co-operative' research that precipitated the introduction of this legislation may have assisted in understanding the background to what would turn out to be a ground-breaking decade in the development of securities regulation in Australia.¹⁴⁴

¹³⁸ See, eg, Avgouleas above n 29.

¹³⁹ (1814) 3 M&S 67; 105 ER 536.

¹⁴⁰ *Scott v Brown, Doering, MacNab and Co* [1892] 2 QB 724. Baxt, *The Rae Report – Quo Vadis?*, above n 137, 116.

¹⁴¹ Robert Baxt and Allen B Afterman, *Casebook on Companies and Securities* (Butterworths, 1976).

¹⁴² This is apparent in other texts written during this period. See, for example, CCH Australia Limited, *A Guide to Australian Securities Industry Law and Stock Exchange Control* (CCH Australia Limited, 1971); WE Paterson and HH Ednie, *Aspects of the Corporations and Securities Industry Bill 1974* (Butterworths, 1975).

¹⁴³ Baxt, Ford and Samuel, above n 15, 26.

¹⁴⁴ One of the earlier pieces of literature, published on 30 June 1970, noted that 'Bills for a Securities Industry Act were introduced in New South Wales and Victoria in March and, with amendments in both States, have become law': 'A Face Lift for The Companies Act' in 'Current Topics' (1970) 44(6) *Australian Law Journal* 245, 246. A brief description of the offences created by the Act relating to share price manipulation is provided at 247.

B *The stock exchanges*

Baxt, Ford and Samuel's text includes a chapter on the internal regulation of the stock exchanges,¹⁴⁵ which appears to be one of the earliest Australian text books that covers this particular subject from a legal perspective.¹⁴⁶ As stated previously, given that share price manipulation is intrinsically linked with share trading on Australia's stock exchanges, it is disappointing that there is no information in this book that provides a clear nexus between the share price manipulation provisions in the *Securities Industry Acts* and how this type of misconduct was dealt with by the exchanges. For example, were there any specific exchange Articles, Regulations or Business Rules that proscribed manipulative activity (in whatever form), how were they dealt with and what sanctions, if any, would apply in identified instances? What action did the exchanges take to prevent, detect and punish this type of activity? Did it ever occur, and was it even an issue of pressing concern for the exchanges? Instead, one is left to draw inferences from the sections on 'Cessation of Membership ... By Expulsion'¹⁴⁷ and 'Disciplinary Powers Over Members ...'¹⁴⁸ to determine whether or not there were any non-specific rules that may have captured identified instances of share price manipulation. Other than reference to Sydney Stock Exchange Limited ('SSE') by-law 8(1), which provides that members may be expelled if they engage in conduct which is prohibited by the *Securities Industry Act*, the likely contenders discussed by the authors include SSE by-law 8(2), which prohibited:

... any act which is intended to disrupt the orderly marketing of securities on the exchange, or engages in activities to affect the price of securities quoted on the exchange so that that price does not represent a fair market value ...¹⁴⁹

and Stock Exchange of Melbourne Limited Article 45, which provided the exchange committee with wide powers to deal with members who engaged in 'prohibited conduct', described as conduct that was:

¹⁴⁵ Chapter 6 *Stock Exchanges: Their Internal Regulation*: Baxt, Ford and Samuel, above n 15.

¹⁴⁶ However, note the below discussion regarding CCH Australia Limited, *A Guide to Australian Securities Industry Law*, above n 142, which is the earliest legal text relating to the regulation of the Australian securities markets and stock exchanges located by the author.

¹⁴⁷ Baxt, Ford and Samuel, above n 15, 45.

¹⁴⁸ *Ibid.*

¹⁴⁹ *Ibid.*

... contumacious, dishonourable, disgraceful or unbecoming a member (whether such prohibited conduct constitutes or involves a breach of any article or regulation of the exchange or not).¹⁵⁰

If there were no specific provisions that addressed share price manipulation perpetrated by members or their employees on the exchange, or if the above provisions (or similar provisions) were, indeed, intended to cover such misconduct, it would have been helpful if this had been clearly articulated. The one exception is buried in the chapter devoted to, inter alia, false trading and fraudulent dealing.¹⁵¹ In discussing ‘corners’, a particular modus of market manipulation,¹⁵² the authors refer to exchange rule 3.7, which provided the Sydney and Melbourne exchanges with certain powers to ensure an equitable settlement was effected where ‘in the opinion of the committee, a corner exists’.¹⁵³ There is no further information provided on this activity from the perspective of the stock exchanges. For example, were corners prohibited by the exchanges and what action would be taken, if any, against members who had participated in a corner? Both the third edition, published in 1988,¹⁵⁴ and the fourth edition, published in 1993,¹⁵⁵ similarly do not address these issues.¹⁵⁶

¹⁵⁰ Ibid 48.

¹⁵¹ Baxt, Ford and Samuel, above n 15, Chapter 13 ‘Shortselling, False Trading and Fraudulent Dealing’.

¹⁵² Note the comments of the Full Court of the High Court regarding corners in *Director of Public Prosecutions (Cth) v JM* [2013] HCA 30, [65]: ‘Given the provisions of Ch 6, it may be unlikely that any buyer or seller can, in any practical sense, “corner” or “squeeze” the market for listed shares.’ Whilst this may be the case today, many of the early cases of share price manipulation in Australia involved corners. See, for example, n 215, n 216 and n 219 below. This also appears to be substantiated by a review of the newspapers published in Australia in the latter part of the 1800s and early 1900s.

¹⁵³ Baxt, Ford and Samuel, above n 15, 195.

¹⁵⁴ Robert Baxt, Christopher Maxwell and Selwyn Bajada, *Stock Markets and the Securities Industry: Law and Practice* (Butterworths, 3rd ed, 1988).

¹⁵⁵ Baxt, Ford and Black, above n 33, 149.

¹⁵⁶ There is a reference in the third and fourth editions in Chapter 5 ‘Stock Exchanges – their internal Regulation’ to art 52, which provides that the Board may conduct a hearing into ‘prohibited conduct’, which is similar to the concept discussed earlier and referred to in Baxt, Ford and Samuel, above n 15, 48. However, the definition of prohibited conduct is different, being described here as ‘conduct which is not efficient, honest or fair or is otherwise conduct prejudicial to the interests of the Exchange’: Baxt, Maxwell and Bajada, above n 154, 71; Baxt, Ford and Black, above n 33, 149. This could, presumably, cover manipulative activities engaged in by members of the Exchange, although this is not expressly stated.

Published in 1971, *A Guide to Australian Securities Industry Law and Stock Exchange Control*, which is the earliest text located that specifically covers the law relating to the securities markets in Australia and the operation and regulation of domestic stock exchanges, essentially adopts the same approach in two key respects. Firstly, chapter one covers the background to the securities industry and notes that ‘the securities industry in Australia has always been a rather mysterious and aloof part of the Australian commercial scene’.¹⁵⁷ Yet, like other literature of the time, and since, the starting point in terms of a historical context is essentially the Australian mining boom and the appointment of the Rae Committee. Secondly, whilst explicitly acknowledging upfront ‘the important role played by the Stock Exchanges of Australia’,¹⁵⁸ and containing equally comprehensive information on their organisation, there is little information provided on the specific forms of misconduct proscribed under the rules of the exchange, including the manipulation of share prices. If there were no specific exchange rules proscribing such activity, or if the rules mentioned above were, in fact, relied on to deal with this type of misconduct, it is unfortunate from a securities regulation and historical perspective that this type of detail is not discussed. Similarly, even if the exchanges were then waiting for either the enactment of the *Securities Industry Acts* or the publication of the Rae Report, or both, before drafting and implementing rules to specifically combat share price manipulation, this information would have been invaluable for those conducting research in this area. It is also unfortunate that there appears to be nothing in the literature reviewed that identifies how the stock exchanges specifically responded to the perpetration of manipulative activities, when they first occurred and how, the prevalence, how their rules developed and what action was taken to prevent, detect and punish those found to have engaged in this type of misconduct.

¹⁵⁷ CCH Australia Limited, *A Guide to Australian Securities Industry Law*, 1.

¹⁵⁸ Ibid ‘Foreword’.

C Domestic Legal Literature – From 1980 to date

From the 1970s to date, it appears that the overwhelming majority of the literature concerning market manipulation has related to the manipulation of the prices of shares listed on stock exchanges.¹⁵⁹ This is certainly the case in Australia, where, following the publication of the Rae Report, academics, legal practitioners, regulators and others have developed an increasingly detailed body of knowledge on stock market manipulation. Indeed, it is fair to say that the literature on securities regulation generally, and share price manipulation specifically, from an Australian perspective, has expanded very significantly over the decades since the 1970s. It now includes a wide range of journals containing, inter alia, legal and other analysis on stock market manipulation in Australia¹⁶⁰ (some focusing purely on domestic issues while others

¹⁵⁹ This is starting to change, however, and there is a growing body of international (non-Australian) literature on the manipulation of financial instruments and benchmarks that are not traded on a stock exchange, for example, manipulation of the London Inter-Bank Offered Rate (LIBOR): see, eg, Liam Vaughan, *The Fix: How Bankers Lied, Cheated and Colluded to Rig the World's Most Important Number* (Bloomberg, 2016); David Enrich, *The Spider Network: The Wild Story of a Math Genius, a Gang of Backstabbing Bankers, and One of the Greatest Scams in Financial History* (Custom House, 2017); Erin Arvedlund, *Open Secret: The Global Banking Conspiracy That Swindled Investors Out of Billions* (Portfolio, 2014)). There is also literature that considers the manipulation of other assets that can be traded on financial markets, such as commodities and foreign exchange: Markham, *Law Enforcement*, above n 85.

¹⁶⁰ See, eg, Emma Armson, 'False Trading and Market Rigging in Australia' (2009) 27 *Company and Securities Law Journal* 411; Janet Austin, 'A Rapid Response to Questionable Trading – moving towards better enforcement of Australia's securities laws' (2009) 27 *Companies and Securities Law Journal* 1; Janet Austin, 'Government to the rescue: ASIC takes the reins of the stock markets' (2010) 28 *Companies and Securities Law Journal* 444; A Black, 'Regulating market manipulation: sections 997–999 of the Corporations Law' (1996) 70 *Australian Law Journal* 95; Lev Bromberg, George Gilligan and Ian Ramsay, 'Financial Market Manipulation and Insider Trading: An International Study of Enforcement Approaches' [2017] 8 *Journal of Business Law* 652; Carol Comerton-Forde and James Rydge, 'Market Integrity and Surveillance Effort' (2006) 29 *Journal of Financial Services Research* 149; Vivien R Goldwasser, 'The Regulation of Stock Market Manipulation – A Blue Print for Reform' (1998) 9(2) *Australian Journal of Corporate Law* 109; Goldwasser, 'Regulating Manipulation in Securities Markets', above n 23; Goldwasser, *Stock Market Manipulation and Short Selling*, above n 24; Hart, above n 116; Paul Latimer, 'False trading and market rigging on the Stock Exchange' (1999) 7(2) *Asia Pacific Law Review* 247; Loke, above n 83; Meyer, above n 117; A Trichardt, 'Australian Greenshoes, Price Stabilisation and IPOs – Part 1' (2003) 21 *Company and Securities Law Journal* 26; A Trichardt, 'Australian Greenshoes, Price Stabilisation and IPOs – Part 2' (2003) 21 *Company and Securities Law Journal* 75; Hui Huang, 'Redefining Market Manipulation in Australia: The Role of an Implied Intent element' (2009) 27 *Company and Securities Law Journal* 8.

include Australia as part of an international analysis), as well as a large number of text and other books on securities regulation with specific sections on market manipulation and other market misconduct,¹⁶¹ and a variety of postgraduate theses that consider aspects of share price manipulation in Australia.¹⁶²

However, the approach taken in the legal/securities regulation literature of the 1970s, which is outlined above, appears to have been largely adopted by authors of the literature that has been produced in the period since then. That is, the starting point for considering securities market regulation in Australia generally, and share price manipulation specifically, is typically a combination of: (a) the treatment of manipulative transactions under the common law in England in the 1800s,¹⁶³ (b) the late 1960s minerals boom that occurred in Australia and which preceded the enactment of the *Securities Industry Acts* in the four States; (c) the Rae Committee's report that highlighted the 'notorious trading abuses'¹⁶⁴ perpetrated during the minerals boom on domestic stock exchanges; (d) consideration of the law in the US that formed the basis for local securities markets regulation; and (e) then generally fast-forward to the position as at the time the relevant

¹⁶¹ See, eg, Baxt, *The Rae Report – Quo Vadis?*, above n 137; Baxt and Afterman, above n 141; Baxt, Ford and Samuel, above n 15; Robert Baxter et al, *An Introduction to the Securities Industry Codes* (Butterworths, 2nd ed, 1982); Baxt, Maxwell and Bajada, above n 154; Baxt, Ford and Black, above n 33; Baxt, Black, and Hanrahan, above n 76; CCH Australia Limited, *A Guide to Australian Securities Industry Law*, above n 142; Paul Redmond, *Companies and Securities Law*, above n 114; Tomasic, Jackson, Pentony, Brendan and Woellner, above n 78; Tomasic, Bottomley and McQueen, above n 33; Walker and Fisse (eds), above n 36.

¹⁶² See, eg, Thomas, above n 30; Vivien Goldwasser, 'The Regulation of Stock Market Manipulation' (Thesis for Doctor of Juridical Science, The University of Melbourne, 1997); Talis J Putnins, *Closing price manipulation and the integrity of stock exchanges* (PhD Thesis, University of Sydney, 2009); Janet Elizabeth Austin, 'When Insider Trading and Market Manipulation Cross Jurisdictions: What Are the Challenges For Securities Regulators and How Can they Best Preserve the Integrity of Markets?' (PhD Thesis, Osgoode Hall Law School of York University, 2016). An example of a non-postgraduate thesis in this area is Graeme McIntyre, 'Reforming the Regulation of Financial Market Manipulation' (Honours Program Thesis, University of Sydney, Faculty of Law, 2014).

¹⁶³ The key authorities cited are usually *R v De Berenger* (1814) 3 M&S 67; 105 ER 536; *Scott v Brown, Doering, MacNab and Co* [1892] 2 QB 724; *R v Aspinall* (1875) 1 LR 730 (QBD), (1876) 2 LR 48 (QBD).

¹⁶⁴ Paul Redmond, 'A Short History of Securities Regulation in Australia' in Walker and Fisse (eds), above n 36, 90; Redmond, Harding, and Cameron, above n 114.

journal article or textbook is written and published. This is broadly the approach taken by many authors, including Armson,¹⁶⁵ Baxt et al,¹⁶⁶ Meyer,¹⁶⁷ Goldwasser,¹⁶⁸ Redmond et al¹⁶⁹ and Tomasic et al.¹⁷⁰ There are a few exceptions, including, for example, Redmond's commentary on the history of securities regulation in Australia, which provides a very brief background to legislative developments that preceded the 'most spectacular stock-market boom in Australian history' that began in September 1969.¹⁷¹ According to Redmond, that boom was, itself, precipitated by a mining boom in the same year of 'unprecedented proportions' that 'disclosed weaknesses in the regulation of securities markets'.¹⁷² There is, however, no substantive discussion of the rationale behind the introduction of the *Securities Industry Acts* in the four States, which is disappointing for securities regulation scholars and historians alike given that this legislation 'established the first general control over the securities industry',¹⁷³ 'enacted provisions to prohibit various forms of abuse in trading in securities'¹⁷⁴ and was essentially the genesis of the very significant changes to the regulation of local securities markets in Australia that began to take place during the 1970s.

As the years progressed and manipulative activities began to be criminally prosecuted by Australian regulators and became the subject of legal proceedings, albeit relatively late by comparison to

¹⁶⁵ Armson, above n 160.

¹⁶⁶ See, eg, Baxt, *The Rae Report – Quo Vadis?*, above n 137; Baxt and Afterman, above n 141; Baxte, Ford, and Samuel, above n 15.

¹⁶⁷ Meyer, above n 117.

¹⁶⁸ See, eg, Vivien Goldwasser, 'The Regulation of Stock Market Manipulation and Short Selling in Australia' in Walker and Fisse (eds), above n 36; Goldwasser, *Stock Market Manipulation and Short Selling*, above n 24.

¹⁶⁹ Redmond, Harding and Cameron, above n 114.

¹⁷⁰ Tomasic, Jackson, Pentony and Woellner, above n 78.

¹⁷¹ Paul Redmond, 'A Short History of Securities Regulation in Australia' in Walker and Fisse (eds), above n 36, 93.

¹⁷² Ibid.

¹⁷³ Ibid 96.

¹⁷⁴ Ibid.

other countries,¹⁷⁵ the literature, unsurprisingly, began to include consideration of, and commentary on, the case law that very slowly began to build in number and which has formed an increasing corpus of domestic common law on share price manipulation.¹⁷⁶

In addition, whilst there is a growing body of literature that considers the role of Australian stock exchanges in the local securities regulation paradigm,¹⁷⁷ there is, nonetheless, a distinct paucity of detailed commentary on how the exchanges have dealt with share price manipulation and other misconduct over their many years of operation. Baxt's *Stock Markets and the Securities Industry: Law and Practice*, published in 1988, adopts much the same approach as that described above in relation to the legal literature dealing with stock exchanges published in the 1970s.¹⁷⁸ There is, for example, a comprehensive account of the regulatory paradigm in which the exchanges operate, how they are established and internally governed, membership requirements, disciplinary powers vis à vis their members, and the sanctions that can be imposed for breaches of the exchanges' rules. However, given that it would appear their markets have from the very early days been abused by the manipulative activities of members of the exchanges and outsiders alike, there is a surprising lack of information on this subject. Unfortunately, Baxt's text does not break the mould in this regard and whilst he discusses, inter alia, the relevant provisions of the *Securities*

¹⁷⁵ According to Goldwasser, the first criminal conviction for stock market manipulation in Australia occurred in mid-1990, reported as *Mark Richard Howard v Bruce Emerton Miles* (Unreported, ACT Magistrates Court, Dainer SM, 30 July 1990): Vivien R Goldwasser, 'The Enforcement Dilemma in Australian Securities Regulation' (1999) 27 *Australian Business Law Review* 482, 484.

¹⁷⁶ In his 1986 article, Meyer includes commentary on some of the early non-criminal cases in Australia where share price manipulation was the subject of proceedings, for example, *R v M* (1979) CCH *Australian Securities Law Cases* 85; *North v Marra Developments Ltd* (1982) 56 *Australian Law Journal Reports* 106; Meyer, above 117, 94, 96. Over time, the literature has continued to include insightful commentary on a growing body of Australian case law in this area: see, for example, Chapter 16 'Market Misconduct, Prohibited Conduct and Short Selling' in Baxt, Black and Hanrahan, above n 76; Chapter 11 'Securities Regulation' in Tomasic, Bottomley and McQueen, above n 33.

¹⁷⁷ See, eg, Comerton-Forde and Rydge, above n 160; Paul Latimer, 'False trading and market rigging on the Stock Exchange', above n 160; Paul Latimer, 'Legal Enforcement of Stock Exchange Rules', above n 32; Baxt, Maxwell and Bajada, Selwyn, above n 154; Walker and Fisse (eds), above n 36; Tomasic, Bottomley and McQueen, above n 33.

¹⁷⁸ Baxt, Maxwell and Bajada, above n 154.

Industry Acts that proscribe manipulative activities,¹⁷⁹ he does not provide any insight on whether or not there were any rules specifically prohibiting the manipulation of listed securities, when they were introduced and why, whether there had been any identified breaches of those rules and what action the exchanges had taken to prevent, detect and punish those who had breached the rules.¹⁸⁰

Other authors appear to have adopted a similar approach. In their 1988 text *Companies and Securities Law: Commentary and Materials*, for example, Redmond, Harding and Cameron briefly consider the ‘business rules’ of the ASX, described as a ‘body of regulations governing the conduct of securities business by members’.¹⁸¹ However, there is no reference to, or discussion of, any specific rules that deal with market misconduct, including share price manipulation, which is only mentioned in the context of the legislation.¹⁸² Instead, it appears that the closest one gets to any discussion of how the stock exchanges dealt with identified instances of share price manipulation in the literature reviewed is a brief reference to a Circular issued by the ASX on 21 June 1990 to its Member Organisations that identifies some of the key techniques used to manipulate share prices and their ‘Runyonesque labels’.¹⁸³ Although the non-legal literature considered below, which includes detailed histories of Australia’s key exchanges, does touch on instances of market misconduct, including share price manipulation, this is only ever peripheral in nature or in the context of the Rae Committee’s report. Not unexpectedly, that literature does not dwell to any significant extent on how the exchanges regulated specific types of market misconduct over the course of their existence, including what specific rules governed such activities.

¹⁷⁹ Ibid ch 13.

¹⁸⁰ However, like Baxt, Ford, and Samuel’s 1977 text, *An Introduction to the Securities Industry Acts* (Butterworths, 1977), 195, Baxt, Maxwell and Bajada’s 1988 text also refers to corners and the business rule that provides the exchanges with certain powers when, in the opinion of the Board, a corner exists: ibid 223. This is the same in Baxt, Ford and Black’s 1993 text, Baxt, Ford and Black, above n 33, 288.

¹⁸¹ Redmond, Harding and Cameron, above n 114, 605.

¹⁸² Ibid 616.

¹⁸³ Redmond, *Corporations and Financial Markets Law*, above n 114, 884. See also Vivien Goldwasser, ‘The Regulation of Stock Market Manipulation and Short Selling in Australia’ in Walker and Fisse (eds), above n 36, 528, note 55.

Of all of the authors whose literature was reviewed for the purposes of this paper, Dr Vivien Goldwasser is one of the most prolific academic writers on share price manipulation in Australia. Through her Doctoral Thesis published in 1997¹⁸⁴ and numerous articles published in books and legal journals, she has made an enormous contribution to our understanding of this particular type of market misconduct from a local perspective.¹⁸⁵ Whilst Goldwasser has often adopted a similar approach to those authors referred to above, for example, commencing her consideration of the historical context of share price manipulation in Australia by reference to the key English authorities from the 1800s,¹⁸⁶ the developments in the US and the Rae Report,¹⁸⁷ she has, nonetheless, made an important contribution to the literature in this area in several respects.¹⁸⁸

By way of example, whilst many commentators have included observations on the reported and better known cases in Australia, such as Tomasic et al,¹⁸⁹ Tomasic, Bottomley and McQueen,¹⁹⁰ and Baxt, Black and Hanrahan,¹⁹¹ Goldwasser is, if not the only, one of the few commentators who have attempted to piece together an inventory of the early unreported cases in Australia that involved criminal charges

¹⁸⁴ Goldwasser, 'The Regulation of Stock Market Manipulation' above n 162.

¹⁸⁵ Ibid; Goldwasser, 'Regulating Manipulation in Securities Markets', above n 23; Goldwasser, 'Market Rigging after Nomura' in O'Connell, Ann (ed), 'Securities Industry and Managed Investments' (1999) 17 *Company and Securities Law Journal* 38; Goldwasser, *Stock Market Manipulation*, above n 24; Goldwasser, 'The Regulation of Stock Market Manipulation in Australia' in Walker and Fisse (eds), above n 36; Goldwasser, 'The Enforcement Dilemma in Australian Securities Regulation', above n 175; Vivien R Goldwasser, 'CLERP 6 – Implications and Ramifications for the Regulation of Australian Financial Markets' (1999) 17 *Company and Securities Law Journal* 206.

¹⁸⁶ As discussed above, *R v De Berenger* (1814) 3 M&S 67 (KB), 105 Eng Rep 536; *Scott v Brown, Doering, MacNab and Co* [1892] 2 QB 724; *R v Aspinall* (1875) 1 LR 730 (QBD), (1876) 2 LR 48 (QBD).

¹⁸⁷ See, eg, Goldwasser, 'The Regulation of Stock Market Manipulation', above n 162, 26-33; Goldwasser, *Stock Market Manipulation*, above n 24, 39-43; Goldwasser, 'Regulating Manipulation in Securities Markets', above n 23, 162.

¹⁸⁸ See, eg, Goldwasser, 'The Regulation of Stock Market Manipulation', above n 162, 26 and following.

¹⁸⁹ Tomasic, Jackson, Pentony and Woellner, above n 78, Chapter 10 'Securities Regulation'.

¹⁹⁰ Tomasic, Bottomley and McQueen, above n 33, Chapter 20 'Securities Regulation'.

¹⁹¹ Baxt, Black and Hanrahan, above n 76, Chapter 16 'Market Misconduct, Prohibited Conduct and Short Selling'.

relating to share price manipulation.¹⁹² This has assisted greatly when tracing the historical roots of share price manipulation in Australia and understanding the response of government authorities and regulators. In addition, the results of her interviews with regulators¹⁹³ and key stock exchange officials, for example, Jim Berry who was the Head of the ASX Surveillance Division,¹⁹⁴ have added an alternative perspective to that of the academic lawyer on the regulation of share price manipulation in Australia. However, whilst Goldwasser's contribution to the literature on this topic has been invaluable in helping to piece together the historical roots of this insidious activity, as with the other commentators discussed above her work has not addressed the apparent gap in the literature with respect to the historical roots of share price manipulation in Australia prior to the 1970s.¹⁹⁵

Nonetheless, there is some legal literature that touches on the historical origins of share price manipulation in Australia before the starting point used by many of the authors discussed above. In his 2015 article comparing the market manipulation regimes in South Africa and Australia, Chitimira is one of the few legal authors who looks back beyond the 1970s to a much earlier time in Australia's history when considering the history of share price manipulation on local markets, albeit very briefly.¹⁹⁶ According to Chitimira:

¹⁹² See, eg, Goldwasser, 'The Regulation of Stock Market Manipulation – A Blue Print for Reform', above n 160, 111, note 10; Goldwasser, *Stock Market Manipulation*, above n 24, 76, note 93; Vivien Goldwasser, 'The Regulation of Stock Market Manipulation in Australia' in Walker and Fisse (eds), above n 36, 535, n 92; Vivien Goldwasser, 'Market Rigging after Nomura' in O'Connell, above n 185, 50, note 12.

¹⁹³ See, eg, Goldwasser, 'The Regulation of Stock Market Manipulation – A Blue Print for Reform', above n 160; Goldwasser, 'The Enforcement Dilemma in Australian Securities Regulation', above n 175, 482, note 1 and 483, note 5.

¹⁹⁴ See, eg, Goldwasser, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales', above n 23, 190, note 144.

¹⁹⁵ For example, in the section titled 'The Australian Historical Context' in Goldwasser, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales', *ibid* 162, Goldwasser commences her discussion by reference to the 1969 share boom and the Rae Report. See also Goldwasser, *Stock Market Manipulation*, above n 24, 39.

¹⁹⁶ Chitimira, above n 37. According to Redmond the '[g]eneral law prohibitions were strengthened by statutory prohibitions upon manipulative activities with the Securities Industry Acts of 1970': Paul Redmond, *Corporations and Financial Markets Law*, above n 114, 885. However, there appears to be no further information provided with respect to the general law prohibitions on share market manipulation in Australia prior to 1970.

...[i]t is generally accepted that market manipulation activities were outlawed under common law in the years prior to 1899 and later codified in 1899 in Australia. Therefore, like the United Kingdom (UK), Australia primarily prohibited market manipulation through common law principles.¹⁹⁷

Whilst potentially acting as a road sign on a researcher's journey, Chitimira's article does not, unfortunately, provide any additional substantive content on the historical roots of share price manipulation in Australia. There are, for example, no additional details on which particular legislation 'codified' the proscription of market manipulation in Australia in 1899, which common law cases or principles applied or even the basis for claiming this to be 'generally accepted'. Unlike many other authors who have contributed to the body of literature on share price manipulation in Australia, Chitimira, a non-Australian academic, at least acknowledges that market manipulation had occurred in the domestic context a very considerable period prior to the typical starting point of the late 1960s/early 1970s.

According to an article by Constable in 2016, 'Psst Want to Hear a Rumour: Rumourtrage May Have Been Occurring in Australia for Longer than We Thought', a number of newspaper articles that appeared in regional and state newspapers across Australia from the latter half of the 1800s suggest that the manipulation of share prices by spreading false rumours has 'been perpetrated in Australia for much longer than may have been thought'.¹⁹⁸ Whilst not specifically outlawed in Australia until 1970, Constable notes that 'rumourtrage',¹⁹⁹

¹⁹⁷ Ibid 113.

¹⁹⁸ Constable, above n 39.

¹⁹⁹ The meaning of this term was noted by ASIC in Australian Securities and Investments Commission, *Consultation Paper 118: Responsible handling of rumours*, September 2009, 7. This type of activity is proscribed in Australia under s.1041E of the *Corporations Act 2001* (Cth). As noted by ASIC in CP118, '[i]n some circumstances the communication of rumours could breach the prohibitions on communicating inside information (s1043A) and trading following communication of rumours could breach the prohibitions on insider trading (s1043A), possibly the prohibition against market manipulation (s1041A) and also the general prohibition against misleading or deceptive conduct in trade or commerce (s12DA of the Australian Securities and Investments Commission Act 2001)': Australian Securities and Investments Commission, *Consultation Paper 118: Responsible handling of rumours*, September 2009, 10. See also Baxt, Black and Hanrahan, above n 76, 16.7 and Black, Ashley, 'Rumourtrage and the Responsible Handling of Rumours' in Overland, Juliette (ed), *The Many Aspects of Market Integrity* (Australian Scholarly Publishing, 2010).

a particular form of market manipulation that involves the spreading of false or misleading information about companies in order to take advantage of the consequent impact on their share prices, appears to have been occurring domestically for almost 100 years earlier.²⁰⁰ By way of example, Constable quotes the following report from the 14 November 1878 edition of the *Bendigo Advertiser*, where George Payne, a sharebroker, had pleaded not guilty to ‘uttering a forged telegraphic message with fraudulent intent’:

The evidence for the prosecution was to the effect that on the 12th July the prisoner sent a telegram from Carisbrook purporting to be signed by J R Williams, the mining manager of the Working Miners’ Gold Mining Company, Homebush, to F T Outterin, the legal manager of the company at Maryborough, stating that a reef had been struck which would yield an ounce to the load, and giving instructions to buy him fifty shares. In consequence of this information the shares went up from £1 to £2 10s, and when it was found out that the telegram was a forgery, and done for the purpose of rigging the market, the shares receded to their former value.²⁰¹

The substantive content of Constable’s article that deals with share price manipulation in Australia in the 1800s is relatively brief and contains only a limited number of examples. However, he has highlighted that the historical roots of share price manipulation appear to stretch back almost a century prior to the starting point for most of the legal literature on this particular form of market misconduct, which suggests there is an opportunity for further research in this area.

Whilst the currently available legal literature is an invaluable resource in piecing together the domestic history of share price manipulation from the 1970s to date, it does little to further our understanding of the historical roots of this insidious activity prior to the 1970s. As such, resort was had to the non-legal literature in order to determine if there is any information that could assist in tracing the history of share price manipulation in Australia in the period leading up to the 1970s.

D Non-legal literature

The non-legal literature, particularly the literature of a historical nature, is helpful in tracing the historical roots of share price manipulation in Australia, but it is fragmented, with many sources often only yielding

²⁰⁰ Constable, above n 39.

²⁰¹ Ibid 59–60.

useful information tangentially.²⁰² Constructing a chronology that details instances of share price manipulation quite literally requires the piecing together of an enormous jigsaw puzzle that spans a period well in excess of 100 years and which traverses multiple state boundaries in Australia. Given that the history of share price manipulation in Australia is inextricably entwined with the history of gold mining and the stock exchanges, literature relating to both of these subjects is critical in trying to understand the historical context in this area.²⁰³

Blainey's history of Australian mining, for example, not only provides that context, but it also provides some information on manipulative activities that were occurring at the time of the various mining booms that have taken place in Australia, including those in the 1880s and 1890s.²⁰⁴

The chance of a quick profit on the stock exchange spurred them on, and promoters continued to float their companies, paying trusted newspapers to puff shares and hush news.²⁰⁵

Moreover, according to Blainey, the shenanigans employed by those intent on benefitting themselves at the expense of investors included the following:

mining speculators were fascinated by share prices rather than mines. Their ignorance of mining was preyed on by directors. Men fired gold from a shotgun into a barren reef to inflate shares. Directors erected

²⁰² Examples include: WB Withers, *The History of Ballarat From the First Pastoral Settlements to the Present Times* (FW Niven and Company, 2nd ed, 1887); Frank Cusack, *Bendigo: A History* (Lerk & McClure, 2002).

²⁰³ Literature from the financial markets and economics disciplines is helpful in providing information on the operations of the stock exchange. For example, RR Hirst and RH Wallace (eds), *Studies in the Australian Capital Market* (FW Cheshire, 1964); RR Hirst and RH Wallace (eds), *The Australian Capital Market* (Cheshire, 1974); MK Lewis and RH Wallace (eds), *Australia's Financial Institutions and Markets* (Longman Cheshire, 1987). To the extent that there is any information in this type of literature concerning the history of Australia's stock exchanges, it is brief. In discussing the role of the stock exchange in *The Handbook of Corporate Finance*, for example, Marshman and Davies provide a history of the stock exchanges in Australia from 1828 to 1986 in five short paragraphs: Peter Marshman and Peter Davies, 'The Role of the Stock Exchange and the Financial Characteristics of Australian Companies' in Robert Bruce et al (eds), *Handbook of Australian Corporate Finance* (University of Hawaii Press, 2nd ed, 1986), 52.

²⁰⁴ Blainey, above n 119.

²⁰⁵ Ibid 188.

crushing machinery on poor reefs to persuade investors that the reef was rich. Managers for months hoarded rich stone in dark corners and then extracted all the gold in one week and sent shares soaring. Directors of rich mines sometimes spread gloomy reports, made bear raids on the shares, and then bought them cheaply from the shareholders they had deceived.²⁰⁶

According to Cusack, similar rumour-mongering occurred in the early 1870s at the Beehive or Sandhurst Mining Exchange in Pall Mall, Bendigo, which was the ‘hub of Sandhurst’s share-trading’:

Its brokers had not the highest reputation for integrity, tammany rings flourished, jobbing the share market was rife and brokers’ stooges plied a busy and profitable trade initiating tips and disseminating rumours at the Shamrock bar.²⁰⁷

Whilst Sykes provides a comprehensive and insightful account of the 1969 mining boom in *The Money Miners*, including the action taken by regulators and the courts in response, his chapter on the origins of ‘mining-share booms’, which he asserts ‘are no strangers to Australia’, is brief. There is a fleeting reference to share trading in the early nineteenth century gold rushes that was largely ‘confined to the actual fields’:

as miners traded shares in syndicates. Thus a royal commission which visited Ballarat in 1854 noted the remarkable rise of syndicates and companies among the diggers and said that ‘share dealing has become a multifarious business’. Later booms were to see organised stock exchanges.²⁰⁸

In *Two Centuries of Panic: A History of Corporate Collapses in Australia*, however, Sykes goes into considerable detail in recounting the boom in Bendigo Waterworks shares, speculation in which would ‘spur the formation of Melbourne’s first stock exchange late in 1859’.²⁰⁹ Whilst he does not specifically deal with share price manipulation, like

²⁰⁶ Ibid 99.

²⁰⁷ Cusack, above n 202, 162.

²⁰⁸ Trevor Sykes, *The Money Miners: The Great Australian Mining Boom* (Allen & Unwin, 1995), 1.

²⁰⁹ Chapter 4 ‘The Original Hot Mining Stock’ in Sykes, *Two Centuries of Panic*, above n 31.

similar literature in this area Sykes provides a good historical context for share trading in Australia in the early days.²¹⁰

Other literature detailing the history of share trading does contain information that suggests share prices were manipulated in Australia long before the 1970s. In his analysis of the first major share market boom in Gympie, Queensland, in 1881, Lougheed alludes to the possibility that the ‘importance of new discoveries was grossly magnified, undoubtedly to enhance the value of the shares of the relevant companies’.²¹¹ Blackley, writing in 1889, is more explicit in his observations and criticisms of stockbrokers of the time, to whom he referred as ‘unprincipled’ and who he believed were:

nothing more or less than associates in, and promoters of, the greatest swindles in the form of companies, going hand in hand with directors and rings to issue fictitious reports for the purpose of ‘bearing and bulling’ the markets to suit their own interests. By such practices an important industry is prejudiced, the public victimised, and, as a necessary consequence, brokers, instead of holding an honorable (sic) position, are viewed with suspicion.²¹²

Blackley also criticises the stockbrokers for their ‘injurious practices’ and ‘secrecy of transactions’ that he believes ‘afford opportunities for abuses and fraud’, and which he argues could be remedied by the creation of an ‘Exchange’.²¹³

Whilst the history of Australia’s key stock exchanges has been comprehensively documented, the literature does not dwell to any great extent on the subject of share price manipulation or even how the

²¹⁰ Other literature in this regard includes literature from the financial markets and economics disciplines, which is helpful in providing information on the operations of the stock exchange. For example, Hirst and Wallace (eds), *Studies in the Australian Capital Market*, above n 203; Hirst and Wallace (eds), *The Australian Capital Market*, above n 203; Lewis and Wallace (eds), above n 203. To the extent that there is any information in this type of literature concerning the history of Australia’s stock exchanges, it is brief. In discussing the role of the stock exchange in *The Handbook of Corporate Finance*, for example, Marshman and Davies provide a history of the stock exchanges in Australia from 1828 to 1986 in five short paragraphs: Peter Marshman and Peter Davies, ‘The Role of the Stock Exchange and the Financial Characteristics of Australian Companies’ in Bruce et al (eds), above n 203, 52.

²¹¹ AL Lougheed, ‘The First Major Share Market Boom in Queensland – Gympie, 1881’, Working Paper Number Forty-Six, July 1984, 22.

²¹² Frank Blackley, *Notes of Interest: ‘On Change’* (Frank Blackley, 1889), 4–5.

²¹³ *Ibid* 5.

exchanges responded to its occurrence.²¹⁴ There are, however, limited references to people trying to ‘corner’ the shares of certain stocks,²¹⁵ which is a form of manipulation referred to in the Rae Report.²¹⁶ According to Salsbury and Sweeney, for example: ‘this ‘manoeuvre was practised routinely on the exchanges of both Melbourne and Sydney during the “silver flutter” of 1887–88’.²¹⁷

Hall, in *The Stock Exchange of Melbourne and the Victorian Economy 1852–1900*, provides an example of an attempt to corner the shares in Round Hill by a member of the Stock Exchange of Melbourne in 1889.²¹⁸ However, there is, for example, no reference to the relevant exchange rules that may have been contravened by this activity or relied upon to deal with the matter or whether this was the first occasion that such conduct had been identified.²¹⁹

There are other passing references in some of the literature on the history of Australia’s stock exchanges to ‘scams and sharp practices’²²⁰ and, more specifically to manipulative practices. Adamson, for

²¹⁴ See, eg, Hall, above n 16, AL Lougheed, *The Brisbane Stock Exchange 1884–1984* (Boolarong Publications, 1984), Adamson, above n 16, Graeme Adamson, *Miners and Millionaires: The First Hundred Years of the People, Markets and Companies of the Stock Exchange in Perth, 1889–1989* (Australian Stock Exchange (Perth) Limited, 1989), R M Gibbs, *Bulls, Bears and Wildcats: A Centenary History of the Stock Exchange of Adelaide* (Peacock Publications, 1998) and Stephen Salsbury and Kay Sweeney, *The Bull, the Bear & the Kangaroo: The History of the Sydney Stock Exchange* (Allen & Unwin, 1988). Other literature in this area includes Gordon R Bruns, *The Stock Exchange* (Gordon R Bruns, 4th ed 1962), William Judd, *The Stock Exchange: Its Organization and Functions* (Sydney Stock Exchange, 2nd ed, 1955), PJ Rose, *Australian Securities Markets* (FW Cheshire, 1969), Keith Sharp, *The House of Mammon: The Stock Exchange at Work* (Hicks Smith & Sons, 1971), FO Steel, *Short Sketch of the Early History of the Sydney Stock Exchange: And Some Particulars About the Working Systems of the London and New York Stock Exchanges* (Publisher unknown, 1939),

²¹⁵ Hall, above n 16, 190–191; Salsbury and Sweeney, above n 214, 150–151.

²¹⁶ ‘(vi) Rules to deal with corners. Notwithstanding the notorious history of corners in share and commodity markets around the world and the existence of rules to deal with them, the Antimony Nickel case (just mentioned) demonstrated that the Sydney Stock Exchange did not have a rule to deal with corners (Ev. 250). To protect member firms against their clients, the Sydney Stock Exchange ultimately followed the New York Stock Exchange rule’: Senate Select Committee on Securities and Exchange, *Australian Securities Markets*, above n 34, 15.11.

²¹⁷ Salsbury and Sweeney, above n 214, 150.

²¹⁸ Hall, above n 16, 190–191.

²¹⁹ According to Hall, this ‘attempt to corner a well-known mining security’ was ‘by no means the only one’: *ibid* 191.

²²⁰ Adamson, above n 214, 54.

example, includes comments from the press in 1889 in relation to a particular gold float, which was believed to have involved a ‘pool to exercise an arbitrary and unauthorised control over the price of the stock’.²²¹ There is also scathing criticism of the stock exchange in Sydney in the 1870s by one of its original members who asserted that it was usual at daily meetings for fictitious sales to be quoted ‘with a view to influence the market’.²²² According to the member in question, this practice ‘at length became so flagrant and glaring that many suggestions were made to the Committee with the view of remedying the evil but without avail ...’²²³

Indeed, according to Bruns in *The Stock Exchange*, ‘creation of a false market is a most serious offence’, which can be caused by a member of the exchange registering a transaction that ‘did not involve a change of ownership’, a form of market manipulation known today as a ‘wash trade’.²²⁴ Where that was found to have occurred, the member in question could be ‘expelled’.²²⁵ It appears that one of the ways in which this type of misconduct was kept in check was through Rule 59, which had been in place since the ‘inception’ of the Melbourne Exchange and which provided: ‘... any member whose published quotation is challenged shall, if so called upon, verify the same to the satisfaction of the Committee’.²²⁶

Sources containing the first-hand recollections of people who lived through the early mining booms in Australia also assist in understanding the general historical context by describing how share trading was conducted in the very early days of Australia’s history. Tilley, for example, provides a description of the operation of a mining exchange in Tasmania that ‘met three times daily’ and included ‘about

²²¹ Ibid 7.

²²² Salsbury and Sweeney, above n 214, 141.

²²³ Ibid 141–142.

²²⁴ Bruns, above n 214, 65.

²²⁵ Ibid.

²²⁶ Ibid. See also RL Matthews, ‘The Stock Exchange, Securities and New Issue Markets, Investment Companies and Unit Trusts’ in Hirst and Wallace, RH (eds), *Studies in the Australian Capital Market*, above n 203 16. This is similar to Rule 12 of the Sydney Stock Exchange referred to in Salsbury and Sweeney, above n 214, 142.

60 members'.²²⁷ He also briefly mentions the large quantities of scrip 'that change hands nightly' in some of the hotels where open mining exchanges were located.²²⁸ Similarly, Calvert provides a contemporary account of how 'pavement stock-brokers' conducted their business in Western Australia in the late 1890s.²²⁹

The pavement stock-broker takes the full licence of the place. He sets up a torch on the side of the side-walk, roars himself hoarse, collects a crowd and chokes the 'gangway'. The stock-in-trade of one of these roaring hawkers of scrip, consists of a strident voice and a good knowledge of the ruling rates of stock. The transactions are conducted on something of the Dutch auction principle; a start is made by the operator announcing that he has a buyer for Devonshires at 49/-, a seller at 65/-. Then he demands to know whether there is a better buyer or a lower seller. He asks the question, perhaps ten or a dozen times – each time more impatiently than before – until, perhaps the buyer will advance 2/6, and the seller will abate 2/6 of the original offer. The public is given the option of claiming the shares ... Sometimes, after ten minutes' chaffering, and a surprising lot of lung power has been expended, no business is done in the line of stock submitted ...²³⁰

As was the case with much of the other literature reviewed, this type of data may not yield much in the way of direct evidence of share price manipulation and how identified instances were dealt with, but it is important both in terms of historical context and potentially corroborating data from other sources with respect to the activities undertaken by those engaged in the buying and selling of shares in Australia in the latter part of the 19th century.²³¹

²²⁷ Wilberton Tilley, *The Wild West of Tasmania: Being a Description of the silver fields of Zeehan and Dundas (1891)* (Evershed, 1891), 36.

²²⁸ Ibid 30.

²²⁹ Calvert, above n 40, 126.

²³⁰ Ibid.

²³¹ See also Withers, above n 202; Cusack, above n 202; John McIlwraith, *A Century of Scripping: The first 100 years of Eyres Reed Limited Stock Broker* (Eyres Reed, 1996); WA Bate, *The Lucky City, The First Generations at Ballarat* (Melbourne University Press, 1978). Literature from the financial markets and economics disciplines is helpful in providing information on the operations of the stock exchange, for example, Hirst and Wallace (eds), *Studies in the Australian Capital Market*, above n 203; Hirst and Wallace, (eds), *The Australian Capital Market*, above n 203; Lewis and Wallace (eds),

Meudell, on the other hand, not only provides similar historical context as Tilley and Calverts with respect to share trading in the late 1800s, which is just as illuminating, but he also reveals his involvement in four ‘corners’.²³²

Amongst the New South Wales gold companies were two in which we had “corners” – Bear Hill, Hillgrove and Earl of Hopetoun. A “corner” is a most amusing and highly exciting event in a Stock Exchange. I took part in four of them, the other two being Round Hill Silver Company at Broken Hill and Duke of York Company at Meredith . . .²³³

Meudell goes on to explain in detail how they were operated.²³⁴

The plan is to form a syndicate to buy, take off the market and put in a Safe Deposit box all the scrip possible up to more than half the register. Then the market price is put up and down and sometimes over sideways to encourage the innocent to “spec-sell” or “bear” them. When the mug speculators (the world is full of them, for they are born at the rate of ten a minute all the time) are well and truly over-sold and the last scrip certificate has been imprisoned, the price is steadily bid up to an impossible and false value and held there. Notices to deliver scrip at once are sent to every broker who is over sold and he has to go to the syndicate, confess he has sinned, and pay whatever the syndicate chooses to exact.²³⁵

This type of literature not only tends to corroborate other information that suggests share price manipulation was occurring in Australia in the late 1800s, but it also provides insight into how it was perpetrated and the attitudes of those engaged in this type of activity. Indeed, according to Meudell: ‘a “corner” is not played like golf, or Mah Jong, or croquet, or rounders, it is not nearly as simple and stupid as these games, but vastly funnier’.²³⁶

Australia’s Financial Institutions and Markets, above n 203. To the extent that there is any information in this type of literature concerning the history of Australia’s stock exchanges, it is brief. In discussing the role of the stock exchange in *The Handbook of Corporate Finance*, for example, Marshman and Davies provide a history of the stock exchanges in Australia from 1828 to 1986 in five short paragraphs: Peter Marshman and Peter Davies, ‘The Role of the Stock Exchange and the Financial Characteristics of Australian Companies’ in Bruce et al (eds), above n 203, 52.

²³² Meudell, above n 41, 87.

²³³ Ibid 87.

²³⁴ According to the *Australian Dictionary of Biography*, George Dick Meudell (1860–1936) became a member of the Stock Exchange of Melbourne in January 1890: Diane Langmore, *Meudell, George Dick (1860–1936)*, *Australian Dictionary of Biography* <<http://adb.anu.edu.au/biography/meudell-george-dick-7564>>. The chronology of events recorded in Meudell’s books suggests that he was a Member of the Stock Exchange of Melbourne at the time

²³⁵ Meudell, above n 41, 87.

²³⁶ Ibid.

There is a small amount of more recent literature that purports to document the history of the local stock exchanges and the experiences of stockbrokers during the nineteenth century gold rushes. Kincade, for example, provides an account of life in Ballarat in the 1800s for those who gathered to discuss and conduct mining business at 'The Corner', which eventually became a popular location for the trading of shares in mining companies.²³⁷ According to Kincade, the regular participants who operated at 'The Corner' from the 1850s assumed for themselves over time the title of share brokers, modelled themselves on 'their British counterparts' and 'loosely' adopted the 'rules of the London Stock Exchange'.²³⁸ Indeed, she claims that 'The Corner' was 'essentially Australia's first Stock Exchange'.²³⁹

Tilston, on the other hand, casts a much wider net and traces what he terms the 'rise and eclipse' of the domestic stock exchanges, from the 'boisterous meeting places' on dusty corners of provincial mining towns where 'shysters, charlatans and gamblers rubbed shoulders with men of high integrity'²⁴⁰ through to the high frequency trading of contemporary Australia.²⁴¹ He also endeavours to place the development of the local stock market in its historical context by drawing a line from its 'antecedents' in London,²⁴² through the gold rushes that predicated the establishment of the early rudimentary markets for share trading to the challenges of the present day where trading is 'more complex and frequently involves little human involvement'.²⁴³ However, whilst Kincade and Tilston's works are welcome additions to the ever growing literature on the history of the stock markets in Australia, like much of the literature reviewed there is not much information provided that materially assists in tracing the historical roots of share price manipulation from a domestic perspective.

²³⁷ Julie Kincade, *To the Miner Born: A Stockbroker's Life in the Ballarat Gold Rush* (JI Kincade, 2015), 21–23. See also J.B. Were & Son, above n 2, 71.

²³⁸ Kincade, above n 237, 22.

²³⁹ Ibid.

²⁴⁰ John Tilston, *Bull Market: The Rise and Eclipse of Australian Stock Exchanges* (The Yellow Sail Company, 2016), iii.

²⁴¹ Ibid 174.

²⁴² Ibid: From the title of Chapter 1, 'The antecedents: London sets the tone'.

²⁴³ Ibid 180.

That being said, Tilston does make brief reference in his work to, arguably, one of the most significant market manipulation cases in Australia involving Nomura International in 1996²⁴⁴ and, more recently, the conviction in 2014 of Jonathan Moylan for manipulating the market in Whitehaven Coal shares by spreading a false rumour that ANZ Bank had withdrawn a \$1.2 billion loan to Whitehaven over environmental concerns about one of its developments.²⁴⁵ In discussing the importance of information such as this to stock markets, Tilston makes the observation that ‘news, information, data can all be manipulated in the short term to create an edge for the unscrupulous and there is a history of such dodgy dealing’.²⁴⁶ Yet, despite this tantalising morsel of information, unfortunately, he does not elaborate any further on that history.

Although both Kincade and Tilston’s works contain a list of sources/references they have relied upon in completing their respective publications, and whilst much of the information appears to be consistent with that contained in other literature reviewed, there is no referencing (for example, footnotes or endnotes) throughout, which makes it difficult to validate and investigate further the sources for many of the assertions being made by the authors.

V CONCLUDING REMARKS

To paraphrase Loss, the occurrence of share price manipulation in Australia did not spring forth fully formed like Athena from the brow of Zeus in the late 1960s.²⁴⁷ Rather, it would seem to have a history that stretches much further back in time than the current legal literature would otherwise suggest.

²⁴⁴ Ibid 149–151. This case ‘involved sophisticated arbitrage trading activities across the equities and futures markets, numerous transactions as well as persons of interest and witnesses located inter-state (Sydney and Melbourne) and in international jurisdictions (Sydney, Hong Kong and London)’: Constable, ‘Ferocious Beast’ above n 13.

²⁴⁵ Ibid 155.

²⁴⁶ Ibid 147.

²⁴⁷ Loss, *Fundamentals of Securities Regulation*, above n 42, 1.

As is apparent from the above discussion, whilst there are a large number of high quality journal articles and texts that document the development of local securities regulation from the 1970s, there appears to be no single source that comprehensively documents the history of share price manipulation in Australia, from its origins to its many and varied contemporary manifestations. In addition, the publication of literature on this particular form of market misconduct appears to have only really started to gain traction in the 1970s, following the criminalisation of, relevantly, market manipulation under the *Securities Industry Act 1970* in four Australian States and the publication of the Rae Report, as well as the consequent reforms that were implemented domestically in its wake. Yet, there is a distinct paucity of literature on share price manipulation in the years prior to 1970. This is surprising given that there is information available to suggest that the historical roots of share price manipulation stretch back as far as the latter part of the 1800s and, in some cases, almost a century before it became the focus of domestic State and Federal government attention. Moreover, despite the fact that share price manipulation has been, and continues to be, intrinsically linked with the markets for share trading operated by the stock exchanges in Australia, there appears to be comparatively little written on the role of the exchanges in combating this insidious activity.

Understanding the causes of share price manipulation in Australia and filling these apparent research gaps will not only make a valuable contribution to the advancement of knowledge in this area, but it may allow for consideration of what lessons can be learnt from this history. This, in turn, may assist those currently responsible for combating share price manipulation in evaluating their ongoing efforts to maintain local securities markets that are fair, orderly and transparent.²⁴⁸

²⁴⁸ Australian Securities and Investments Commission, *Our Role*, <<https://asic.gov.au/about-asic/what-we-do/our-role/>>. As noted by Kaye J in *R v Jacobson* [2014] VSC 592, the ‘express objective of s 1041A of the *Corporations Act* [‘Market manipulation’] is to promote a fair, orderly and transparent market for registered securities’: at [41].

DEFICIENCIES IN AUSTRALIA'S CURRENT MERGER REGIME: THE CALL TO COMBAT CREEPING ACQUISITIONS

ASHLEIGH CAVAGNINO*

ABSTRACT

Competition and Consumer Act 2010 (Cth) – Australian Competition and Consumer Commission – Market Regulation – Creeping Acquisitions – Substantial Lessening of Competition – Supermarkets

The ACCC does not have adequate tools to prevent anti-competitive 'creeping acquisitions' under the Competition and Consumer Act 2010 (Cth) ('CCA').

Firms engaging in creeping acquisitions perform a number of small piecemeal mergers or acquisitions that, when considered in isolation, do not fall foul of the existing mergers and acquisitions test, but when considered in cumulative, do in fact have the effect of substantially lessening competition in the market.¹ For example, if a major chain were to buy out 100 stores in one transaction that would come under the ACCC's spotlight. If the same chain made those same acquisitions one by one, as part of a strategic plan to acquire that same level of market share over a period of years, it would be very difficult for the ACCC to find that each acquisition on its own represents a substantial lessening of competition.²

Over the past 40 years, Australia has seen the demise of hundreds of small grocery stores, butchers, bakers, florists, greengrocers, pharmacists, newsagents, liquor outlets and other small retailers as a direct result of the continued expansion of the major supermarket chains utilising this practice.³

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¹ Chris Bowen MP, 'Creeping Acquisitions' (Discussion Paper, Consumer Affairs, 5 August 2008).

² Senate Economics References Committee, Parliament of Australia, *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* (2004) 60.

³ Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia's Retailing Sector* (1999) ('the Baird Report'), vii.

Using the Australian supermarket sector as a case study, this article identifies the manner in which creeping acquisitions offend the anti-competitive policy upon which the CCA was founded and recommends legislative and administrative changes that would enable the ACCC and the Courts to adequately regulate creeping acquisitions.

I INTRODUCTION

The expression ‘creeping acquisitions’ refers to a number of small individual mergers or acquisitions that, when considered in isolation, do not have a sufficient impact on competition to breach s 50, but when considered together, have a cumulative effect of substantially lessening competition in a market.⁴

This article addresses the failure of Australia’s current merger regime to adequately regulate and prevent creeping acquisitions.

Significant research was conducted in preparing this article and is presented in Six Chapters. Chapters One to Four discuss the issue of creeping acquisition in the context of Australia’s current merger provisions. Chapter Four contrasts this to the regulatory approach taken by other Organisation for Economic Co-operation and Development (‘OECD’) jurisdictions. This draws out and critically analyses the strengths and weaknesses in Australia’s legislative regime.

After discussing observations as to the scale and reach of the issue, Chapter Five will conclude with a number of recommendations. These include: reinterpreting the objects clause of the CCA to widen the ambit of protections; aggregating all previous piecemeal acquisitions over a two-year period so as to capture the totality of multiple transactions; and introducing additional mechanisms such as mandatory notification and Commissioner’s declarations to pinpoint firms and industries that may be predisposed to the engagement of this practice.

This article will primarily focus on the impact of this practice in the Australian supermarket and grocery sector and extrapolate from this the threat posed to other markets.

⁴ Bowen, above n 1.

II IS THERE A NEED TO REGULATE CREEPING ACQUISITIONS IN AUSTRALIA?

A Introduction

The preservation of competition is highly desirable – it brings benefits to consumers such as: lower prices, higher quality and greater variety of goods and services, and continual innovation. By contrast, the broader economic impact of reduced competition will likely include higher prices, reduced quality and variety of goods and services, fewer gains in efficiency and productivity, and reduced innovation.

The process of competition necessitates competitors. The greater the number of efficient competitors, the greater likelihood of vigorous competition in the market place. The fewer the competitors and the more concentrated the relevant market, the greater the likelihood of ‘price coordination’ or even collusion.⁵

Competition inevitably results in harm to less efficient competitors – leading to a reduction in sales and potentially being forced to exit the market. Competition therefore benefits consumers rather than competitors.

As discussed in Chapter Three, s 50 prohibits mergers and acquisitions that will have the effect or likely effect of substantially lessening competition in any market. But, as will be argued, s 50 looks at each transaction in isolation. It doesn’t allow for aggregating successive transactions. This permits entities to circumvent the operation of s 50 by growing in market dominance through a succession of small transactions not large enough to attract the operation of s 50 – that is, creeping acquisitions.

This Chapter considers creeping acquisitions that have occurred to date and the risks of them occurring in the future. It argues that the supermarket sector has seen an increase in market concentration, partly due to creeping acquisitions. It posits that Australia has several oligopolistic markets that are susceptible to future creeping acquisitions. It also looks at some of the current characteristics of the supermarket

⁵ Frank Zumbo, Submission No 14 to Senate Economics Legislation Committee, *Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment)* Bill 2009, January 2010, 12.

industry and argues that these characteristics are not in the best interests of consumers or other market participants.

This article pursues the implications of a statement made by Peter McDonald, Marketing Lecturer at the University of Sydney – namely, the anomaly of having two grocery chain owners dominating so many different sectors of the Australian market⁶ This leads to anti-competitive conduct which in other markets may not be considered so harmful – hence the strong emphasis in the following pages on consumer choice, the need to guard against predatory conduct and ‘predatory capacity’, the benefits of preserving small independent retailers and the growing significance of vertical integration. In many markets, conduct of this kind could be evidence of vigorous and even necessary competition. This is often not the case in the Australian grocery market. As a consequence, this article contains comments and observations which, at first glance, might seem insupportable in other markets but which, upon reflection, do have a clear method and intention about them. That should also be clear from the conclusions this article draws in Chapter Five – where suggestions are made to enlarge the CCA’s preamble, include an additional merger factor and provide for mandatory notification. All of these suggestions might appear unnecessary in normal, functional markets. However, this article argues that they are necessary in the present case.

This article will now consider some of the inherent characteristics of Australian markets. Australia is a relatively young economy, which is geographically isolated from other larger markets and has a comparatively smaller population. However, it possesses some of the most highly concentrated markets in the OECD.⁷ To illustrate this, Australia is a market of only 25 million people.⁸ It has a gross domestic product (‘GDP’) of US\$1,229.6 billion.⁹ By comparison, the

⁶ Sarah Whyte, *Pharmacies Next Target Of Big Two, Say Analysts* (2013) *The Sydney Morning Herald* <<http://www.smh.com.au/data-point/pharmacies-next-target-of-big-two-say-analysts-2013092-7-2ujm0.html>>.

⁷ Rod Sims, ‘Thoughts on Market Concentration Issues’ (Speech delivered at the Australian Food and Grocery Council Industry Leaders Forum, Canberra, 30 October 2013).

⁸ Australian Bureau of Statistics (2018), *Australian Demographic Statistics*,

⁹ OECD (2017), *OECD Economic Surveys: Australia 2017*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/eco_surveys-aus-2017-en>. <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/3101.0>>.

European Union ('EU') is a market of 508.5 million people with a GDP of US\$16,224 billion,¹⁰ and the North American Free Trade Area¹¹ is a market of 476 million people with a GDP of US\$20,650.4 billion.¹² Despite its significantly smaller size, Australia has a disproportionate number of Fortune top 500 global companies prevalent in the mining,¹³ banking,¹⁴ telecommunications¹⁵ and retail industries.¹⁶

A deeper examination of these industries highlights just how concentrated Australian markets are. In the supermarket and grocery industry, the top three firms control more than 70% of the market, with Wesfarmers and Woolworths alone controlling 67.7%.¹⁷ In the banking and finance sector, the top four firms control over 70% of the market.¹⁸ In telecommunications, the top three firms control 65% of the market, with no firm in the remaining 35% controlling more than 5% market share.¹⁹ In the mining industry, the top two firms control approximately 30% market share, again with no other player controlling more than 5%.²⁰ The definition of a major player is a company that operates primarily within the relevant industry and generates over 5% of industry's revenue.²¹ Therefore, outside these top firms, there are no major competitors in these markets. The table below compares the concentration levels in Australian markets against their US counterparts:

¹⁰ OECD (2016), *OECD Economic Surveys: European Union 2016*, OECD Publishing, Paris.

<http://dx.doi.org/10.1787/eco_surveys-eur-2016-en>.

¹¹ Canada, Mexico and the United States

¹² OECD (2016), *OECD Economic Surveys: United States 2016*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/eco_surveys-usa-2016-en>; OECD (2016), *OECD Economic Surveys: Canada 2016*, OECD Publishing, Paris.

<http://dx.doi.org/10.1787/eco_surveys-can-2016-en>; OECD (2017), *OECD Economic Surveys: Mexico 2017*, OECD Publishing, Paris.

<http://dx.doi.org/10.1787/eco_surveys-mex-2017-en>

¹³ BHP-Billiton and Rio Tinto.

¹⁴ National Australia Bank, Commonwealth Bank, Australia and New Zealand Banking Group and Westpac.

¹⁵ Telstra alone exudes dominance generally, but also Optus and Vodafone in provision of specific services.

¹⁶ Woolworths and Wesfarmers/Coles.

¹⁷ Nathan Cloutman (on behalf of IBISWorld), *Supermarkets and Grocery Stores in Australia*, Industry Report G4111 (2018).

¹⁸ Tommy Wu, *Finance in Australia*, IBISWorld Industry Report K6200 (2016).

¹⁹ Brian Lo, *Telecommunications Services in Australia*, IBISWorld Industry Report J5800 (2017).

²⁰ Alen Allday, *Mining in Australia*, IBISWorld Industry Report B (2017).

²¹ Lo, above n 19.

Table 1.1 Three stark examples: the US v Australia²²

Industry	Market share of major AU firms	Market share of major US firms
Commercial banking	70%	28% ²³
Supermarkets	80%	31% ²⁴
Telecommunications	65%	30% ²⁵

This composition is apparent in many other Australian markets including airlines,²⁶ paper and packaging,²⁷ print media,²⁸ and beer industries.²⁹ These characteristics increase the potential for firms to merge to achieve market power, or those holding substantial market power to exploit that power by engaging in uncompetitive behaviour.³⁰ Australia's comparatively small size and geographical isolation make the market less able to correct for prolonged anti-competitive behaviour. The market share of dominant firms and Australia's isolation from the rest of the world create a sizeable barrier to entry.³¹ With the exception of concentration, no social, economic, political or legislative response can alter these characteristics.

²² Andy Kollmorgen, 'Squeezing out the Competition' *Choice*, 2016.

²³ Wells Fargo & Company (12.6%), JP Morgan Chase & Co. (9.1%) and Bank of America Corporation (7.1%) see Viraj D'Costa, *Commercial Banking in the US*, IBISWorld Industry Report 52211 (2017).

²⁴ The Kroger Co (15.8%), Albertsons companies LLC (9.9%) and Publix Super Markets Inc. (5.7%) see Meghan Guattery, *Supermarkets & Grocery Stores in the US*, IBISWorld Industry Report 44511 (2017).

²⁵ AT&T Inc. (20%), Century Link Inc. (7.4%) and Verizon Communications Link (3%).

²⁶ Virgin and Qantas.

²⁷ Visy and Amcor.

²⁸ News Corporation and Fairfax.

²⁹ Lion Nathan and Carlton United Breweries control over 90% of beer taps nationwide.

³⁰ Mika Oinonen, *Does EU Merger Control Discriminate Against Small Markets Companies? Diagnosing the Argument with Conclusions* (Kluwer Law International, 2010), 329.

³¹ Frank Zumbo, 'Don't Bank on Bank Competition: The Case for Effective Laws Against Anti-competitive Mergers and Creeping Acquisitions' (2010) 18 *Trade Practices Law Journal* 26, 1–2.

This Chapter will examine Australia's grocery industry – where creeping acquisitions have been the most prolific. As a microcosm of the Australian market place, the grocery sector provides a case study of the dangers associated with highly concentrated markets which have been partly achieved through creeping acquisitions.

B Case Study: *The Supermarket and Grocery Sector – a Microcosm of the Australian Market Place*

1 *An Example of Creeping Acquisitions in Australia*

The creeping acquisition reforms suggested by this article have been influenced by Australia's experience of creeping acquisitions in the food and grocery retailing sector and the adverse consequences of the current concentrated market structure for suppliers, competing smaller businesses and, to a lesser extent, consumers. It is acknowledged that not all increases in market power have been due to creeping acquisitions. The grocery sector has inherent features that make it susceptible to anti-competitive outcomes. These include very high levels of market concentration, extensive vertical integration³² and high barriers to entry. The negative outcomes discussed below have a broader focus than just consumer welfare. It is acknowledged that the CCA is largely concerned with consumer welfare, through protecting the process of competition (rather than competitors). However, this article argues for a broader focus.

The Australian retailing sector provides a vast array of products to consumers through a wide range of outlets. Food retailing in Australia is defined under the Australian and New Zealand Standard Industrial Classification³³ to include supermarkets and grocery stores (including convenience stores) and specialised food retailers.³⁴

³² Vertical integration is a strategy where a company expands its business operations into different steps on the same production path, such as when a manufacturer owns its supplier or distributor.

³³ Abs.gov.au, 1292.0 – *Australian And New Zealand Standard Industrial Classification (ANZSIC)*, 2006 (Revision 2.0) (2015) <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/1292.0>>.

³⁴ Specialised food retailers include retailers that sell fresh meat, fish and poultry, fruits and vegetables, confectionery, liquor, non-alcoholic drinks, small goods, baked goods not manufactured on premises, and any other specialised food items.

Both Coles and Woolworths have a long history of expansion through acquisition. Rapid urbanisation in Australia in the 1950s and 1960s created economic conditions favouring the establishment of supermarkets as the dominant food store format. Woolworths and Coles moved away from variety store bases to supermarket operations through a combination of organic growth and the acquisition of small chains such as BCC in Brisbane and Flemings in Sydney.³⁵

In the 1970s and 1980s, Coles and Woolworths acquired four major competitor discount chains – Franklins in NSW; Bi-Lo in South Australia; Shoeys in Victoria and Jack the Slasher in Queensland.³⁶ Within the same decade, another 126 Safeway stores in eastern Australia were purchased by Woolworths.

In 1981, Woolworths moved into the electronics market with the acquisition of Dick Smith Electronics. This continued in 2001 with the acquisition of the Tandy chain in Australia from InterTan. In 1999, Coles expanded into computer hardware by acquiring Harris Technology.

The late 1990s saw the expansion of Coles and Woolworths into ‘express’ or ‘metro’ stores. These scaled-down ‘convenience’ stores were located in high-traffic metropolitan areas and successfully competed against stores such as 7-Eleven by offering a better-balanced portfolio of products with high convenience and at more reasonable prices.

A submission by NARGA in response to the *Inquiry into the Competitiveness of Retail Prices for Standard Groceries* (2008) (‘Grocery Inquiry’) reported that acquisitions in the period of 1993–2007 represented 39% of the growth in the number of sites of major chains, making a substantial contribution to their market share growth over that period.³⁷

³⁵ Kyle W Stiegart and Dong Hwan Kim, ‘Structural Changes In Food Retailing: Six Country Case Studies’ (2009), 22.

³⁶ Franklins, Submission to the Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia’s Retailing Sector* (1999), 200.

³⁷ National Association of Retail Grocers of Australia Pty Ltd, Submission to the Australian Competition and Consumer Commission, ‘Creeping Acquisitions’ (2008) 3.

In 1996, Bi-Lo, operated by Coles, acquired six Newmart discount supermarket stores in Western Australia. By 2002, this grew to 16 stores. In 1998, Woolworths expanded into the liquor businesses with the acquisition of Dan Murphy's.

The 2000s saw the acquisition of the retail fuel operations of Shell Australia, with the fuel outlets rebranded as Coles Express to counter Woolworths' similar move with Caltex. These alliances with major petrol refiners/retailers and petrol store ownership enabled Coles and Woolworths to offer discount petrol as an incentive for customers who shop in their stores.

In 2005, Woolworths acquired 23 demerged Foodland Action supermarkets. In the same year, a joint venture between Woolworths and hotel operator Bruce Mathieson purchased the Australian Leisure and Hospitality Group ('ALH'). Later that year, ALH expanded its portfolio to 250 hotels by acquiring the Taverner Hotel Group and the Bruce Mathieson Group.

Preceding the acquisition of the Coles Group, Wesfarmers' expansion was also spurred on by an agenda of acquisitions including, but not limited to, CSBP (a manufacturer and supplier of chemicals), Western Collieries, Bengalla Deposit, MDL and Curragh mining operations, Dalgety and IAMA rural merchandise wholesaler and retailers, Bunnings Warehouse and Howard Smith hardware networks, Australian Railroad Group freight operator, Lumley Finance Australia and New Zealand, OAMPS Insurance Brokers, Coregas, Australian Vinyls and Greencap Limited.

In 2010 to 2011, the Australian grocery industry was worth \$130.6 billion, accounting for around 10% of the Australian economy. With a population of 25 million,³⁸ Australia is significantly smaller than the United States ('US') and United Kingdom ('UK'), yet has more supermarkets per capita than the US and nearly three times as many as the UK.³⁹

³⁸ OECD (2017), *OECD Economic Surveys: Australia 2017*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/eco_surveys-aus-2017-en>.

³⁹ Stuart Alexander Website Development Link Digital, *Australian Market – Stuart Alexander & Co: Premium FMCG Specialist Marketers, Distributors And Importers* (2015) [Stuartalexander.com.au](http://www.stuartalexander.com.au) <http://www.stuartalexander.com.au/aust_grocery_market_woolworths_coles_wholesale.php>.

The Australian grocery retailing industry is accurately described as a duopoly. It is dominated by two large vertically integrated retailers, each with significant economic influence and market power – Coles (until recently part of Wesfarmers Limited) and Woolworths Limited possess 30.9% and 36.8% market share respectively.⁴⁰ Woolworths Limited and Wesfarmers Limited were ranked the 18th and 22nd largest retailers in the world respectively by Deloitte's Global Powers of Retailing 2013 report.⁴¹ These two companies take in 40 cents in every retail dollar spent in Australia.⁴²

By total revenue, Woolworths is ranked number 2 of the top 2000 companies in Australia. In 2017, the company generated total revenue of \$55 billion, including sales and other services. In 2017, Woolworths had 202,000 employees in Australia, including employees from all subsidiaries under the company's control.⁴³

Wesfarmers Limited is one of Australia's largest diversified companies. Wesfarmers' industry specific revenue is expected to be \$31.2 billion dollars in 2017/18.⁴⁴

This high level of retail concentration is unprecedented. As stated above, a significant contributing factor has been the number of creeping acquisitions that, little by little, have augmented the retail dominance of the two chains.

The Report by the Joint Select Committee on the Retailing Sector titled *Fair Market or Market Failure? A Review of Australia's Retailing Sector* (1999) ('Baird Report') was the first contemporary review to identify the significant role that creeping acquisitions played in the rise to dominance of the major supermarket chains. However, as early as 1936, the Industrial Commission of New South Wales was directed to inquire and report on the management, control and operation of chain stores in that State. The terms of reference focused on the effects of the chain stores, which included Coles and Woolworths, on other parties, including producers, wholesalers, storekeepers and consumers, and

⁴⁰ Cloutman, above n 17.

⁴¹ Deloitte, *Global Powers of Retailing 2015* (2015), 2 <<http://www2.deloitte.com/content/dam/Deloitte/au/Documents/consumer-business/deloitte-au-cb-gpor-120115.pdf>>.

⁴² National Association of Retail Grocers of Australia Pty Ltd, above n 37, 2.

⁴³ IBIS World, *Woolworths Ltd*, Company Premium Report (2017).

⁴⁴ Cloutman, above n 17.

whether there was any evidence of unfair competitive practices or undue restraints of trade.⁴⁵

Since that time, Australia has experienced a half-century of food retail development culminating in significant market concentration. Current day concerns have been taken up by the major political parties, particularly during the 1998 election campaign, with a commitment by the Coalition party to set up an enquiry into retail domination as soon as possible after the election.⁴⁶ Since that time, a myriad of Government reports focused on corporate behaviour in the grocery sector have been conducted.

The majority of submissions to the Trade Practices Act Review Committee – Review of the Competition Law Provisions of the Trade Practices Act in 2003 (‘Dawson Review’)⁴⁷ made reference to the retail grocery market as a prime example of creeping acquisitions which may ultimately result in the significant lessening of competition.⁴⁸

On 5 August 2008, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon. Chris Bowen MP, released the Government’s preliminary action plan in response to the Grocery Inquiry.⁴⁹ This was the original call for tangible legislative reform addressing creeping acquisitions. The ACCC stated that the particular structural features of the supermarket industry meant that acquisitions by Coles and Woolworths of small independent supermarkets were a potential competitive concern and those acquisitions were unlikely to be prohibited under current legislative provisions.

The Grocery Inquiry also reported the Herfindahl–Hirschman Index (‘HHI’)⁵⁰ for the retailing of packaged groceries to be between 2750 and

⁴⁵ Baird Report, above n 3, 3.

⁴⁶ Ibid, 1.

⁴⁷ Trade Practices Act Review Committee, Commonwealth of Australia, *Review of the Competition Law Provisions of the Trade Practices Act (2003)* (‘The Dawson Review’).

⁴⁸ Julie Clarke, Submission to the Australian Competition and Consumer Commission and Treasury, *Creeping Acquisitions, Discussion Paper 1*, 2011, 2.

⁴⁹ Bowen, above n 1, 1.

⁵⁰ As discussed in Chapter Three, the HHI is a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers, and can range from close to zero to 10,000.

3000.⁵¹ The Merger Guidelines consider markets that generate a HHI of greater than 2000 to be concentrated for the purposes of notification. By the ACCC's own definition, the market for packaged groceries is concentrated.

The Australian Airports Association, NRMA, Retail Guild of Australia, Council of Small Business Australia, Friends of Hawker Village, Metcash and Australian United Retailers Limited trading as Foodworks have all called for changes to address creeping acquisitions.⁵²

2 *The Materialisation of Harm*

After a string of acquisitions and expansions, it is clear that Woolworths and Coles dominate the Australian supermarket retail sector. Coles and Woolworths have utilised their position to expand into a vast range of Australian industries, including insurance, petrol, liquor, clothing, data companies, office supplies, hotels, gaming, mining and hardware, and intend to move directly into pharmacy operations to compete with legislatively-protected specialised pharmacy/chemist stores. Peter McDonald, Marketing Lecturer at Sydney University commented: 'it's an anomaly worldwide to have ... two owners dominating so many different sectors'.⁵³

Consumers, retail competitors, suppliers, wholesalers, producers and manufacturers have all felt the impact of this. They require a pro-competitive environment that encourages investment and innovation, choice, variety, value and responsiveness in the long term. Benefit means a lot more than just short-term low prices. Forward looking regulation must be adopted to ensure consumers will not be worse off in the end.

(a) *The Impact on Consumers – Reduced Variety, Quality and Service*

The following discussion identifies areas where consumers could legitimately claim that the Coles/Woolworths duopoly has resulted in their being worse off.

⁵¹ National Association of Retail Grocers of Australia Pty Ltd, above n 37, 5.

⁵² Commonwealth of Australia, 'Report on Competition Policy Review' (2015) 265 (*Harper Report*).

⁵³ Sarah Whyte, *Pharmacies Next Target Of Big Two, Say Analysts* (2013) *The Sydney Morning Herald* <<http://www.smh.com.au/data-point/pharmacies-next-target-of-big-two-say-analysts-20130927-2ujm0.html>>.

Part of consumer welfare involves consumers having a variety of goods and services to choose from. Coles and Woolworths have utilized their position as vertically integrated suppliers and retailers with significant market power to reduce and eliminate other brands in favour of their own multi-tiered private label products. The lack of competition in the retail market makes it difficult for consumers to purchase those branded goods elsewhere, resulting in an overall reduction in the variety available to consumers.

According to the Australian Food Grocery Council cited in the KPMG Report – Competitiveness & Sustainable Growth⁵⁴ ('KPMG Report'), the number of branded products retired in FY13 was the highest over the previous four years, while the number of private label products retired that year was the lowest. In the same year, 88 new private label products and 1048 new branded products were introduced. In comparison, 211 private label products and 1743 branded label products were retired. That is, there was a net reduction in variety. Retail data suggests that the share of the AU\$1.6 billion bread market held by private label products grew from 11% to 19% from 2008 to 2009 while the share held by major manufacturer Goodman Fielder fell from 42% to 34.5% over the same period.⁵⁵

Market analytics organisation Roy Morgan Research found that only 52% and 56% of customers who shop at Coles and Woolworths respectively say their supermarket stocks the brands they want, and these numbers have been declining since a peak in 2011.⁵⁶ Forty-eight per cent of IGA's customers said they could find the brands they want, while only 29% of ALDI shoppers expressed the same. General Manager of Consumer Products at Roy Morgan Research, Geoffrey Smith commented:

⁵⁴ Australian Food and Grocery Council, 'Competitiveness & Sustainable Growth' (June 2014).

⁵⁵ Stiegart and Kim, above n 35, 25.

⁵⁶ Sophie Langley, 'Australian Supermarket Consumers Miss Branded Food Products', *Australian Food News* (5 August 2013) <<http://ausfoodnews.com.au/2013/08/05/australian-supermarket-consumers-miss-branded-food-products.html>>.

[O]ver the last few years, an increasing number of well-known brands have been replaced on supermarket shelves with stores' own home brands – and it appears shoppers are noticing the absence.⁵⁷

CHOICE – a leading independent consumer advocate, surveyed members regarding the prevalence of their favourite brands. The response was described as overwhelming with comments such as:

1. '[m]ore and more I find I have to drive around town to get the products I'm looking for.'⁵⁸
2. 'I'm sick of having to chase my favourite products down.'⁵⁹
3. 'Pretty much everything I used to buy is getting less shelf space, only to be replaced with the three varieties of shop brand.'⁶⁰

The issue is not the disappearance of brands per se because in a competitive market, weaker competitors will be eliminated. Rather, it is the disappearance of brands that are otherwise popular with consumers, due to the vertically integrated Coles/Woolworths duopoly either failing to stock those brands, failing to stock those brands in sufficient quantities to make them viable, failing to display those brands in ways that enable them to compete or purchasing those brands at prices that are unsustainable for the suppliers.

CHOICE reported on the experiences of a company's managing director in dealing with Coles: they would only stock his product behind obstructions and refused the use of promotions in stores or catalogues. 'It made it impossible for us to compete.' Eventually his product was retired due to lack of sales. He commented: 'We suspect what they were really doing was targeting products they wanted to delete so that it would be easier to justify in six to eight months' time'.⁶¹

Tim Morris, managing director of New Zealand strategic management consulting and market research firm Coriolis Research commented:

At the end of the day, the retailer owns the store and can do whatever they want. They can put rival products on the bottom of the shelf, and their own products at eye level. They can manipulate the price. The only controls are competition and the consumer.⁶²

⁵⁷ Ibid.

⁵⁸ Elise Dalley and Zoya Sheftalovich, 'The Situation on the Supermarket Shelves' *CHOICE*, 11 September 2014.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Dalley and Sheftalovich, above n 58.

⁶² Ibid.

Another report by CHOICE told of Mark (name changed) who had his organic product retired directly after Woolworths acquired the Macro wholefoods label. Following steady sales for three years, Woolworths' category buyer told him there was only room for one organic label – Macro.⁶³ Products that do not maximise profits fall by the wayside. A very popular item with low margins is not worth the shelf space.

Another example is the bankruptcy of wholly Australian-owned cannery, Windsor Farm Foods, who packed for Edgell, Cowra Gold and Lachlan Gold.⁶⁴ It has been alleged that part of the reason was the pressure which Coles and Woolworths placed on growers and food manufacturers.⁶⁵

There are other examples. In 2011, Woolworths replaced the entire range of Allsep's bagged lollies with Chinese imports, thus replacing a brand in circulation since 1934.⁶⁶ In January 2012, Heinz Australia closed its tomato sauce factory in Gigarre, Victoria. Heinz's Golden Circle beetroot and fruit processing facility in Queensland's Lockyer Valley shared a similar fate as its business was partly relocated outside Australia and New Zealand.⁶⁷ Factories in Northgate, Brisbane, Wagga Wagga and New South Wales have undergone downsizing.⁶⁸ 'Greenseas', one of Heinz's popular brands, reported significant deletions in lieu of Coles' private label brand.⁶⁹

Gourmet Food Holdings, which owns the iconic brands Rosella and Aristocrat, as well as Galiko, the Curry Makers, Blue Banner Onions, Artisano, Waterthins, Waterwheel, and Stromboli branded condiments, was unable to cope with strategies adopted by Coles and Woolworths and went into liquidation in 2012.⁷⁰

⁶³ Ibid.

⁶⁴ Sophie Langley, 'Last Australian Food Cannery Turns off the Light', *Australian Food News* (14 August 2013) <<http://ausfoodnews.com.au/2013/03/14/last-australian-food-cannery-turns-off-the-light.html>>.

⁶⁵ Ibid.

⁶⁶ Stuart Washington, 'Consumers May be Winning but at a Hefty Cost to the Food Industry' *The Sydney Morning Herald*, 26 November 2011.

⁶⁷ Langley, above n 64.

⁶⁸ Matt Paish, 'AFGC Renews Calls for Government Action on Factory Closures', *Australian Food News* (9 January 2012) <<http://ausfoodnews.com.au/2012/01/09/afgc-renews-call-for-government-action-on-factory-closures.html>>.

⁶⁹ Washington, above n 66.

⁷⁰ Ferrierhodgson.com, *The Gourmet Group* (2015) <<http://www.ferrierhodgson.com/au/administrations/the-gourmet-group>>.

For a succession of years, Coca-Cola Amatil has carried the losses of its subsidiary SPC Ardmona ('SPCA'), the last remaining fruit processor in Australia. In 2013, significant workforce restructuring and downsizing was made by management to maximise efficiency and save the industry. This included SPCA's cannery operations in Victoria's Goulburn Valley and Murray Valley.⁷¹ Although SPCA secured a \$70 million supply deal with Woolworths, it is reported that this deal will only allow SPCA to break even. This can be compared to the previous deal, which saw SPCA run at a 30% loss.⁷²

In 2016, IBISWorld reported that approximately one in three products on supermarket shelves were private label⁷³ and it is predicted that the private label products' global market share will double to 50% by 2025.⁷⁴

In the cases where entire brands have collapsed, consumers are also no longer able to source these brands from independent or rival retailers.

In addition to variety, consumer welfare also requires quality goods and services. In 2014, Mr Sims, Chairman of the ACCC, noted examples of a decline in quality of products due to the private label market. In an article published in the *Financial Review*, Mr Sims said:

Major retailers are sourcing private label and branded products more cheaply from overseas by cutting out "middleman" distributors and agents. They do not have proper systems and processes in place to ensure that the products they import comply with Australian safety standards.⁷⁵

These comments followed legal action led by the ACCC against Woolworths for selling faulty products such as deep fryers, drain cleaners, folding stools and safety matches.⁷⁶

Ironically, competitors of Coles and Woolworths such as ALDI and Costco compete on price, resulting in necessary reductions in product

⁷¹ Sharman Stone, 'Hon Dr Sharman Stone Speech' (Media Release, 6 May 2014) <<http://spcardmona.com.au/en/media-room/media-releases?article=/Hon%20Dr%20Sharman%20Stone%20MP%20House%20of%20Representatives%20speech>>.

⁷² Jared Lynch, 'Growers Welcome \$70m Woolworths Deal with SPC', *The Sydney Morning Herald* (online), 11 March 2014 <<http://www.smh.com.au/business/growers-welcome-70m-woolworths-deal-with-spc-20140311-34k0d.html>>.

⁷³ Zoya Sheftalovich, *Choice Supermarket Investigation*, (11 September 2014) Choice <<https://www.choice.com.au/shopping/everyday-shopping/supermarkets/articles/choice-supermarket-special>>.

⁷⁴ Rabobank, 'Producing Both Brands and Private Label' (May 2012), 9.

⁷⁵ Sue Mitchell, 'Faulty products don't wash with ACCC' *The Australian Financial Review*, 18 September 2014.

⁷⁶ *Ibid.*

variety and quality of service. ALDI operates on a discount supermarket format with limited product assortment⁷⁷ and service. Ninety per cent of its products are private label brands delivered to stores via one of ALDI's centralised distribution centres.⁷⁸

While this limited range is advertised by ALDI as a benefit to consumers – being a carefully selected range of products, designed to match the needs of a price conscious consumer,⁷⁹ the real benefit achieved is the ability for ALDI to operate out of smaller stores⁸⁰ – reducing overheads such as rent, utilities and payroll.⁸¹ To further reduce costs and keep prices low, ALDI does not undertake significant advertising and marketing campaigns. ALDI displays products on pallets or packaging boxes and its checkout system is designed to minimise both labour costs and queue times with customers having to pack their own groceries into either purchased or bought from home bags. Consumers effectively trade lower prices for reduced variety and service.

ALDI also sources many of its more affordable products from abroad. In isolation, this is not an issue. However, it raises concerns as to whether there will be sufficient retailers of local products in the long term for the Australian agricultural sector to remain viable.

Similarly, Costco Wholesale Corporation operates an international chain of member only big-box discounter warehouses, under the 'Costco Wholesale' name. Costco introduced a new style of 'big box' retailing in Australia by operating out of simple warehouses and stocking a wide range of products in sizeable quantities including grocery, jewellery, office supplies, homewares, sports, clothing, meats, bakery, fresh produce, dairy, and others. It also offers its own private label product line – Kirkland. Costco claims that the size and efficiency of these warehouses allow for lower costs than traditional retailers. However, Costco is not substitutable to a full-service supermarket. Costco's

⁷⁷ 900 products.

⁷⁸ Australian Competition and Consumer Commission, Parliament of Australia, *Inquiry into the Competitiveness of Retail Prices for Standard Groceries* (2008) 43 ('*Grocery Inquiry*').

⁷⁹ ALDI, Submission to the Australian Competition and Consumer Commission, *The Grocery Inquiry*, 7.

⁸⁰ With the average trading area of ALDI sites being around 850m².

⁸¹ ALDI, above n 79, 7.

unique large format, with only 9 warehouse locations Australia wide and bulk product range, is not accessible by or practical for the average Australian consumer.

Furthermore, a PriceWaterhouseCoopers report on the state of the Australian grocery industry shows that despite controlling an 80% market share, Woolworths, Coles and ALDI only employ 43 per cent of all grocery employees. In contrast, independent retailers with a 20% market share employ 57% of Australia's grocery staff.⁸² Keeping this in mind, a Network Economics Consulting Group report referred to in the Senate Committee's report on *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* analysed the volume of business expected to be lost by Metcash (nearest competitor to the major supermarket chains) as a result of 'an expected current round of creeping acquisitions involving 16 stores' as 1.77%. It considered a range of scenarios relating to further losses in sales volume of up to 10% as a result of possible future acquisitions.⁸³ A loss of such volume compromises the sustainability of these independent retail outlets that employ many Australians.

(b) *The Impact on Competing Retailers – the Waterbed Effect and Predatory Pricing*

The market power of the major supermarket chains allows them to force lower prices onto suppliers. On its own, this is no problem. However, the price paid by Coles and Woolworths to milk processors has reached an unsustainable level, leading the processors to charge a higher price on milk when selling to other retailers.⁸⁴ This is known as the 'waterbed effect'. The 'waterbed effect' describes the result when a large player in a market demands lower wholesale prices from suppliers, forcing those suppliers to increase prices to other customers – or retailers in this case – to bring earnings back to a sustainable level.⁸⁵

⁸² Nick Xenophon, *Australia's Grocery Sector* (2015) <<http://www.nickxenophon.com.au/campaigns/supermarkets>>.

⁸³ Senate Economics Reference Committee in the Report *Milking it for all it's Worth – Competition and Pricing in the Australian Dairy Industry* ('Milk Report'), 61.

⁸⁴ *Ibid*, 27.

⁸⁵ Grocery Inquiry, above n 78, 353.

Independent retailers told the Senate Economics Reference Committee in the Report *Milking it for all it's Worth – Competition and Pricing in the Australian Dairy Industry* ('Milk Report') that this worked as follows:

Independent retailers pay more than the contract price for house brand milk to Fonterra and to National Foods. They have to charge me more so that they can, at the end of the day, make money. I am, in effect, subsidising the supply of house brand milk to those people [major supermarket chains].⁸⁶

The lower the prices paid by the major supermarket chains for private label milk, the higher the prices the milk processor will need to charge smaller retailers for branded milk to make up for the lower returns from Coles and Woolworths.⁸⁷

Australia is a market dominated by two fully vertically integrated retailers with high barriers to entry. For small retailers to remain competitive they have had to band together under banner groups such as Metcash Limited⁸⁸ and IGA.

A further practice is predatory capacity. Predatory capacity describes the situation where the major supermarket chains build an oversized supermarket in a town where there is no need. The new supermarket runs at a loss up until the point where smaller local businesses' loss of trade becomes too much for them and they close. The oversized retailer's initial losses are funded by the profits earned in other unrelated markets

⁸⁶ *Committee Hansard*, 4 February 2010 (Mr Ken Henrick).

⁸⁷ Zumbo, above n 5, 9.

⁸⁸ Metcash, previously named Davids, is Australia's largest wholesale distribution and marketing company specializing in independently owned grocery, fresh food, liquor, hardware, automotive parts and accessories. Metcash operates under three business pillars – Metcash Food & Grocery (MF&G), Australian Liquor Marketers (ALM) and Metcash Hardware & Automotive. Metcash uses a franchise model for its retail activities; these stores and hotels are outlets owned by independent retailers who draw on the full marketing, branding, logistical and distributional support of Metcash. MF&G is comprised of 2,400 independent stores across Australia including: 1,365 IGA branded stores, 117 Foodland stores, 484 FoodWorks stores and 245 Lucky 7 convenience stores. The IGA network alone competes in a number of retail formats. Supa IGA and IGA Fresh stock a full range of products in larger format stores. IGA Stores are medium neighbourhood stores with a more limited range. IGA X-Press is the smaller convenience store format and IGA Liquor, a line of liquor stores across Australia. A large proportion of these independent retailers serviced by Metcash operate in rural or regional areas. Metcash does not operate in Tasmania; with the wholesaling function for independent retailers being undertaken there by Woolworths owned SIW.

and industries. A report by the Commonwealth Bank pointed out that Woolworths was accumulating around \$1 billion worth of property per annum.⁸⁹ Retail floor space is actually being built faster than population growth.⁹⁰ Of this, Wakefield Planning, a Melbourne based consultancy firm commented:

Any future commercial development ... needs to be completely justifiable on the basis of current population levels. Given that levels of growth are below the levels predicted for the initial planning period, floor space needs to not 'lead demand'. This is because there is highly limited ability for population growth to 'take up' floor space demand provided in advance of such growth. This again reinforces the importance of retail floor space trailing rather than leading population growth.⁹¹

Bermagui, a small town with 2,323 residents in south-east New South Wales provides an example of this practice.⁹² Woolworths Limited lodged a development proposal to build a 1,852 square metre Woolworths supermarket and a 152 square metre liquor store in Bermagui.⁹³ At the time, the residents of Bermagui were already serviced by a 450 square metre FoodWorks, an IGA, a 777 store, a butcher, greengrocer, bakery, pharmacy and newsagent. Just 20 minutes away in both Bega and Narooma there were also Coles and Woolworths supermarkets.

The Woolworths development application avoided considering whether an oversupply of retail space for the resident population would occur by citing a previous case involving a Woolworths' subsidiary, *Fabcot Pty Ltd v Hawkesbury City Council (97) LGERA* ('Fabcot Pty Ltd'). In *Fabcot Pty Ltd*, Justice Lloyd noted 'economic competition between individual trade competitors is not an environmental or planning consideration to which the economic effect described in s 90(1)(d) is directed'.

⁸⁹ Commonwealth Bank, When Woolies Became an A-REIT, *Global Markets Research: Equities, Woolworths Limited*, 1 June 2012.

⁹⁰ Z Fielding, 'Shop Space Grows Despite Slow Sales', *The Australian Financial Review* (Sydney), 11 July 2012, 46.

⁹¹ Wakefield Planning, *Submission on DA 2012.0098: Proposed Woolworths Supermarket, Bermagui*, June 2012, 5.

⁹² ID, *Population, Dwellings & Ethnicity | Bermagui Coast – Wapengo and District* (2015) Profile.id Community Profile <<http://profile.id.com.au/bega-valley/population?WebID=120>>.

⁹³ Fabcot Pty Ltd, submission on DA 2013.405: *Proposed Woolworths Supermarket – Montague Street, Young Street and Unnamed Laneway, Bermagui*, 26 March 2014.

The development application also contended that any detrimental effects would be outweighed by the benefits of greater competition, price, product range and convenience provided by the proposed Woolworths supermarket development.⁹⁴ Contrary to the representations in the development application, competition and product range have reduced since Woolworths opened with both the Foodworks and IGA closing down, and the 777 store reporting a 40 per cent downturn in profits.⁹⁵

The market power of the major supermarket chains allows for the cross subsidisation of unviable developments with their extensive network of stores including related retail, fuel, insurance, liquor and gambling enterprises. These initial losses are offset by their ability to drive out all competition and consequently not have to compete on price in the medium and long term.

The problem with this behaviour is that it eliminates any chance of small or independent competitors growing into businesses with economies of scale sizeable enough to enjoy similar buying power and influence. As long as the major supermarket chains are able to employ strategies that keep small retailers small or eliminate them from the market, a shift in the competitive structure will never be seen.

While these practices may in fact be a breach of the market power provisions in ss 46(1) and 46(1AA) of the CCA, establishing a breach is problematic. The initial symptoms often appear pro-competitive and acquiring clear, cogent evidence of anti-competitive purposes to support such an allegation is inherently difficult.

To properly deal with these weaknesses, Australia requires a pro-active competition regime that guides and permits decision makers to consider the aggregation of previous piecemeal acquisitions from the outset. The objective of policy makers should be to prevent damage from arising in the first instance, rather than seeking to unwind it through the market power provisions. These pro-active approaches are considered in detail in Chapter Five.

⁹⁴ Ibid.

⁹⁵ Albery McKnight, 'Bermagui Woolworths' market share cutting main street profits *Bega District News*, 20 July 2015.

(c) *The Impact on Farmers and Suppliers – Unsustainable Incomes*

Farmer organisations have expressed concern that the market power of the major supermarket chains has enabled them to drive aggressive bargains in the purchase of produce. Coles and Woolworths account for a very large part of food processors' businesses – up to 70% in some cases. Any loss of distribution to Coles and Woolworths would dramatically decrease the volume output through their factories, impacting on efficiency, economies of scale and overhead recovery.⁹⁶ So farmer organisations have to accept the lower prices that Coles and Woolworths offer. The issue is whether these lower prices are sustainable for the suppliers.

A KPMG Report found Coles had cut the prices of more than 6,000 grocery items by an average of 10% since its 'down' campaign began in 2010. Woolworths did the same.⁹⁷ Viewed in isolation, this is good for consumers. But the issue is whether this comes at the cost of the prices paid to suppliers being unsustainable.

A further issue arises in relation to private label products. In many cases, the supplier and producer of a branded product is also the supplier and producer of the major supermarket chain's private label product. To secure a contract with the major supermarket chains, processors are pressured to reduce prices for the supply of private label products. If these reduced prices are unsustainable, then the lost revenue must be recovered from the branded products produced by the processors, which makes the branded products less competitive. Take for example a firm such as Murray Goulburn – Murray Goulburn may lose its Devondale milk shelf space to the Coles private label milk product, both of which it supplies. Although on paper, Murray Goulburn is still supplying the same volume of milk, the less profitable private label milk sales are increased at the expense of the highly profitable branded Devondale sales. Volume remains steady but profits are decreasing to levels which might not be sustainable.

⁹⁶ Stiegart and Hwan Kim, above n 35, 84.

⁹⁷ Interview with Hon Bruce Billson MP, Minister for Small Business (Radio Interview, 19 June 2014).

Firms who accept these arrangements are effectively competing with themselves, cannibalising their own margins and reducing their long-term competitiveness. In 2011, Coles announced a pricing strategy of \$1 per litre for its home brand milk.⁹⁸ The milk would be used as a 'loss leader' product to encourage consumers into the store. Woolworths followed suit. Overnight, milk in Australia became cheaper than bottled water and soft drinks.⁹⁹ The milk processors were told they would as a result be paid less and had no alternative but to pass that price cut on to the producer – a dairy farmer. The dairy farmers had no power to refuse supply to Coles and Woolworths and were forced to accept a price below the cost of production. This ability of the major supermarket chains to extract more advantageous trading terms from suppliers and access financial benefits at the beginning of the retail chain can never be recovered by a competitor.

An Inquiry by the Senate Committee in 2010 that resulted in the *Milk Report* was established to investigate a number of concerns with the pricing strategies implemented in the milk sector. The major supermarket chains' use of certain pricing strategies in relation to home brand products was found to have unintended and anti-competitive consequences. It was found that the major supermarket chains were making far more profit from the sale of milk than were the farmers.¹⁰⁰ The *Milk Report* also noted that although the impetus of this report was the dairy industry, the issues were common to many other sectors of the economy where the retail market was also becoming increasingly dominated by private label products sold by the major supermarket chains. Processors were increasingly in the position of having to compete with their own branded goods.¹⁰¹

The ACCC's media release of 22 July 2011 stated that it considered there to be no evidence that Coles acted in breach of the CCA in relation to milk discounting. The ACCC revealed evidence that Coles' purpose in reducing the price of its house milk was to increase its market share

⁹⁸ Coles, 'Because We All Buy Milk: Coles Cuts the Price to Help Shoppers Save' (Media Release, 26 January 2011).

⁹⁹ [Australiancompetitionlaw.org](http://www.australiancompetitionlaw.org), *Australian Competition Law* (2015) <<http://www.australiancompetitionlaw.org/reports/2011milk.html>>.

¹⁰⁰ Milk Report, above n 83, 2.

¹⁰¹ Milk Report, above n 83, 7.

by taking sales from its competitor Woolworths. This is consistent with what the ACCC would expect to find in a competitive market.¹⁰² The reality of the situation however was that Coles and Woolworths adopted the same strategies, resulting in no significant effect on market share or milk consumption but an unfavourable outcome for the milk production chain.¹⁰³

For the major supermarket chains, private label goods are big profit drivers. Marketing them is cheap and manufacturing is streamlined. Lion Dairy & Drinks, which previously held private label contracts in most states with both Coles and Woolworths, stepped out of the bidding war based on the plain reasoning that ‘the extra volumes merely help recover fixed costs in processing plants. They are not profitable for the sake of putting volume through milk plants, but without such contracts more than half of the market is effectively closed to them’.¹⁰⁴

Furthermore, where suppliers provide both brand and private label business, the negotiation position of the supplier versus the food retailer is far from equal. The negotiation position of a supplier pivots on the information asymmetry regarding the supplier’s cost base, pricing structure and innovation pipeline. Through the private label supply, the supplier is disclosing most of its cost structure, undermining the market position of its brand and reinforcing the retailer’s negotiation power. By introducing a 1:1 copy of a branded product anywhere from 20% to 60% cheaper, the retailer can quite easily infer the mark-up attracted to a branded product and demand a larger share of the profit pool. The retailer is in the position to negotiate the purchase price of branded products more similar to the price charged for private label products. This indicates a shift in market power in the Australian food-value chain from producers and manufacturers to retailers.¹⁰⁵

The overarching concern here is the reduction in the return back down the value chain to processors and farmers. This redistribution of wealth along the supply chain is having detrimental effects on the Australian

¹⁰² Australian Competition and Consumer Commission, ‘Coles discounting of house Brand Milk is Not Predatory Pricing’ (Media release 22 July 2011).

¹⁰³ Roger Crook, ‘Do Coles and Woolworths Control Australian Agriculture?’ *Global Farmer*, (16 August 2014).

¹⁰⁴ Sue Mitchell, ‘Fonterra Inks Milk Deal With Woolworths’ *The Financial Review*, 3 April 2014.

¹⁰⁵ Stiegart and Kim, above n 34, 24–25

farming sector, particularly in regional communities. Society as a whole would suffer if it did not have the diversity and opportunity that many competitors bring to the market.¹⁰⁶ NARGA's national spokesman, Mr Alan McKenzie commented:

If the government fails to intervene, the market share of the independent retailers will continue to be eroded, to the point where the entire sector will be threatened with irreversible market failure due to the loss of critical mass. The consequences of such an outcome will be severe and, in particular, will bring great hardship to rural Australia. At 80 per cent of the retail grocery market, when do we say enough is enough?¹⁰⁷

Exacerbating the effects on every level is the scope of vertical integration by the major supermarket chains, often achieved through creeping acquisitions. Vertical integration enables the major chains to derive their entire profitability from retail operations, while in the independent sector both the warehouse and the retail stores make separate profits.

Vertical integration enables a firm with market power to increase monopoly profits through price discrimination. As Mason CJ and Wilson J observed in QCMA:

... vertical integration may help a monopolist distinguish between customers whose demand is less and more elastic. Where consumers are able to trade amongst themselves, the monopolist cannot discriminate. By integrating vertically it may be possible for a monopolist to prevent this inter-trading. For example, power companies usually own distribution systems. This enables them to discriminate in pricing between residential and commercial users. Therefore, although vertical integration does not by itself mean that a firm has a substantial degree of market power; it may well be the means by which the firm capitalises on that market power.¹⁰⁸

The push towards vertical integration has the potential to put good firms out of business – with all the implications that brings for competition, consumer choice and our capabilities as a food exporting nation. For most grocery manufacturers, supermarkets are their main distribution channel to customers. That leaves many at the mercy of the big two – and reliant on the terms and conditions they choose to offer.

¹⁰⁶ Baird Report, above n 3, 138.

¹⁰⁷ Commonwealth, *Parliamentary Debates*, Senate, 12 July 1999, 1031 (Mr Alan Mackenzie).

¹⁰⁸ Australian Competition and Consumer Commission, Parliament of Australia, 'Merger Guidelines' (1999) 5.156 <<https://www.accc.gov.au/publications/merger-guidelines>>.

Australia has already experienced the collapse of a number of large-scale manufacturers and a reduction in the number of independent supermarkets as customers of those manufacturers.¹⁰⁹ Without a viable food-processing sector, Australia's long term domestic agricultural and manufacturing industry is at risk. According to the Australian Food and Groceries Council, between 2011 and 2012, 335 food-processing businesses closed down in Australia or moved overseas. The Parliamentary Report titled *The Supermarket Revolution in Food*¹¹⁰ published in 2011 recorded that in the previous three months alone, there had been a number of closure announcements of major food factories in regional areas and movement of their operations overseas. The closure of a dairy factory, for example, means that farmers no longer have an outlet for their milk. This comes at the cost of many jobs, leading to dramatic economic flow-on effects for local communities. With the loss of a major industry, small regional areas shut down because of the inability to sustain social infrastructure such as schools, hospitals, banks, supermarkets, and other services.¹¹¹

The ability of the major supermarkets to impose such onerous terms on their suppliers distorts markets in ways that consumers don't see and suppliers can't effectively counter. The impact of such low prices is far beyond the supermarket shelves, and far beyond saving to consumers.¹¹²

C Conclusion

This case study provides an example of what other markets in Australia may look like if unregulated creeping acquisitions were adopted in these sectors.

As discussed above, the major supermarkets have incrementally gained control over all levels of the supply chain so that they now deal directly with suppliers or have entirely eradicated their need. This translates to further commercial control and advantage over the independents that must source supply from wholesalers that are often

¹⁰⁹ Dalley and Sheftalovich, above n 58.

¹¹⁰ Stiegart and Kim, above n 35.

¹¹¹ Stiegart and Kim, above n 35, 86.

¹¹² Charles Fishman, *The Wal-Mart Effect* (Penguin Press, 2006), 80.

owned by their major supermarket competitors. The ongoing viability of independents relies on their share of the market not shrinking to the stage that they become unviable. Mr John Hunter, General Counsel for Metcash Trading Ltd, summarised the situation as follows:

[T]he cumulative impact of creeping acquisitions by the major chains in the retail grocery sector is anticompetitive. That is not only because the ‘ongoing duopolisation’ of the grocery sector means that price competition offered by a ‘third full service player’ is at risk, but also because the competitive ability of wholesalers who supply independent grocery retailers is under threat.¹¹³

Detriment has also materialised for consumers. A report prepared by the Network Economics Consulting Group on behalf of Metcash Trading Ltd and submitted to the 2004 Senate Inquiry concluded:¹¹⁴

If cost increases are not passed through to consumers, the viability of Metcash and/or its independent retailers will be threatened well before a ten per cent loss of volume is reached. With as little as a six per cent loss of volume, we estimate that Metcash would no longer be able to raise equity finance. Well before this, Metcash’s ability to provide retail support services would be squeezed, which would flow through to deteriorating customer service at the retail level.¹¹⁵

The point of the above discussion of the supermarket sector is that merger laws need to operate to prevent the loss of competition and resulting negative outcomes in the supermarket sector from spreading to other markets. It is conceded that not all increases in market power in the supermarket sector arose from creeping acquisitions, but they have played a significant role. This article takes the position that creeping acquisitions could occur in other markets, given the oligopolistic nature of many Australian markets. The next Chapter will discuss why creeping acquisitions avoid the operation of s 50. The article will then discuss how this loophole could be closed.

¹¹³ Milk Report, above n 83, 60.

¹¹⁴ Metcash Trading Ltd, Submission to the Australian Competition and Consumer Commission, ‘*The Grocery Inquiry*’ (2003), 4.

¹¹⁵ *Ibid.*

III HOW DO CREEPING ACQUISITIONS CURRENTLY AVOID REGULATION?

A Introduction

The merger review process can be broken down into three distinct phases. First, the administrative processes of bringing a merger or acquisition under review; secondly, the process of analysing the effects on competition of that merger; and thirdly, remedies and penalties for any breach of the merger provisions.

As Australia's current competition law stands, there are severe remedies and penalties if s 50 is breached and the parties involved do not modify or withdraw the merger or acquisition. In these cases the ACCC may commence proceedings for pecuniary penalties,¹¹⁶ seek an injunction to prevent the merger or acquisition occurring,¹¹⁷ apply for an order of divestiture requiring the disposal of shares or assets acquired from the merger,¹¹⁸ seek damages for loss as a result of the contravention,¹¹⁹ or accept undertakings to resolve matters without proceeding to litigation.¹²⁰ Parties may also be liable for significant fines.¹²¹

Where the merger provisions are deficient, however, is in the first two phases. While the remedies and penalties are there, the tools and guidelines to bring high-risk mergers to the attention of the ACCC and establish a breach are not. The drafters of the Trade Practices (Creeping Acquisitions) Amendment Bill 2007 [2008] also regarded s 50 as inadequate in dealing with 'acquisitions by stealth'.¹²² Broadly, the three main deficiencies include:

1. No obligation to notify the ACCC of high-risk mergers;
2. the counterfactual can only apply to a single merger and does not reflect commercial realities; and
3. no express authority in the merger factors for the ACCC or the Courts to consider the cumulative effect of mergers and acquisitions.

¹¹⁶ *Competition and Consumer Act 2010* (Cth) s 76.

¹¹⁷ *Ibid* s 80.

¹¹⁸ *Ibid* s 81.

¹¹⁹ *Ibid* s 82.

¹²⁰ *Ibid* s 87B.

¹²¹ *Ibid* s 76.

¹²² Explanatory Memorandum, Trade Practices (Creeping Acquisitions) Amendment Bill 2007 [2008] (Cth), 3.

B No Obligation for Pre-merger Notification

Around the world,¹²³ pre-merger notification is considered essential to allow governments either to stop anti-competitive mergers or negotiate remedies with the parties. Compulsory notification is enshrined in the ICN guidelines and most international jurisdictions have some form of compulsory notification regime.

Despite this, there is currently no statutory pre-merger notification regime in Australia requiring parties to notify and seek approval from the ACCC before merging or seeking an acquisition.¹²⁴ The current Merger Guidelines only urge firms to notify the ACCC when the merged firm will have a post-merger market share greater than 20% of the relevant market and the products of the merged firms are substitutes or complements of each other. The traditional avenues where the ACCC may be notified of an acquisition early enough to intervene are purely voluntary. These include:

1. Assessment of a proposed acquisition on an informal basis;
2. An application for formal clearance of a proposed merger;¹²⁵
3. Assessment of an application for authorisation of a merger, using a net public benefit test.¹²⁶

An informal clearance is essentially a statement from the ACCC that the merger would not be likely to lessen competition under s 50, and the ACCC does not oppose the merger. Although this is not binding¹²⁷ and the ACCC may still bring action against a merger,¹²⁸ this statement from the ACCC means the parties can proceed with greater confidence that their conduct will not be challenged.

¹²³ These include but are not limited to, Austria, Bulgaria, Canada, China, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Egypt, Estonia, Finland, Germany, Greece, Hungary, India, the Isle of Man, Italy, Korea, Latvia, Lithuania, Mexico, the Netherlands, Nicaragua, Norway, Pakistan, Poland, Portugal, Romania, the Slovak Republic, South Africa, Spain, Switzerland, Taiwan, Turkey, Uruguay and the US.

¹²⁴ Australian Competition and Consumer Commission, Parliament of Australia, 'Merger Guidelines' (2008) 7.12 <<https://www.accc.gov.au/system/files/Merger%20guidelines.pdf>> 2.1-2.9.

¹²⁵ *Competition and Consumer Act 2010* (Cth) Part VII, Division 3, Subdivision B.

¹²⁶ *Ibid* Part VII, Division 3, Subdivision C.

¹²⁷ See, for example, *Trade Practices Commission v Santos Ltd* (1992) 38 FCR 382.

¹²⁸ Herbert Smith Freehills, *Changes To Informal Merger Clearance Guidelines* (2015) <<http://www.herbertsmithfreehills.com/insights/legal-briefings/changes-to-informal-merger-clearance-guidelines>>.

Alternatively, parties to a merger can obtain statutory immunity from s 50 through formal clearance granted by the ACCC. Formal clearance confers legal protection from s 50 to the entity to whom it is granted. This means that neither the ACCC nor any other party may initiate action on the basis of an alleged contravention of s 50 so long as the merger is in accordance with the clearance.¹²⁹ The ACCC's decision must be based on a determination that the merger would not have the effect or be likely to have the effect of substantially lessening competition in any market.

As a third option, under ss 88(9) and 90(9) of the CCA, if a merger is found to substantially lessen competition it may nevertheless proceed if the ACCC grants an authorisation on the grounds that the merger, while lessening competition, leads to public benefits that outweigh the possible anti-competitive detriments.¹³⁰ This principle is based in the objectives of the CCA – 'to enhance the welfare of Australians through the promotion of competition and fair trading and provisions for consumer protection'.¹³¹

There has been widespread criticism of the two formal processes¹³² and in practice the formal merger clearance process has never been used in Australia while the merger authorisation process has only been used three times to date.¹³³

In Canada, the Notifiable Transactions provisions in Part IX of the Competition Act¹³⁴ require parties to notify the Competition Bureau when transactions are of a specific type, exceed certain thresholds and are not subject to any exemptions, regardless of their likely impact on competition.

The Competition Bureau must be given advance notice of proposed transactions when the target entity's assets or revenue in Canada exceed

¹²⁹ Australian Competition and Consumer Commission, *Merger Reviews* (2015) <<https://www.accc.gov.au/business/mergers/merger-reviews>>.

¹³⁰ *Competition and Consumer Act 2010* (Cth) s 95AZH.

¹³¹ *Competition and Consumer Act 2010* (Cth) s 2.

¹³² Allens Linklaters, *Competition, Consumer & Regulatory* (2018) <<https://www.allens.com.au/services/comp/harpmaj-mergers.htm>>.

¹³³ AGL Energy Limited – ACT 1 of 2014, Sea Swift Pty Ltd – proposed acquisition to acquire assets associated with the Toll Marine Logistics business and Proposed merger of Tabcorp Holdings and Tatts Group cited on merger register.

¹³⁴ Competition Act, RSC 1985, c C-34.

\$88 million, or when the combined Canadian assets and revenues of the parties and their affiliates in, from or into Canada exceed \$400 million.¹³⁵ Failure to notify is a criminal offence.¹³⁶

Similarly in the US, where applicable thresholds are met and the transaction is not otherwise exempt, notification is mandatory. The *Hart-Scott-Rodino Act* ('HSR Act') established the federal premerger notification program, which provides the Federal Trade Commission ('FTC') and the Department of Justice ('DoJ') with information about large mergers and acquisitions before they occur. The parties to certain proposed transactions must submit premerger notification to the FTC and DoJ. Premerger notification involves completing a HSR Form, also called a 'Notification and Report Form for Certain Mergers and Acquisitions', with information about each company's business. The parties may not finalise their deal until the waiting period outlined in the HSR Act has passed, or the government has granted early termination of the waiting period.¹³⁷

For the HSR Act to apply to a particular transaction, it must satisfy three tests: the commerce test,¹³⁸ the size of transaction test and the size of person test.¹³⁹

An acquisition will satisfy the commerce test if either party to a transaction is engaged in commerce or any activity affecting commerce. The size of transaction test is met if, as a result of the transaction, the acquiring person will hold an aggregate amount of voting securities, non-corporate interests and assets of the acquired person valued at more than US\$50 million. The size of person test is met if one of the parties has sales or assets of at least US\$100 million and the other party has sales or assets of at least US\$10 million.¹⁴⁰

¹³⁵ Ibid ss109 and 110.

¹³⁶ Government of Canada, *Reviewing Mergers* (2018) <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/h_00114.html>.

¹³⁷ Federal Trade Commission, *Premerger Notification Program* (2018) <<https://www.ftc.gov/enforcement/premerger-notification-program>>.

¹³⁸ *Clayton Antitrust Act 1914*, 15 USC 18A(a)(1) (2000)

¹³⁹ *Clayton Antitrust Act 1914*, 15 USC 18A(a)(2) (2000).

¹⁴⁰ Federal Trade Commission, Premerger Notification Office, To File or Not to File: When you Must File a *Premerger Notification Report Form*, 2.

Other countries such as Argentina, Indonesia, Japan and Russia also have post-merger notification regimes.¹⁴¹

Failing to adhere to a regime of mandatory notification for mergers puts Australia out of line with international best practice.¹⁴² Australian competition would be better served by legislating such a regime.

C The Process of Reviewing a Merger

Mergers and acquisitions are regulated by the substantially lessening of competition test enshrined in s 50 of the CCA. Section 50(1) prohibits corporations from acquiring ‘shares in the capital of a body corporate’ or ‘any assets of a person’ if that acquisition ‘would have the effect, or be likely to have the effect, of substantially lessening competition in any market’.

In *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd*,¹⁴³ Smithers J summarised the elements required by the substantial lessening of competition test:

To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition.¹⁴⁴

The elements of the test are therefore: was there an acquisition; what is the extent of concentration in the relevant market; and has there been a substantial lessening of competition in that market?

These elements will be discussed below.

1 Merger or Acquisition

Merger and acquisition are not terms defined in the CCA. In Australia, the term merger is a commercial concept rather than a legal one.¹⁴⁵ The 2017 Media Merger Guidelines authored by the ACCC notes that s 50 mergers

¹⁴¹ Lex Mundi, ‘Global Practice Guide: Pre-Merger Notification’ (2012).

¹⁴² Clarke, above n 48, 2.

¹⁴³ (1982) 44 ALR 173.

¹⁴⁴ Ibid, 173.

¹⁴⁵ Allens Linklaters, ‘The Allens Handbook on Takeovers in Australia’ (2017) 11 <<https://www.allens.com.au/pubs/pdf/ma/takeovers-handbook.pdf>>.

are those transactions where typically the shareholders of two companies (the merger parties) become the shareholders of a newly merged company.¹⁴⁶ An example is the 1985 merger of Coles Variety Stores and Myer Emporium Ltd to form the new entity Coles Myer Ltd.¹⁴⁷

Acquisitions on the other hand are those transactions where a company (the acquirer) acquires the shareholding or assets of another company or person (the target).¹⁴⁸ From this transaction no new entity is formed. One entity expands its scope and size while the other entity is either reduced or eliminated. An example is Wesfarmers' acquisition of the Coles Group¹⁴⁹ in 2007.¹⁵⁰ As a result, all Coles Group activity became wholly owned and controlled by Wesfarmers. Its shares were suspended from trading on the Australian Securities Exchange (ASX) and the Coles Group ceased to exist.¹⁵¹

The occurrence of a merger or acquisition under these definitions satisfies the first element.

2 The Extent of Concentration in the Relevant Market

This element requires two steps – first, what is the defined market affected by the merger or acquisition, and secondly, is there an absence or presence of concentration in that defined market?

The first step, market definition, establishes the broad 'field of inquiry' relevant to the ACCC's consideration of the acquisition. It identifies the areas of competition that may be affected by the proposed acquisition. When determining the limits of the relevant market, the Australian Competition Tribunal ('Tribunal') and the courts must consider all influential factors – product substitutability,¹⁵² geographical

¹⁴⁶ Australian Competition and Consumer Commission, Parliament of Australia, 'Media Merger Guidelines' (2007). <https://www.accc.gov.au/system/files/Media%20Merger%20Guidelines%202017_0.pdf>.

¹⁴⁷ Deloitte Access Economics, 'Analysis Of The Grocery Industry' (2012) 3 <http://www.academia.edu/7969473/Analysis_of_the_grocery_industry>.

¹⁴⁸ Australian Competition and Consumer Commission, above n 144.

¹⁴⁹ No longer Coles Myer Ltd as Coles and Myer demerged in 2005.

¹⁵⁰ Deloitte Access Economics, above n 145, 3.

¹⁵¹ Wesfarmers Limited, *Wesfarmers – Corporate Transactions* (2015) <<https://www.wesfarmers.com.au/investors/shareholder-information/corporate-transactions.html>>.

¹⁵² This process of defining a market by substitution involves both including products which compete with the defendant's and excluding those which because of differentiating characteristics do not compete. *Queensland Wire Industries Pty Ltd v BHP Ltd* (1989) 167 CLR 177, 577.

constraints on supply and demand, function¹⁵³ and temporal dimensions of the market.¹⁵⁴ The *market* in the context of s 50 can include multiple geographical markets for goods or services in Australia, including state, territory, regional or local markets.¹⁵⁵ It may also include upstream and downstream markets.¹⁵⁶

For the purposes of the CCA, s 4E defines the market as ‘a market in Australia and, when used in relation to goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services’.¹⁵⁷

The Tribunal in *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd*¹⁵⁸ (‘QCMA’) elaborated upon this to also capture the network of actual and potential transactions between buyers and sellers of goods and services that are, or could be, in close competition.¹⁵⁹

A market is an area of close competition between firms or, putting it a little differently, the field of rivalry between them ... Within the bounds of the market there is substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is a field of actual and potential transactions between buyers and sellers amongst whom there can be *strong substitution, at least in the long run*, if given sufficient price incentive ... Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, cost and price incentives ... In determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to ‘give less and charge more’ would there be, to put the matter colloquially, much of a reaction? (emphasis in original).¹⁶⁰

¹⁵³ That is, whether the focus is to be on the *selling function* or the *buying function*.

¹⁵⁴ That is, how much time is needed for customers and suppliers to make their adjustments in response to economic incentives?

¹⁵⁵ *Competition and Consumer Act 2010* (Cth) s 50(6).

¹⁵⁶ Explanatory Memorandum, Competition and Consumer Legislation Amendment Bill 2011 (Cth) 1.6.

¹⁵⁷ *Competition and Consumer Act 2010* (Cth) s 4E.

¹⁵⁸ (1976) 8 ALR 481.

¹⁵⁹ Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law* (Kluwer Law International, 2003) 14.

¹⁶⁰ *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) 8 ALR 481, 517.

Without an accurately defined market, competitors cannot be clearly identified, as was articulated by Mason CJ and Wilson J:

too narrow a description of the market may exclude legitimate competitors, creating the appearance of more market power than in fact exists; too broad a description may erroneously classify certain non-rivals as competitors, creating the appearance of less market power than there actually is.¹⁶¹

The case of *Australian Competition and Consumer Commission v Metcash Trading Limited*¹⁶² exemplifies this. In that case, Emmett J did not accept the ACCC's market definition and the Commission's case failed on that basis.¹⁶³

The ACCC relied primarily on economic theories, namely the theory of coordinated effects, in support of its preferred market definition.¹⁶⁴ The ACCC alleged that the acquisition would substantially lessen competition in the independent wholesale grocery market for 'packaged groceries'. The Commission based its case on there being a separate market for the wholesale supply of packaged groceries. This was limited to branded and generic items, such as breakfast cereal, canned food, biscuits, flour, tea, coffee, soft drinks, nappies, cleaning products, personal hygiene products and frozen food, but not including fresh items such as fruit and vegetables, meat, delicatessen items and bakery items.¹⁶⁵

On appeal, the Full Court soundly rejected this theoretical approach, in line with earlier decisions criticising arguments based primarily on economic theory.¹⁶⁶ The Court found no such separation, and defined the market more broadly as a national market for the supply of packaged groceries as well as fresh products, general merchandise, health, beauty and cosmetic products to the consuming public.¹⁶⁷ Because the Court

¹⁶¹ *Queensland Wire Industries Pty Ltd v BHP Ltd* (1989) 167 CLR 177, 577.

¹⁶² [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011).

¹⁶³ *Australian Competition and Consumer Commission v Metcash Trading Limited* [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011) 337.

¹⁶⁴ Jack Wright Nelson, 'The ACCC Merger Guidelines 2008: Some Concerns and Recommendations', (2012) 14 *The University of Notre Dame Australia Law Review*, 85.

¹⁶⁵ *Australian Competition and Consumer Commission v Metcash Trading Limited* [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011), 182.

¹⁶⁶ See *Australian Gas Light Company v Australian Competition and Consumer Commission* (2003) 137 FCR 317, 416.

¹⁶⁷ *Australian Competition and Consumer Commission v Metcash Trading Limited* [2011] [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011), 341–342.

defined the market by reference to a broader range of products, the post-merger market concentration, the ACCC argued, would not have occurred.

To apply the *QCMA* analysis above, the Court in *Metcash* found the rivalry between the major supermarket chains (Coles and Woolworths) and independent retailers was such that there was significant constraint on the capacity of Metcash to increase price or decrease service without losing business. The Court found that, even post-merger, if Metcash gave less and charged more, there would be a significant reaction from consumers to the benefit of Metcash's competitors. To this Emmett J commented:

I am not persuaded that an increase of between five and ten per cent in the price at which goods are supplied by Metcash to independent retailers could be sustained without a resultant significant loss of business.

Once the relevant market is defined, a conclusion about the presence or absence of market power, and whether the merger or acquisition ought to proceed, will follow.¹⁶⁸

The Merger Guidelines published in 1996 introduced an administrative safe harbour and the CR4 concentration ratio as tools to measure market concentration. Safe harbours are a practical tool widely used by administrators to specify certain conduct deemed not to violate a given rule. The safe harbour and the CR4 approach stipulate that for a merger resulting in a market share held by the four (or fewer) largest firms (CR4) of 75% or more, and the merged firm will supply at least 15% of the relevant market, the Commission will need to give close consideration to other merger factors to determine whether or not the merger is likely to result in a substantial lessening of competition.¹⁶⁹

Certain shortfalls were acknowledged with this formulation. The 2008 Revised Merger Guidelines replaced the 1999 articulation.¹⁷⁰ The Revised Merger Guidelines introduced the HHI, which is still current. The HHI, which is also used by the US DoJ Antitrust Division, takes into

¹⁶⁸ Stephen Corones, *Competition Law and Policy in Australia* (Lawbook, 1990), 58.

¹⁶⁹ Australian Competition and Consumer Commission, Parliament of Australia, above n 108, 5.103.

¹⁷⁰ Alex Bruce, *Restrictive Trade Practices Law in Australia* (LexisNexis Butterworths, 2010), 187.

account the relative size distribution of firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm. The HHI increases both as the number of firms in a market decreases and as the disparity in size between firms increases.¹⁷¹

The HHI captures the number of firms and the dispersion of the market shares by taking into account the pre- and post-merger market shares of the merged firms, the level of symmetry between rival firms' market shares and the actual increase in concentration.¹⁷² The HHI is calculated by adding the sum of the square of both pre- and post-merger market shares of the merged firms and each rival in the relevant market.¹⁷³ The ACCC will be less likely to identify concerns when the post-merger HHI is:

- > Less than 2000; or
- > Greater than 2000 with a delta¹⁷⁴ less than 100.¹⁷⁵

For example, if the market is composed of five firms: A, B, C, D and E, with market shares of 12%, 15%, 18%, 25% and 30% respectively, then the pre-merger HHI value is 2218:

$$12^2 + 15^2 + 18^2 + 25^2 + 30^2 = 2218$$

Post-merger, the market is composed of four firms as B and C merged, so the market shares are now 12%, 33%, 25% and 30% respectively. The post-merger HHI value is 2758:

$$12^2 + 33^2 + 25^2 + 30^2 = 2758$$

The delta, or change from the pre-HHI value to the post-HHI value, is 540:

$$2758 - 2218 = 540$$

In this circumstance, the merger would invite close scrutiny by the ACCC as the HHI is greater than 2000 and the delta is greater than 100.

¹⁷¹ The United States Department of Justice, *Herfindahl-Hirschman Index* (29 July 2015) <<https://www.justice.gov/atr/herfindahl-hirschman-index>>.

¹⁷² Australian Competition and Consumer Commission, Parliament of Australia, above n 124.

¹⁷³ Corones, above n 168, 18.

¹⁷⁴ The delta reflects the changes in market concentration as a result of the merger.

¹⁷⁵ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 7.14.

It is important to note that the HHI threshold is a screening device for identifying merger and acquisitions that may require closer scrutiny. HHI values above the threshold do not determine that a merger will result in a substantial lessening of competition. Likewise, a merger falling below the HHI threshold may still raise competition concerns.

For that reason, the next step is to consider further merger factors as part of the overall assessment of whether a merger or acquisition is likely to substantially lessen competition. These factors are codified in s 50(3) of the CCA and are discussed below.

3 The Substantial Lessening of Competition Test, the Counterfactual and the Merger Factors

‘Substantial’ is an important concept in competition and consumer law. It arises in a number of provisions, yet there has been little judicial guidance. ‘Substantial’ has been defined in case law as large, weighty, big, real, of substance or not insubstantial. The meaning of substantial depends on the context and it is used in a relative sense.

In *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000]¹⁷⁶ French J said that to work out whether competition is being substantially lessened

... there [must] be a purpose, effect or likely effect of the impugned conduct on competition which is substantial in the sense of meaningful or relevant to the competitive process.

The application of the substantial lessening of competition test involves a comparison of the competitive situation with the merger against the competitive situation without the merger. The latter is called the ‘counterfactual’. The counterfactual is an analytical tool used in answering the question of whether the merger gives rise to a substantial lessening of competition.¹⁷⁷ The description of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, enabling the Commission or the Court to predict with some confidence what the outcome of a merger and acquisition on the market would be.

¹⁷⁶ FCA 38; (2000) ATPR 41-752.

¹⁷⁷ *Australian Competition and Consumer Commission v Metcash Trading Ltd* [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011), [130].

At trial in the case of *Metcash*,¹⁷⁸ Emmett J considered that it was necessary for the ACCC to establish ‘on the balance of probabilities’ what the ‘future state of the market will be, both with and without the proposed acquisition’.¹⁷⁹ The without test predicts what the future state of the market will be should the *proposed* merger not occur. It deliberates on the potential changes in the market and compares this ‘hypothetical market’ to the present state of the market. Should the future market with the merger stifle competition, the acquiring firm may be prohibited from proceeding with that transaction.¹⁸⁰ However, should the future market with the merger or acquisition maintain or encourage competition that would otherwise not occur, the transaction is likely to be permitted to proceed.

In considering the future, assumptions are made about what is likely to happen. An analysis of s 50 does not encompass ‘mere possibility’ but requires assessment ‘at a level that is commercially relevant or meaningful’.¹⁸¹ Given the penalties that apply for a breach of s 50, this prediction must be more than a hypothesis or conjecture.¹⁸²

The Federal Court’s 2011 decisions in *Metcash*¹⁸³ and *Australian Gas Light Co v Australian Competition and Consumer Commission* (No 3)¹⁸⁴ (AGL Case) addressed the necessary level of proof required to demonstrate that a proposed merger would substantially lessen competition. The Court approached the assessment in two stages:

- (a) The counterfactual must be proved on the balance of probabilities so that it is more probable than not that the proposed counterfactual will come to pass if the acquisition does not proceed.
- (b) There must be a ‘real chance’ that the effect or likely effect of the acquisition will result in a substantial lessening of competition. That is, there must be a real chance that if the proposed acquisition does proceed, that would result in a substantial lessening of competition compared to the scenario in which an alternative counterfactual comes to pass.¹⁸⁵

¹⁷⁸ Ibid, [130].

¹⁷⁹ Ibid, [45].

¹⁸⁰ Ibid, [135–136].

¹⁸¹ Ibid, [136].

¹⁸² Ibid, [88].

¹⁸³ Ibid.

¹⁸⁴ (2003) 137 FCR 317.

¹⁸⁵ *Australian Competition and Consumer Commission v Metcash Trading Ltd* [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011), [146].

In determining whether a substantial lessening of competition is likely to occur for the counterfactual analysis the court and ACCC may consider the merger factors enshrined in s 50(3) of the CCA. They outline the analytical and evaluative framework that the ACCC applies when reviewing mergers under s 50.¹⁸⁶ The nine merger factors are a non-exhaustive list of factors to guide the courts and ACCC regarding the possible effect on competition of a given merger. The nine merger factors are discussed below.

(a) *The actual and potential level of import competition in the market*

Import competition refers to the level of actual or potential direct competition from substitutable imported goods or services in the relevant market. The extent to which the merging firms are constrained by this is an effective check on market power. Former Chairman of the ACCC, Allan Fels commented:

Potential, or real, import competition is considered an important factor because of the globalisation of markets. If import competition is an effective check on the exercise of market power, it is unlikely the Commission will intervene in a merger.¹⁸⁷

There is no judicial interpretation of the requisite level of import competition needed to deem that no substantial lessening of competition has occurred; however, the ACCC has indicated that it will not oppose mergers in markets where the market share of imports has been more than 10% for at least 3 years.¹⁸⁸

An example is the merger between *Avery Dennison Australia Group Holdings Pty Ltd and Jackstaedt Holdings Pty Ltd JAC Australia Pty Ltd*. In this case, the merger concentration thresholds were significantly exceeded. The merger was not opposed because:

¹⁸⁶ Nelson, above n 164.

¹⁸⁷ Allan Fels, 'Mergers and Market Power' (Speech delivered at the Australian Financial Review Conference, CFO 2001 Summit, Sydney, 7 June 2001) <http://www.accc.gov.au/speeches/2001/pdf/Fels_AFR_CFO_Summit_7_5_01.pdf>.

¹⁸⁸ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 5.111.

[W]hile the merger combines the two largest domestic manufacturers of label stock; customers have indicated that their ability to import, or vertically integrate their operations by manufacturing label stock, will constrain price levels in the market post-merger ... [T]he Commission notes that imports have constituted at least 10% of the Australian market for label stock for at least the last 3 years.¹⁸⁹

In some cases, it is not necessary for imports to have reached 10% as long as there is the potential to import. A case example is *Cesco Australia Ltd and Forbes Engineering Holdings (Aust) Pty Ltd*. The proposed joint venture between these parties would have resulted in ‘the two largest manufacturers and services of concrete mixers combining their operations’. Despite the fact that existing imports ‘did not exceed 10 per cent’, the Commission found there was a ‘potential for imports ... particularly from New Zealand’ and that this was a key factor in not opposing the merger.¹⁹⁰

For markets where import competition is not an effective check on market power, barriers to entry are explored.

(b) The height of barriers to entry to the market

The ease with which a new firm may enter a market can provide an important source of competitive constraint on existing operators. Markets with low barriers to entry are comprised of consumers who easily switch to operators providing the greatest benefit. Therefore, threats of new entrants make it unsustainable for existing operators to raise prices or reduce the quality of services. A credible threat of a new entry may alone be sufficient to regulate the market.¹⁹¹

Barriers to entry have a wide-reach. The Explanatory Memorandum to the *Trade Practices Revisions Bill 1986* (Cth) summarised barriers to entry as ‘[A]ny feature of a market that places an efficient prospective entrant at significant competitive disadvantage compared with

¹⁸⁹ Avery Dennison Australia Group Holdings Pty Ltd (acquirer) and Jackstaedt Holdings Pty Ltd – JAC Australia Pty Ltd (target) (decided 19 November 2001): Mergers Public Register 2001: <http://www.accc.gov.au/pubreg/s50/nov_dec_2001/138m01.pdf>.

¹⁹⁰ Cesco Australia Ltd (acquirer) and Forbes Engineering Holdings (Aust) Pty Ltd (target) (decided 31 October 2001): Mergers Public Register 2001: <http://www.accc.gov.au/pubreg/s50/sep_oct_2001/128m01.pdf>.

¹⁹¹ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 7.17.

incumbent firms'.¹⁹² Commercially, this may include structural or technological barriers, strategic barriers, legal and regulatory barriers, or any combination of these factors. Examples include licensing requirements, planning or environmental controls, industry standards, scarce resources, threat of retaliatory action by incumbents and pre-existing economies of scale or scope such that a new firm may find it near impossible to establish brand loyalty.¹⁹³

If there is a high likelihood¹⁹⁴ of timely¹⁹⁵ and sufficient¹⁹⁶ entry in all relevant markets post-merger (low barriers to entry), it is unlikely that a merger will have the effect of substantially lessening competition. If barriers are high, contemplation of further factors may be required.

The 'Airport Monitoring Report' describes the situation where barriers to entry are intentionally created by Melbourne Airport to reduce the ability of off-airport parking and private bus operators to compete with the airport's own car parking services.¹⁹⁷ The ACCC found that Melbourne Airport 'imposes excessive access levies, and controls the available space for [off-airport parking and private bus] operators, [which] affects those operators' own prices, convenience and, therefore, attractiveness to consumers'. By reducing the ability of alternative operators to successfully enter the market and compete, Melbourne Airport can increase demand for its own parking services, charge higher prices to consumers, and therefore earn monopoly profits.¹⁹⁸

¹⁹² Explanatory Memorandum, *Trade Practices Revisions Bill 1986* (Cth), 5.

¹⁹³ Russell V Miller, *Miller's Australian Competition and Consumer Law Annotated* (Lawbook, 37th ed, 2015) 637; *Merger Guidelines*, above n 124, 7.26–7.32.

¹⁹⁴ The ACCC needs to be satisfied that actual or threatened entry post-merger is not just possible but likely in response to an attempted exercise of market power by the merged firm; Australian Competition and Consumer Commission, above n 108, 7.24.

¹⁹⁵ Entry will generally provide an effective competitive constraint post-merger if actual or threatened entry would occur in an appropriate time to deter or defeat any non-transitory exercise of increased market power by the merged firm.

¹⁹⁶ Entry must be of sufficient scale with a sufficient range of products to provide an effective competitive constraint.

¹⁹⁷ Australian Competition and Consumer Commission, 'Airport Monitoring Report 2009-10' (2011) vii <<https://www.accc.gov.au/system/files/Airport%20monitoring%20report%202009-10.pdf>>.

¹⁹⁸ Australian Competition and Consumer Commission, 'ACCC Issues Annual Report on Airport Performance' (Media Release, 7 February 2011).

Moreover, customers of Melbourne Airport car park reported increasing detriment despite having to dig deeper into their pockets. The 'Airport Monitoring Report 2012–13' revisits the latest passenger and customer ratings for these services:

- > Curbside space congestion fell to 'poor'.
- > Ratings for availability of parking bays fell to 'very poor'.
- > Ratings for the availability of taxiways fell to 'poor'.¹⁹⁹

Similar findings were presented for Sydney Airport.²⁰⁰

(c) *The level of concentration in the market*

Any increase in market concentration resulting from a reduction in the number of competitors or accrual of significant additional market share will be relevant. The HHI threshold, as discussed, is used to determine the weight of this factor. It is the link between concentration and the strength of competition.

For example, the ACCC opposed the merger of the number two and three paint manufacturers in *Barloworld/Wattyl*.²⁰¹ The ACCC determined that the post-merger firm would have a 90% market share.²⁰²

(d) *The degree of countervailing power in the market*

Countervailing power exists where customers or suppliers have special characteristics allowing them to act independently of the merging parties. Such specific characteristics of a buyer may include size, market power, commercial significance compared to suppliers or the possession of negotiating leverage over suppliers.²⁰³ In *George Weston/Good Stuff Bakery*²⁰⁴ the ACCC concluded that in an acquisition in the wholesale

¹⁹⁹ Ibid, 285.

Chris Pash, 'Poor Service, Expensive Parking But Australia's Monopoly Airports Are Making More Money Than Ever', *Business Insider Australia* (3 April 2014) <<http://www.businessinsider.com.au/poor-service-expensive-parking-but-australias-monopoly-airports-are-making-more-money-than-ever-2014-4>>.

²⁰⁰ Australian Competition and Consumer Commission, above n 197.

²⁰¹ Australian Competition and Consumer Commission, Competition Assessment, 11 August 2006.

²⁰² Russell V Miller, *Miller's Australian Competition and Consumer Law Annotated* (Lawbook, 33rd ed, 2011), 720. The 2015 edition of this text (Miller, above n 191, 639) refers to other examples – *Bluescope Steel Ltd/Hills Holdings Ltd and Carsales.com Ltd/Telstra Corporation Ltd and Mestle S.A/Pfizer Inc*.

²⁰³ Miller, above n 191, 638.

²⁰⁴ Australian Competition and Consumer Commission, Competition Assessment, 16 March 2007.

market for the manufacture and distribution of bread in southern Queensland and northern New South Wales, the major supermarket chains of Coles and Woolworths were likely to possess countervailing power (buyer power) and therefore constrain the merged firms from exercising market power.²⁰⁵ Therefore, the merger was permitted to proceed.

(e) *The likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins*

Sustained price increases above competitive levels are the most obvious and visible manifestation of market power and reduction in competition. In general, an increase in price will result in a corresponding increase in profit margins. For this factor, it is irrelevant whether the merged firm actually exercises this power.

The closeness of rivalry between the merger parties and other market participants is also relevant. If, for a significant number of customers, the merger parties are the other's closest competitor and there would be no close competitors to the merged firm in one or more relevant markets, the ACCC considers this environment at risk of substantially lessening competition.²⁰⁶ Conversely, if the merger parties are distant competitors and the comparable alternatives to the merged firm are available in plentiful supply to the entire market then, in the absence of coordinated effects, this can indicate that a merger is unlikely to substantially lessen competition.²⁰⁷

In the *Metcash* case, the major supermarket chains were determined to be a significant constraint on the capacity of Metcash Ltd to increase the price at which it supplied goods. A price increase of five to ten per cent could not be sustained without losing business to its competitors – Coles or Woolworths.²⁰⁸

²⁰⁵ Miller, above n 202, 720. The 2015 edition of this text (Miller, above n 191, 639) refers to other examples – *Baxter International Inc/Gambro AB and Hexion/Orica*.

²⁰⁶ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 7.42.

²⁰⁷ *Ibid*, 743.

²⁰⁸ *Australian Competition and Consumer Commission v Metcash Trading Ltd* [2011] FCA 967 (25 August 2011); [2011] FCAFC 151 (30 November 2011), [340].

(f) *The extent to which substitutes are available in the market or are likely to be available in the market*

The availability or potential availability of substitutable products provides consumers with viable alternatives if a merged firm seeks to raise prices. The extent to which substitutability constrains the merged firm's market power depends on how substitutable other products are, however, a narrow assessment is not adopted. It is not necessary that the competing product be identical, it is sufficient if the substitute is a workable alternative. For example, in *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission*²⁰⁹ it was said that:

A wall is a wall, whether it is made of concrete blocks, tilt-up concrete bricks or clay bricks. The only need of the builder is to have a wall that will perform as a wall, and for the lowest cost possible. Within the market in which builders acquired materials for the use in the construction of walls there was not only the ever present threat of potential substitution but actual substitution over the time.²¹⁰

(g) *The dynamic characteristics of the market, including growth, innovation and product differentiation*

When analysing the competitive effects of a merger, the forward looking nature of merger analysis requires the ACCC to take into account the changing nature of the market in the future.²¹¹

Markets that are growing rapidly are more likely to see competitive new entrants and the erosion of market shares of incumbents over time. Conversely, markets that are stagnant or reducing may see the opposite.

Other occurrences such as product innovation, improved distribution methodologies, brand loyalty or regulatory and technical changes must also be considered under s 50(3)(g).

The 2003 *Coca-Cola Amatil/Berri*²¹² merger involved the unification of the market for the manufacture and wholesale supply of chilled and ambient fruit juice and fruit drink. The ACCC observed that although there was evidence of small or regional entry occurring to some extent and the erosion of market shares over time, very few new entrants had

²⁰⁹ (2003) 195 ALR 609.

²¹⁰ *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374, 130.

²¹¹ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 7.52.

²¹² Australian Competition and Consumer Commission, Competition Assessment, 8 October 2003.

captured meaningful market shares in recent years. On these grounds the merger was opposed. The parties withdrew the application.

(h) *The likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor*

The removal of a vigorous competitor from the market will have a significant impact on the level of competition in the market.

Vigorous and effective competitors drive significant aspects of competition, such as pricing, innovation and product development. A merger that removes a vigorous and effective competitor may therefore remove one of the most effective competitive constraints on market participants and thereby result in a substantial lessening of competition.²¹³

For example, the proposed merger between *Healthe/Healthscope*²¹⁴ involved the acquisition of a private hospital in the Gosford (NSW) area, where Healthe already operated a private hospital. The ACCC considered post-acquisition competitive tensions between the two hospitals would cease, leading to a reduced incentive on the part of Healthe to provide quality service.²¹⁵

(i) *The nature and extent of vertical integration in the market*

Some horizontal mergers can be affected by vertical integration in the market. Vertical mergers occur between two or more firms that operate within varying stages of production and distribution within the same industry. For example, where a retailer acquires a manufacturer or wholesaler in its supply chain.

Vertical mergers do not reduce the total number of entities operating at one level in the market, but it may change patterns of industry behaviour. Vertically integrated firms may discriminate in favour of their own business to the detriment of others in the market. Suppliers may lose a market for their goods, retail outlets may be deprived of

²¹³ Australian Competition and Consumer Commission, Parliament of Australia, above n 124, 7.57.

²¹⁴ Australian Competition and Consumer Commission, Competition Assessment, 22 January 2007.

²¹⁵ Miller, above n 202, 721. The 2015 edition of this text (Miller, above n 193, 639) refers to other examples – *Perpetual Ltd/The Trust Company Ltd and PMP/McPherson's*.

supplies and competitors may find that both supply and outlets are blocked. Vertical mergers may also substantially lessen competition by discouraging new businesses from entering the market.

*Trade Practices Commission v Rank Commercial Ltd*²¹⁶ provides an example of how the court interprets and applies the substantial lessening of competition test. Using the merger factors the court identified a number of characteristics of the market and the particular transaction that it determined would result in a substantial lessening of competition should the merger proceed.

In this case, the Trade Practices Commission ('TPC') successfully obtained an interim injunction for the duration of two months preventing Rank from proceeding with a public offer to acquire Foodland ('FAL').²¹⁷ To establish its case, the TPC relied on the existence of a Deed of Operation between Respondents that arranged a complex chain of transactions ending with Coles Myer Limited ('CML') acquiring the Australian assets of Foodland.

The TPC was successful on the basis that the transaction was likely to substantially lessen competition in the wholesale grocery market in Western Australia. In applying the SLC test the TPC examined the current state of the market without the merger and the hypothetical state of the market with the merger. It was accepted that FAL had New Zealand assets and was also the independent West Australian grocery wholesaler where there were already 'substantial barriers to entry' into the wholesale retail market, with FAL and CML being each other's main rival. If CML obtained control of FAL, or of FAL's WA operations, CML would 'control approximately 75%' of the WA retail grocery sales. There was likely to be a substantial lessening of competition in the retail market because CML would 'directly control the supplies and retail outlets of its most significant competitor'. There would be 'no alternative but to deal with CML' and 'little ability to influence the terms of trade'.

²¹⁶ (1994)123 ALR 551.

²¹⁷ FAL had New Zealand assets and was also the independent West Australian grocery wholesaler.

Rank withdrew its take-over offer of Foodland before proceeding to a final hearing in the Federal Court.

There are three significant commercial difficulties with this counterfactual analysis.

First, it ignores the cumulative effect of mergers and acquisitions. Secondly, the counterfactual does not have the ability or scope to consider cross-market concentration. Thirdly, there is no express mention of the cumulative effect of mergers and acquisitions in the merger factors.

As s 50 refers only to a single acquisition there is no power in the assessment of mergers and acquisitions to consider the cumulative effect of multiple acquisitions that raise competitive concerns.²¹⁸ The application of the 'with' or 'without' formulation of the counterfactual nullifies the effects of any previous acquisitions on the market. It focuses less on capturing the 'creeping' effect of a series of acquisitions and more on preventing dominant firms from enhancing their market power.

In applying the counterfactual, the present state of the market at the time the merger or acquisition is proposed is used as the benchmark. The 'without' test hypothesises what the future state of the market will be should the *proposed* merger *not* occur versus what the future state of the market is likely to be *should* the *proposed* merger proceed. It deliberates on the potential changes in the market and compares 'hypothetical markets' as well as the present state of the market.

Should the future market with the merger stifle competition, the transaction will likely not be permitted to proceed. However, should the future market with the merger or acquisition maintain or encourage competition that would otherwise not occur the transaction will likely be permitted to proceed.

In both cases, whether the merger or acquisition will advance or limit competition in the future market is a judgement based on comparing the future market to the present market. Acquisitions occurring prior to the crystallisation of the benchmark present market do not form any part of the backdrop for assessing the competitive implications of a proposed transaction. The number, size, manner or timeframe in which any previous mergers or acquisitions took place is ignored. All

²¹⁸ Clarke, above n 48, 6.

that is relevant is the current state of the market at the point in time immediately before the *proposed* merger or acquisition.

For example, a market in 2015 is comprised of 10 firms, each with 10% market share.

$$10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

Firm A undertakes five piecemeal acquisitions over a period of two years. Each individual acquisition increases firm A's market share by 10%.

Acq 1

$$20\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

Acq 2

$$30\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

Acq 3

$$40\% + 10\% + 10\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

Acq 4

$$50\% + 10\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

Acq 5

$$60\% + 10\% + 10\% + 10\% + 10\% = 100\%$$

When considering the effects on competition, the counterfactual limits the analysis only to the acquisition immediately before the acquisition in question. The counterfactual does not have the scope to examine firm A's exponential increase in market share from 10% to 60% between acquisition 1 and acquisition 5. The analysis is restricted to each individual proposed acquisition and the relevant benchmark market.

For acquisition 1, the benchmark state of the market comprises of firm A possessing 10% market share. The future hypothetical state of the market with the proposed acquisition sees firm A increase their market share by an unalarming 10% – to 20%.

For acquisition 2, the composition of the market after acquisition 1 (firm A with 20% market share) becomes the new benchmark state of the market. Again, the future hypothetical state of the market with the second proposed acquisition sees firm A increase their market share by an unalarming 10% – to 30%.

As this example highlights, the proposed hypothetical market for the counterfactual analysis of acquisition 1 has now become the present benchmark market for acquisition 2. The counterfactual analysis neutralises the increase to 10%, rather than for what it really is – a 20% increase in market share.

This cycle can continue until firm A achieves a market share of 60% yet the transactions are only ever analysed in 10% increases; despite the fact that firm A's increase is actually sixfold.

From a theoretical point of view it is easy to understand that while a merger that gives a large firm an extra 5% market share is unlikely to lead to substantial anti-competitive effects (depending on the relevant market dynamics), four similar transactions by the same large firm which increase its market share from 40% to 60% will almost certainly do so.²¹⁹ In this way creeping acquisitions circumvent s 50, with little to no recourse.²²⁰

While there is an argument for certainty, commercially, markets are not linear. Dealings permitted to proceed today can have an anti-competitive impact on the market in a year from now. Certainty must be balanced with fairness, sustainability and the correction of anti-competitive conduct. The advantage of a creeping acquisition provision would allow the regulator to address and prevent industries from becoming excessively concentrated as a result of creeping acquisition activity. To balance the need for certainty, the recommendations discussed later in this article suggest legislating a review period of two years allowing the ACCC and courts to look back at the total cumulated transactions. Where appropriate, any mergers or acquisitions during this two-year period may be considered as one.

As currently defined, the counterfactual 'with' or 'without' test also does not provide power to the ACCC to consider the level of concentration an entity may possess across numerous unrelated markets. The narrowness of the counterfactual does not permit considerations of cross-market concentration as it is focused solely on competition in

²¹⁹ Genna Robb, 'Creeping Mergers – should we be concerned? A Case Study of Hospital Mergers in South Africa' (Paper presented at the Seventh Annual Conference on Competition Law, Economics and Policy, 5 and 6 September 2013).

²²⁰ Australian Competition and Consumer Commission, Submission to Competition and Consumer Policy Division of the Commonwealth Treasury, *Creeping Acquisitions: Discussion Paper 1*, 23 October 2008, 5.

the defined market in which the merger or acquisition is proposed.²²¹ The existing rules do not currently require or allow the ACCC or the Courts to analyse all past history when determining whether the latest acquisition has substantially lessened competition.

Cross-market concentration refers to high levels of aggregate concentration in markets where a small group of economic entities control large parts of the economies' activity through holdings in 'unrelated' markets. For example, where multiple subsidiaries or branches of the same parent entity operate and dominate different unrelated markets.

Cross-market concentration is a concern nationally and in other jurisdictions around the world.²²² In Australia, there are already examples of corporations having subsidiaries across a vast range of industries and markets. For example, the Woolworths group is made up of four main divisions: Supermarkets, General Merchandise (Big W and consumer electronics), Hotels (via its 75% shareholding in ALH) and Wholesale.²²³ The Supermarkets Division alone comprises Australian Food and Liquor, Petrol and New Zealand Supermarkets.

For merger analysis, each division and subdivision operates in separate and distinct markets with Woolworths being a dominant player in each of these markets. Woolworths' grocery/supermarket business has 'partnered' with its petrol retailing business through the use of shopper docket incentives. In this arrangement, 4-cent discounts are offered on fuel purchases at Woolworths 516 petrol sites and 92 Caltex-operated sites²²⁴ when a customer spends \$30 or more on groceries from Woolworths' supermarkets. These redemptions link money spent

²²¹ This is to be differentiated from conglomerate mergers that involve firms that interact across several separate markets and supply products that are typically in some way related to each other. For example, products in neighbouring markets or products that are complementary in either demand or supply, such as staples and staplers. The issue of conglomerate markets was addressed by amendments to s 50 intended to clarify the ability of the ACCC or a court to consider multiple markets when assessing mergers. While this expanded the ACCC's ability to consider the totality of the competitive effects resulting from an acquisition, it continues to fall short in assessing situations of unrelated cross-market concentration.

²²² Michael S Gal and Thomas K Cheng, 'Aggregate Concentration: A Study of Competition Law Solutions' (2016) 4 *Journal of Antitrust Enforcement* 2, 282-322.

²²³ Woolworths Limited, *Woolworths Annual Report 2015*, 116.

²²⁴ *Ibid*, 25.

in one division to the redemption of discounts in another division in an unrelated market. Likewise, the shopping dockets customers receive when purchasing items from a Coles supermarket contain a discount that can be redeemed at participating Shell petrol retailers.

While the ACCC has confirmed this arrangement is not in itself anti-competitive, the concern for merger analysis is that this cross-market domination is not considered when determining the counterfactual. These cross-market benefits should be considered during the analysis of a merger.

Looking at the 9 merger factors, while the merger guidelines are a powerful tool, they offer little assistance on the issue of creeping acquisitions, and what guidance they do offer has no legislative force.²²⁵

The 2008 Merger Guidelines are substantially more discretionary than their 1999 version. This is the result of two particular aspects of the current guidelines. First, the use of uncertain and imprecise language; and second, the removal of the safe harbour doctrine.

In the 1999 Merger Guidelines, the potential harm due to creeping acquisitions was acknowledged, but not completely addressed. Paragraph 3.31 of the 1999 Merger Guidelines provided that:

The Commission may, under s 50, also consider the collective effect of shareholdings that are acquired incrementally over a period. In particular, the Corporations Law permits acquisitions beyond 20 per cent (the normal takeover threshold), of up to 3 per cent every six months without triggering the requirement for a full takeover offer. The initial acquisition may not raise substantial competition concerns, and each incremental acquisition may not give rise to a substantial lessening of competition in its own right. However, collectively the acquisitions may give rise to competition concerns and may eventually deliver control of the target company. The Commission considers that the Act may apply to such creeping acquisitions.

Paragraph 5.99 added:

A further relevant consideration is the extent of the increase in concentration. In many situations the acquisition of a small market player, resulting in a small increase in concentration, will have little effect on

²²⁵ Australian Competition and Consumer Commission, *Competition and Consumer Legislation Amendment Act 2011* (3 September 2014) <<https://www.accc.gov.au/system/files/Merger%20guidelines.pdf>>.

competition. However, in some instances a small increase in concentration may involve the removal of a market participant which played a significant role in maintaining a competitive market, e.g. by undermining attempts to coordinate market conduct. In other circumstances a small acquisition may form part of a pattern of creeping acquisitions, which have a significant cumulative effect on competition.

Paragraph 5.99 went on to acknowledge that vertical mergers, although they may involve no increase in concentration, still enable the extension of market power into a vertically related market – which is the preferred structure of the supermarket duopoly today.²²⁶

This express mention of creeping acquisitions or ‘small increases’ was omitted from the 2008 Merger Guidelines, so they no longer refer in any way to the cumulative effect of previous acquisitions.²²⁷ No explanation has been provided as to why this section was omitted.

There is an argument that the current merger factors and Guidelines provide scope for the ACCC to consider creeping acquisitions. The view is that Parts 5 and 6 of the 2008 Guidelines inexplicitly address the competition problems associated with creeping acquisitions²²⁸ by requiring assessment of competitive effects based on the theories of competitive harm – namely, unilateral or coordinate effects that may arise as a result of the acquisition.²²⁹ In cases where unilateral or coordinate effects amount to a significant and sustainable increase in market power of the merged firm or other firms in a given market, the merger is likely to substantially lessen competition in contravention of the CCA. Similarly, s 50(3)(g) – ‘the dynamic characteristics of the market including growth, innovation and product differentiation’ – is claimed to be sufficiently broad in scope to permit a court or the ACCC to consider issues such as creeping acquisitions.

The uncertainty created by drawing inferences from the current Guidelines to cover the issue of creeping acquisitions seems an

²²⁶ Australian Competition and Consumer Commission, Parliament of Australia, above 108, 5.99. Vertical mergers may involve no increase in concentration but may enable the extension of market power into a vertically related market.

²²⁷ Australian Competition and Consumer Commission, Parliament of Australia, above 108, 5.99.

²²⁸ Australian Competition and Consumer Commission, Parliament of Australia, above 124, 3.31 and 5.99.

²²⁹ Australian Competition and Consumer Commission, Parliament of Australia, above 108, 11.

unnecessary stretch. Furthermore, what implicit guidance can be extrapolated is weak. A decision handed down by the ACCC that a merger or acquisition is anti-competitive as a result of the cumulative effects on competition rather than the isolated effect of the merger would unlikely survive legal challenge. That is, it would be beyond the power of the regulator under the existing legislation to prohibit a merger based on the effects of a series of mergers which are said to collectively offend the existing law.

Secondly, while providing a useful illustration of the HHI's application, the Guidelines have no statutory effect and are not binding on the ACCC or the Court. Thus, collective mergers with anti-competitive effects may be ignored in the decision-making process. For example, the *Grocery Inquiry* reported the HHI for the packaged groceries market is between 2750 and 3000.²³⁰

Given the Guidelines state that the ACCC considers markets to be concentrated when the HHI is greater than 2000, clearly, according to the ACCC's own definition, the market for packaged groceries is concentrated to a level that requires action on the part of the regulator. Surprisingly, this level of concentration appears to be overlooked and given little weight. Mergers and acquisitions in this market continue to be permitted despite exceeding the concentration ratios used to identify commercial behaviour that is prima facie anti-competitive.

In 2011 it was noted that the Guidelines have not been referred to by an Australian court considering a merger.²³¹ This can be contrasted with the US. While the US Merger Guidelines²³² are also a statement of policy that is not binding on the courts,²³³ in practice, the US courts have relied on them heavily.²³⁴ In the US, the Guidelines are given 'precedent-like'

²³⁰ National Association of Retail Grocers of Australia Pty Ltd, above n 37, 5.

²³¹ John Duns and Arlen Duke, *Competition Law: Cases & Materials* (LexisNexis Butterworths, 3rd ed, 2011) 110.

²³² Issued jointly by the DoJ and the FTC.

²³³ *Chicago Bridge & Iron Co v FTC* 534 F 3d 410, 431 n 11(5th Cir 2), cited in *The Anti Trust Source*, 'The Revised Horizontal Merger Guidelines: Can the Courts be Persuaded' (October 2010) <https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct10_Brannon10_21f.authcheckdam.pdf>.

²³⁴ *The Anti Trust Source*, 'The Revised Horizontal Merger Guidelines: Can the Courts be Persuaded' (October 2010) 2 <https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct10_Brannon10_21f.authcheckdam.pdf>.

treatment by the courts, and in some cases, the courts have given the Guidelines more weight than their own precedent.²³⁵

While this more extreme treatment may be inappropriate for a statement of policy, it arguably points to the need for Australian Courts to place greater importance on the Guidelines.

D Conclusion

There is a need for specific provisions to be introduced regulating creeping acquisitions to prevent firms ‘exploiting the ‘loophole’ in the current legislation’.²³⁶ The recommendations touched on in this Chapter could empower regulators to deal pro-actively with the competitive impacts created by creeping acquisitions. Competition is critical to the market economy and it is a critical role of Governments worldwide to keep economies open for competition. The answer involves a balance of securing the benefits some mergers or acquisitions produce and ensuring these benefits are passed on to consumers. While this will be discussed in more detail in Chapter Five, a mandatory notification regime inspired by comparable countries such as the US and UK would be preferred, with an expansion of the threshold test to require notification when the cumulative value of all entities over the previous two years exceeds reasonable thresholds.

²³⁵ *United States v Baker Hughes* 731 F Supp 3 (DDC 1990) and *FTC v Cardinal Health Inc* 12 F Supp 2d 34, 53 (DDC 1998), cited in *The Anti Trust Source*, ‘*The Revised Horizontal Merger Guidelines: Can the Courts be Persuaded*’ (October 2010) <https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct10_Brannon10_21f_authcheckdam.pdf>.

²³⁶ Law Council of Australia, Submission to Australian Competition and Consumer Commission, Consumer Amendment Bill 2010, 5.

IV HOW HAVE CREEPING ACQUISITIONS BEEN REGULATED ABROAD?

A Introduction

In 2002 the International Competition Network ('ICN')²³⁷ and the Organisation for Economic Co-operation and Development ('OECD')²³⁸ released a report entitled *Policy Roundtables: Substantive Criteria Used for Merger Assessment* ('OECD Report'). The OECD Report assessed the criteria used for merger assessment in its member states. In the report the Secretariat posed a number of hypotheticals to the participating 19 member states.²³⁹ One of those questions was:

Please explain why you do or do not believe that the choice of substantial lessening of competition or dominance test would make a difference in reviewing ... a series of small mergers which appear to be leading to the creation of a firm having significant market power.

The OECD Report reflected a high recognition from various international jurisdictions that creeping acquisitions are a serious issue in the competition space and are not easily addressed under current competition tests.²⁴⁰ It was widely acknowledged²⁴¹ that creeping acquisitions could be difficult to address under both the substantial lessening of competition test and the dominance test.²⁴² Of the 19 states providing submissions, only Germany and Mexico indicated

²³⁷ The ICN mission statement is to advocate the adoption of superior standards and procedures in competition policy around the world, formulate proposals for procedural and substantive convergence, and seek to facilitate effective international cooperation to the benefit of member agencies, consumers and economies worldwide.

²³⁸ The OECD Competition Committee has devoted substantial efforts to studying the merger review process and its work helped inform the development of the ICN Recommended Practices. The OECD and ICNs 'international best practices' are used as a guidepost and define a path to address many of the concerns identified with the merger review process. Australia is one of over 100 member-countries of the ICN.

²³⁹ Australia, Canada, Chile, Czech Republic, Denmark, the European Commission, Finland, Germany, Hungary, Ireland, Japan, Korea, Mexico, the Netherlands, New Zealand, Poland, Romania, South Africa, Spain, Switzerland, Chinese Taipei, Turkey, the United Kingdom, the United States.

²⁴⁰ Metcash Limited, Submission to Competition and Consumer Policy Division of the Commonwealth Treasury, *Creeping Acquisitions: Discussion Paper 1*, 10 August 2008, 5.6.

²⁴¹ By Australia, Brazil, Finland, Hungary, Ireland, Italy, Lithuania, Nederland, New Zealand and Norway.

²⁴² Under the dominance test, mergers resulting in the creation of a firm in a dominant position in a substantial market for goods and services in Australia, or a State or Territory of Australia, were prohibited.

unequivocally that their current merger regime would be sufficient to address creeping acquisitions.²⁴³ A small number of states²⁴⁴ with little comparability to Australia deemed the consideration irrelevant in the context of their anti-trust system.

The remainder of this Chapter will explain the approach various jurisdictions have taken to regulate creeping acquisitions.

1 Europe

The European Commission Merger Regulation ('ECMR') is the main legislative text for merger decisions within the EU.²⁴⁵ The ECMR regulates competition in the EU by prohibiting mergers that would significantly impede effective competition in a primary market, or in a substantial part of a market.²⁴⁶ The ECMR prohibits mergers resulting in the creation or strengthening of a dominant position.²⁴⁷

The ECMR does not expressly define creeping acquisitions; however it does consider a series of previous transactions if they have taken place 'within a reasonable period of time even if they fall below turnover thresholds'.²⁴⁸ The ECMR explains that a single concentration will also arise in cases where control over one undertaking is acquired by a series of transactions in securities from one or several sellers taking place within a reasonably short period of time. The concentration in these situations is not limited to the acquisitions of the 'one and decisive' share but will cover all acquisitions of securities. This approach also aggregates acquisitions carried out between different entities belonging to the same group. The provision applies to two or more transactions between the same persons or undertakings if they are carried out simultaneously. Such simultaneous transactions between the same

²⁴³ Organisation for Economic Co-operation and Development, 'Policy Roundtables: Substantive Criteria Used for Merger Assessment' (Report, 2002) 181, 235. <<http://www.oecd.org/competition/mergers/2500227.pdf>>.

²⁴⁴ Chinese Taipei, Czech Republic, Korea and Spain.

²⁴⁵ European Commission, *Merger Regulation* (25 November 2014) <<http://ec.europa.eu/competition/mergers/legislation/regulations.html>>.

²⁴⁶ *Council Regulation (EEC) No 4064/89* of 21 December 1989 on the control of concentrations between undertakings (published in Official Journal L 395, 30 December 1989 as last amended Official Journal L40, 13 February 1998), Article 3.

²⁴⁷ OECD, above n 243, 309.

²⁴⁸ Australian Competition and Consumer Commission, *Creeping Acquisitions*, Discussion Paper 1, 2008, 73.

parties are deemed to form a single concentration even if they are not connected with each other.

Although the term ‘within a reasonable period of time’ is not defined, Article 5(2) subparagraph 2 provides a specific rule which allows the Commission to consider two or more transactions taking place within a two-year period between the same persons, or undertakings to be treated as one and the same arising on the date of the last transaction. This is irrespective of whether or not those transactions relate to parts of the same business or concern the same sector.²⁴⁹ The two-year rule does not apply where other persons or undertakings join the same persons or undertakings for only some of the transactions involved.²⁵⁰ This two-year review period has been adopted across many European nations.²⁵¹

The objective of this provision is to capture cases of attempted circumnavigation of the ECMR merger regulations.²⁵² The provision ensures that entities do not strategically breakdown an overall transaction into a series of smaller acquisitions over a period of time that individually do not exceed turnover thresholds but cumulatively have that effect.

Within the EU region, Finland reported great difficulty in addressing creeping acquisitions. Finland currently adheres to the dominance regime explaining that a series of small mergers will only be covered by the dominance test when a required level of dominance is achieved. For example, a merger between the number two and three firms in a market that does not result in the merged entity becoming the number one firm would not be covered by this dominance test.

Finnish merger controls implement an explicit merger provision to account for a series of small mergers in line with the ‘two-year rule’.²⁵³

²⁴⁹ Article 5(2) of the European Commission Merger Regulation, European Council regulation No 139/2004 of 20 January 2004, OJ L 24. 29.1.2004.

²⁵⁰ Kirsty Middleton (ed), Blackstone’s UK and EU Competition Documents (Oxford University Press, 7th ed, 2011) 502.

²⁵¹ Council Regulation 139/2004 EC.

²⁵² T-282/02 *Cementbouw Handel & Industrie BV v Commission of the European Communities* [2006] ECR II-319, 118.

²⁵³ OECD, above n 243, 171 and Articles 11b(4) and (5) of the Finnish merger control, the *Competition Act*. The Act was amended in 2004 and Article 11b(5) was repealed. Now, when the turnover of concentrations concluded after 1 May 2004 is calculated, transactions made in the same line of business are no longer taken into account. However, the two-year rule on arrangements between the same buyer and seller under Article 11(4) is still in force.

According to Articles 11b(4) and (5) of the *Finnish Competition Act* (661/2012), where business operations are acquired through two or more successive transactions, the turnover of the target of the acquisition shall mean the combined turnover related to the business operations acquired from the same entity or foundation, and the turnovers of the entities or foundations acquired within the same industry in Finland during the two preceding years.²⁵⁴ In any successive two-year period,²⁵⁵ the turnovers of the business operations acquired are cumulated.

Similarly, in Hungary, the Hungarian Office of Economic Competition can prohibit a transaction at any time within a two-year period where a series of mergers place the acquiring firm in an economic position of market power, allowing the firm to act independently of the market.²⁵⁶

Lithuania acknowledged that a problem could arise with the practical application of either the dominance or substantial lessening of competition test if any small merger were analysed in isolation and treated as neither being a substantial lessening of competition nor creating or strengthening a dominant position.²⁵⁷

The UK, Spain, Norway and the Netherlands insist that in such a scenario of creeping acquisitions there is little difference between the ultimate outcome of applying a substantial lessening of competition test or a dominance test given the similarities in these two competition assessments. Each nation had its own view on why this is so.

Spain commented:

These models include heterogeneous criteria with many common aspects which are ultimately based on economic analysis and which lead to the same results in the vast majority of cases.

Despite this indifference, the Spanish regard the substantial lessening of competition test to better fit with economic analysis and that it would allow more flexibility especially when dealing with small-scale mergers.²⁵⁸

The Dutch view other considerations, such as specific market structure, conditions of the market place, and freedom of interpretation

²⁵⁴ Metcash Limited, above n 240, 5.5(a).

²⁵⁵ OECD, above n 243, 171.

²⁵⁶ *Ibid*, 195.

²⁵⁷ *Ibid*, 227.

²⁵⁸ *Ibid*, 269.

of the antitrust authority, to be more influential than the question of which test is to be applied.²⁵⁹

Although Norway adheres to a substantial lessening of competition test, it does not believe there is any difference whether the substantive test is dominance based or a substantial lessening of competition.²⁶⁰ Under s 16 of the *Competition Act 2004* (Norway) merger control is based on a twofold test consisting of a substantial lessening of competition test and an efficiency test. The substantial lessening of competition test permits the Competition Authority to intervene in mergers that create or strengthen significant market power. An intervention under s 16 can only be directed against the merger which creates a situation of significant market power. Thus, if the firm does not already possess significant market power the authority cannot intervene until significant market power is created by a final transaction pushing the entity over the threshold. It is not possible under current competition law to stop a ‘wave of mergers’ in its incipiency. The New Zealand submission expressed similar confusion as to what point, if at all, the threshold would be triggered in these cases.²⁶¹

An example of this in practice could be seen in the Norwegian electricity market. The major producer in the market – Statkraft – announced an intention to acquire a significant portion of its competitors. Prior to this the Competition Authority had considered competition somewhat restricted but not to a substantial degree. It was not until after the last acquisition of Agder Energi that the Authority considered Statkraft had reached the requisite level of significant market power to intervene. Therefore, only the last acquisition was prohibited.²⁶² A divestiture of the previous creeping acquisitions could not be ordered.

The UK *Enterprise Act 2002* expressly addresses creeping acquisitions. Section 29, titled ‘Obtaining control by stages’ permits, where appropriate, the decision-making authority to consider two or more transactions that have occurred within a two-year period to be treated as having occurred simultaneously on the date on which the latest of them occurred. Where the last of a series of transactions is an

²⁵⁹ Ibid, 249.

²⁶⁰ Ibid, 262.

²⁶¹ Ibid, 256.

²⁶² Ibid, 262.

anticipated merger and has not yet been completed, the Competition Markets Authority ('CMA') may still take this anticipated merger into consideration even though it may not actually be completed in the two-year period.²⁶³

The CMA also possesses broad powers to investigate industries which are suspected of showing anti-competitive effects associated with creeping acquisitions. If problems are found and a requisite degree of market disintegration is established, severe remedies can be imposed including requiring firms to divest assets or business units. For example, in the recent market study into the airport sector the CMA found that common ownership of airports in certain regions posed problems for competition and required the British Airports Authority to divest several airports.²⁶⁴

The CMA investigates the competitive effects of a series of creeping acquisitions on a case-by-case basis rather than a law of general application.²⁶⁵ It also investigates several facets of anti-competitive activity, including whether an acquisition in the UK will create certain market features to prevent, restrict or distort competition and particularly whether the acquisition will have any adverse effects on competition in a market.²⁶⁶ While this is very much substantial lessening of competition terminology,²⁶⁷ like Spain, Norway and the Netherlands, the UK is of the view that the two tests are likely to yield the same outcome in a situation of creeping acquisitions:

Where one of a series of mergers leads to an immaterial increase in market power then it is unlikely to be viewed as reinforcing or creating a dominant position or as a substantial lessening of competition. On the other hand, where such a small merger led to a material increase in market power, by definition, it is not a reinforcement or creation of a dominant position and substantial lessening of competition.²⁶⁸

The discussion will now be widened beyond the EU.

²⁶³ Jurisdictional and Procedural Guidance, para 4.33. Article 3, *Enterprise Act 2002 (Anticipated Mergers) Order 2003, SI 2003/1595*.

²⁶⁴ Competition and Markets Authority, 'BAA Airports: Evaluation of the Competition Commission's 2009 Market Investigation Remedies' (16 May 2016).

²⁶⁵ Australian Competition and Consumer Commission, above n 248, 70.

²⁶⁶ *Ibid*, 68.

²⁶⁷ John Davies, *Getting The Deal Through – Merger Control 2010* (September 2014) <<https://gettingthedealthrough.com/area/20/merger-control/>>.

²⁶⁸ OECD, above n 243, 286.

2 The Americas

US law and experience has had considerable influence on other jurisdictions. The US competition authority has published detailed Horizontal Merger Guidelines. These Guidelines adopt the substantial lessening of competition test for merger analysis so that mergers are prohibited if they create a ‘substantial lessening of competition or tend to create a monopoly²⁶⁹ in any market’.²⁷⁰ Merger guidelines indicate that the FCT or DoJ will oppose a merger if it is ‘likely to create or enhance market power or facilitate its exercise’. The statute has also been interpreted to prohibit mergers that worsen the competitive health of markets already exhibiting weak competition, and mergers, that forestall future competition.²⁷¹

When the FCT or DoJ review a merger that has come to their attention, they typically evaluate each individual transaction on its own merits. Each transaction is subject to the question of whether or not the transaction at issue will lead directly to anti-competitive effects.²⁷²

While the analytical framework is forward-looking and therefore does not specifically look back to previous acquisitions, it does explicitly entail considerations of ‘changing market conditions’ because ‘recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the likely future competitive significance’.²⁷³ This widens the authority’s consideration beyond statutory concentration ratios and notification thresholds. It acknowledges that in some cases, while these may not be triggered by the single transaction being reviewed, there might still be significant competitive effects. The US competition authorities expressed the opinion that:

²⁶⁹ A monopoly describes a market structure in which a commodity for which there are no close substitutes is supplied by only a single firm. As with perfectly competitive markets, absolute monopolies are rare.

²⁷⁰ Clayton Act 7, 15 USC 18, Sherman Act, 15 USC 1, Federal Trade Commission Act, 15 USC 45.

²⁷¹ Clayton Act 7, 15 USC 18.

²⁷² OECD, above n 243, 295.

²⁷³ The United States Department of Justice, *Concentration and Market Shares* (29 July 2015) <<https://www.justice.gov/atr/herfindahl-hirschman-index>>-concentration-and-market-shares

Concentration trends alone are irrelevant except insofar as they might suggest that somewhat more severe anti-merger rules be applied when an industry reaches or approaches a particular level of concentration ... In that event it is the present market structure that is critical.²⁷⁴

In the US in 1996, over 1000 mergers resulted from the liberalisation of previous statutory limitations on radio ownership. This catalysed a rapid consolidation of the industry in which the DoJ brought a number of cases. One such case was American Radio Systems Corp's merger with EZ Communications. The DoJ's action arose out of a series of proposed acquisitions by American Radio and EZ, culminating in the *American Radio/EZ* merger. In the Charlotte Metro Survey Area, these transactions would have resulted in American Radio having 55% of Charlotte's radio advertising revenue. In the Sacramento Metro Survey Area, the merger would have given American Radio 36% of Sacramento's radio advertising revenues.²⁷⁵ The US authority had the ambit to consider the series of transactions in their totality rather than the effect of each individual transaction. This resulted in the divestiture of KSSJ-FM and another Sacramento FM station from American Radio Corp in order for the proposed transactions to proceed and the market to remain competitive.

The press release by the DoJ concerning this case explicitly stated that when considering the effects on consumers, consumers encompassed small business that rely on competition to keep prices low.²⁷⁶ This is contrasted to Australia's competition laws that do not offer protection to small businesses.

The competition issues raised by creeping acquisitions are relatively similar in both the Australian and US experience.²⁷⁷ The US authorities in some cases appear to have considered the effect of a series of mergers despite not having explicit legislation. The US appears to acknowledge in some capacity that incrementally accruing concentration via creeping acquisitions should be considered during a merger review, and where

²⁷⁴ OECD, above n 243, 295.

²⁷⁵ Department of Justice, 'Justice Department Requires American Radio Systems Corp to Divest Radio Stations in California and North Carolina' (Press Release, 97-090, 27 February 1997).

²⁷⁶ Ibid.

²⁷⁷ Law Council of Australia, Submission to Competition and Consumer Policy Division of the Commonwealth Treasury, *Creeping Acquisitions: The Way Forward*, 12 June 2009, 13.

required, action on behalf of the authority should be taken to preserve competition. In the case above, that action was a negotiated divestiture.

Mexican competition law can be regarded as a mixture of substantial lessening of competition, dominance and the substantial market power models. Similar to many European states but unlike Australia, notifications of concentrations are compulsory when certain established thresholds are surpassed.²⁷⁸ Compulsory notification empowers the Federal Competition Commission to investigate all concentrations that point to a probability of creating a firm with significant market power.

3 *New Zealand*

New Zealand and Australia's similarities and proximity create a close economic relationship. Both nations have very similar market structures. They are both geographically isolated, have small populations, relatively small markets and share similar competition policy and statutes. In 2001 the Commerce Act 1986 (NZ) was amended to align more closely with Australia's then Trade Practices Act 1974 (Cth). The NZ regime does not regulate specifically for creeping acquisitions. Like Australia, the NZ substantial lessening of competition test prohibits the acquisition of shares or assets in a business if it would have, or be likely to have, the effect of substantially lessening competition in a market.²⁷⁹

In its submission to the OECD, NZ indicated little difference between the substantial lessening of competition and dominance test. NZ conceded the substantial lessening of competition test did have a real effect at an earlier point than the dominance test. It relied on the fact the substantial lessening of competition sets a lower threshold than the dominance test, however difficulty remained in identifying the point where small acquisitions trigger the substantial lessening of competition test. The central difficulty remains knowing at what point to intervene – at what point is the substantial lessening of competition threshold triggered?²⁸⁰ These uncertainties compromise the efficient regulation of creeping acquisitions. The New Zealand Commerce Commission's 2016

²⁷⁸ Cf Article 20, FLEC.

²⁷⁹ *Commerce Act 1986* (NZ) Pt III.

²⁸⁰ OECD, above n 243, 256.

Consumer Issues Report describes creeping acquisitions as harmful to market structures and were given a high risk of harm rating.²⁸¹ It has been listed by the Commission in the 5 ‘current issues and emerging risks to consumers from markets’ for New Zealand.

The echo of Australia’s concerns in the similar jurisdiction of New Zealand further suggests reform around creeping acquisitions needs to occur.

B *Would Regulation Put Australia out of Step with International Best Practice?*

Creeping acquisitions are a feature of most merger regimes around the world. There is significant variation across jurisdictions in what form review tests are articulated. How a merger review test is applied is as important as how it is formulated. Application of even the same formulation varies considerably across jurisdictions. In this way, there is no ‘consensus’ on the approach to creeping acquisitions. No uniform resolutions have been made or adopted by the OECD or ICN that dictate best practice for addressing creeping acquisitions.

By legislating to deal explicitly with this issue, Australia would not be diverging from current international best practice but pioneering the movement. Introducing a law to address creeping acquisitions, which does not throw out the current test but provides for the consideration of a new factor (that is, creeping acquisitions), is not ‘radical’ and is not moving Australia away from international merger standards. The options available to address the creeping acquisitions issue vary in scope. For example, one recommendation that will be explored later in this article is the adoption of mandatory notification and corporate unbundling orders which are widely used mechanisms in line with international best practices.

C *Conclusion*

A number of countries in the developed world have passed legislation in an attempt to deal with the issue. This has somewhat mitigated the risk; however, it is widely acknowledged that creeping acquisitions continue to be a prevalent and concerning practice that requires further attention.

²⁸¹ Commerce Commission of New Zealand, *Consumer Issues Report 2016* (2016) 44.

The recommendations in Chapter Five will draw on the effective and ineffective features of these varying systems. The recommendations will apply and refine some of these approaches and encourage Australia to pioneer a more explicit response to the issue.

V PROPOSED MODELS FOR ADDRESSING CREEPING ACQUISITIONS

It is beyond the powers of the legislature and authorities to change the organic characteristics of the Australian market. However, the Government does have a responsibility to protect the Australian market place from anti-competitive behaviour and market disruption. The words of the late Honourable Sir Garfield Barwick are as pertinent today as they were over 50 years ago:

I have formed myself the view that the maintenance of competition is, in the broad, indispensable to our economic growth. It seems to me that the pattern of trading in this community should be set on a competitive basis now, before the restrictive tendencies now present become entrenched to the point where their dislodgement would entail too great a business upheaval.²⁸²

Legislators must be vigilant about ensuring companies do not thwart the competition laws by acquiring dominance ‘under the radar’ of legislative prohibition.²⁸³ Implementing a regime that acknowledges this is vital. A strategy of incrementally acquiring smaller competitors to avoid the threshold of substantial lessening of competition is repugnant to the competition model and objectives of competition policy and law.

Prevention is the best-case solution to avoiding anti-competitive dominance and consumer detriment. Australia ought to be proactive in implementing a framework that deals with creeping acquisitions so that detriment can be subdued and benefits unlocked. A reactive approach prolongs the adverse effects of creeping acquisitions and the damage to competition may be irreparable.

This Chapter will present and critically analyse a number of recommendations with the objective of introducing safeguards empowering administrators and decision makers to regulate mergers and acquisitions that are likely or currently displaying anti-competitive

²⁸² Ray Steinwall (ed), *25 Years of Australian Competition Law* (Butterworths, 2000), 25.

²⁸³ Clarke, above n 48, 4.

outcomes. The recommendations include the introduction of an additional merger factor (j) into s 50(3) of the CCA enabling the ACCC to assess the cumulative effect of current and previous acquisitions; a contemporary interpretation that enlarges the objects of the CCA to explicitly permit prohibition based on anti-competitive intentions towards small enterprises; introducing a mandatory notification regime for mergers that breach high risk thresholds and Commissioner's declarations that bestow a watching brief and extra regulatory obligations on high risk entities or industries.

A Amendments to the Competition Act

1 Enlarging the Preamble

The performance of competition agencies depends not only on the way they implement specific policies but also on their legal and institutional design. Competition agencies need to not only define and implement their strategies and goals but also design the appropriate instruments to measure the degree of accomplished goals. To achieve this, competition policy needs to clearly define what it intends to do, and the competition agency needs to make sure it actually does that. The first step for understanding the intention of a piece of legislation is the objects clause.

The objects clause outlines the underlying purposes of the legislation and can be used to resolve uncertainty and ambiguity. Objects clauses assist the courts and others in the interpretation of legislation.²⁸⁴ Section 15AA of the *Acts Interpretation Act 1901* (Cth) states that:

In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

The objects clause of the CCA is enshrined in section 2 of the CCA. It reads: '[t]he object of this Act is to enhance the welfare of Australia through the promotion of competition and fair-trading and the provision of consumer protection'.

The CCA is a complex piece of legal drafting and the distinction between promoting competition and protecting competitors is well worth the debate. Whilst regard must be had to the objects clause to resolve any uncertainty or ambiguity, it does not possess clear statutory language, or

²⁸⁴ *Tickner v Bropho* (1993) 114 ALR 409.

command a particular outcome in the exercise of discretionary power.²⁸⁵ Moreover, the terms that appear in s 2 are not defined terms in the Act. They are open to an evolved and contemporary interpretation that preserves the effectiveness of the competitive process and should not be given a narrow interpretation that defeats the purpose of the Act.

Competition law is an economic law and must evolve with our understanding of how the economy functions. So far as the language permits, it should receive the meaning that ensures achievement of its objects.²⁸⁶ It is instructive to reflect on Kirby J's statement in *Visy Paper Pty Ltd v Australian Competition and Consumer Commission*:

It is in the context of such legislative opacity and unwieldiness that it is essential, in my view, to adopt a construction of the TPA that achieves the apparent purpose of that Act by furthering the objectives of Australian competition law. Keeping such purposes in mind helps to shine the light essential to finding one's way through the maze created by statutory language.²⁸⁷

This article argues that an interpretation of the objects clause that affords no consideration to the preservation of small enterprise is outdated, narrow and inflexible.²⁸⁸ It calls for an interpretation that contemplates contemporary issues and aligns with commercial realities.

The current construction of the objects clause is a multifaceted policy objective and coordinated approach that can be used to protect both consumers and afford protection of business-to-business transactions. Analysing the elements of the objects clause reveals that embedded in the purpose of the CCA is scope for legislators to not just examine the effect of actions by dominant businesses but also the intent behind those actions.

Determining legality by looking beyond merely the commercial facts and outcomes of a transaction, and into the intent of the controlling mind behind a transaction is a contemporary concept that has also become the focus of other areas of Australian corporate law. For example, under

²⁸⁵ *Minister for Urban Affairs and Planning v Rosemount Estates Pty Ltd* (1996) 91 LGERA 31, 78.

²⁸⁶ *Rural Press Ltd v Australian Competition and Consumer Commission* (2003) 216 CLR 53, 100 (Kirby J).

²⁸⁷ *Visy Paper Pty Ltd v Australian Competition and Consumer Commission* (2003) 201 ALR 414, 431.

²⁸⁸ Harper Report, above n 52.

the General Anti-Avoidance Provisions in Part IVA of the *Income Tax Assessment Act 1977* (Cth), efficient schemes that are entered into for the dominant purpose of creating a tax advantage or benefit, that would otherwise be legal but for the egregious intention behind the arrangement, are outlawed and the orchestrators of these offences can face serious penalties.

Applying this to competition law, competition policy is not about the pursuit of competition as an end in itself, but about promoting the competitive process where there are public benefits to be gained. The action is the protection of small enterprise, but the benefit is the preservation and promotion of competition for the long term.

The key terms in the objects clause will be examined now. First, what is ‘welfare’ and how is it achieved? Welfare is a very broad term. In rare cases competition policy accounts for producer welfare. Producer welfare focuses on market participants other than those who consume goods or services in the Australian economy. Producer welfare is generally explored ancillary to a total welfare assessment that weighs up consumer welfare against producer welfare – that is, balancing anti-competitive effects with efficiency gains.²⁸⁹ In practice, certain anti-competitive mergers that result in significant efficiency gains may be authorised to proceed on public benefit grounds.

For the most part however, the objects of Australian competition law promote consumer welfare. Under this approach, conduct is assessed according to whether it is likely to lead to lower prices, greater choice and innovation on the one hand, or an increase in prices, reduction in choice or pause in innovation, on the other. These benefits, as examined, are the product of competition and competitive rivalry. In this context, creeping acquisitions present a double-edged sword. They might initially give rise to economies of scale that reduce the costs of the merged entity and should result in lower prices for consumers. Consumers say that this is great, and welfare is achieved. As these acquisitions gather inertia, more and more competitors are eliminated. The elimination of sufficient small business competitors has profound consequences for

²⁸⁹ Richard A Epstein and Michael S Greve (eds), *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* (AEI Press, 2004), 167.

consumer welfare. This confers market power on the dominant entity allowing it to raise prices to the detriment of consumers. This reduces consumer welfare.

In this way, preserving small business is in the interests of enhancing consumer welfare. Small business creates jobs for Australians and its presence in the market place encourages new competition. The Senate Committee's *Milk Report* agreed with this proposition. It considered that the Act could best protect competition by maintaining a range of competitors (large and small), who should rise and fall in accordance with the results of competitive rather than anti-competitive conduct, such as creeping acquisitions.²⁹⁰ At the end of the day, while small business may be the obvious victim of the misuse of market power, the real victim will be the consumer.

The second element of the objects clause is the 'promotion of competition'. The ACCC in interpreting competition borrows from the 'effective competition' and 'workable competition' models.²⁹¹ Finkelstein J describes both:

Effective competition requires internal and external conditions. The internal conditions are: (a) a reasonable degree of parity among the competitors; and (b) a high enough number of competitors to prevent effective collusion among them to rig the market. The external condition is easy entry. Effective competition denotes the idea that firms should be subject to a reasonable degree of competitive constraint from actual and potential competitors as well as from customers.

Workable competition is to envisage the market with a sufficient number of firms (at least four or more) where there is no significant concentration, where all firms are constrained by their rivals from exercising any market power, where pricing is flexible, where barriers to entry and expansion are low, where there is no collusion, and where profit rates reflect risk and efficiency'.²⁹²

The strong theme of both models is the presence of rivalry from two sources – firstly from many competitors in the market, and secondly from the presence of imminent entry of rivals to the market. This rivalry fosters diversity and choice by encouraging innovation and

²⁹⁰ Milk Report, above n 83, xi.

²⁹¹ Australian Competition and Consumer Commission, *Economics | Substantial Lessening of Competition* (10 November 2017) <<http://www.australiancompetitionlaw.org/law/economics/competition.html>>.

²⁹² *Application by Chime Communications Pty Ltd* (No 2) [2009] ACompT 2 [37].

entrepreneurship in response to the competitive pressure of meeting changing customer tastes and demands. Diversity and choice require the presence of many competitors and the imminent threat of potential competitors. As to what ‘many’ means, Finkelstein J referenced four or more competitive players in the market with a spread of concentration a situation that, as the case study in Chapter Two highlights, is not present in some Australian markets.

Where markets do not have conditions favourable to the smooth entry and exit of competitors, under the objective of promoting competition, reasonable and lawfully justified intervention can be undertaken. This includes actions that preserve small businesses where necessary to ensure sufficient rivalry remains in the market.

This protection does not go so far as to make small business infallible by diminishing incentives to remain competitive in terms of price, quality and innovation. It ensures competition remains. That means even small business will have rivals who will provide sufficient competitive restraint.

The last element, the ‘promotion of fair-trading’, was discussed in the Senate Committee’s report on *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business*. After referring to s 2, the report stated:

The objects of the Act ... also refer to ‘fair-trading’ which suggests that traders, including small business, might expect protection under the Act from ‘unfair trading’. This, in turn, has led the Committee considering in this report the extent to which the Act ... Contribute[s] to fairness in the general, everyday common-sense use of the term.²⁹³

Fair-trading incorporates the prevention of companies from engaging in unfair trading practices towards both consumers and competitors.

Further, it was affirmed in the Harper Review that ‘consumers’ in the context of the objects clause includes businesses transacting with other businesses.²⁹⁴ In the US, the DoJ explicitly stated when dealing with consumers that ‘consumer’ encompasses small businesses that rely on competition to keep prices low.²⁹⁵ The reality is that small businesses

²⁹³ Milk Report, above n 83, 8.

²⁹⁴ Harper Report, above n 52, 16.

²⁹⁵ The Department of Justice, above n 275.

face the same vulnerability as consumers. They lack the resources and sophistication of large companies, making them susceptible to unconscionable and unfair conduct in the market place.

Creeping acquisitions threaten the competitive process and cannot be described as promoting 'fair, vigorous and lawful competition'. Suppliers, small business competitors and, to an extent, consumers, are suffering serious detriment from agendas of creeping acquisitions.

There is no definitive High Court precedent as to the interpretation of the objects clause of the CCA. Therefore, a contemporary interpretation would support the ACCC putting forward a legislative agenda aimed at backing small business suffering at the hands of creeping acquisitions. This would be valuable in the minimisation of harm associated with creeping acquisitions.²⁹⁶ Without a clear object, the intention and prohibition within s 50 is diluted.

2 *An Additional Merger Factor*

The second recommendation calls for the insertion of an additional merger factor (j) into s 50(3) that explicitly references incremental acquisitions as a relevant concern when determining whether a merger or acquisition would have the effect of substantially lessening competition.

Section 50(3)(j) is proposed in the following form:

[i]n determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

(j) previous acquisitions undertaken by the acquirer in a market over the preceding two years.²⁹⁷

On a functional level, the amendment integrates a backward looking test, to what is currently only a forward-looking test.²⁹⁸ This would permit acquisitions undertaken by a corporation within the previous two-year period to be considered as an aggregate when assessing whether or not an acquisition would have the effect, or likely effect, of

²⁹⁶ *Competition and Consumer Act 2010* (Cth) s 2.

²⁹⁷ Business Council of Australia, Submission to Australian Competition and Consumer commission, (Media Release MR 178/08 25 June 2009) 8.

²⁹⁸ The current formulation of the merger guidelines adopts a one to two-year forward-looking time frame when assessing whether competitive constraints are likely to substantially lessen competition in future markets. Australian Competition and Consumer Commission, above n 124, 3.6.

substantially lessening competition in a market.²⁹⁹ It is important that previous mergers can be examined so that competition policy and any decision making aligns with commercial realities. To borrow the words of the Tribunal in *Re Howard Smith*,³⁰⁰ the Court is concerned with ‘commercial likelihoods relevant to the proposed merger ... the test has to be applied at a level that is commercially relevant or meaningful as must be the assessment of the substantial lessening of competition under consideration’.³⁰¹

Unlike other proposed regulatory models that call for a complete overhaul of the substantial lessening of competition test, this approach would provide the ACCC ‘with an express ability to deal with creeping acquisitions’ whilst retaining the well understood substantial lessening of competition test.

Under the previously proposed aggregation model, an acquisition would be prohibited if the combined effect of the acquisition and any other acquisitions by the corporation within a six-year period would substantially lessen competition.

The six year ‘specified period’ attracted much criticism at the time³⁰² and raised a number of conceptual difficulties.³⁰³ Market boundaries and the structure and functioning of markets are likely to change over time.³⁰⁴ This means an assessment of prior acquisitions to determine whether the current acquisition substantially lessens competition may necessitate an analysis of acquisitions on the basis of different market definitions and different dynamics of competition to when they occurred. Other criticisms included that the six-year retrospective analysis may impose significant uncertainty for business, may delay the merger clearance and investigation process by increasing pressure on businesses and the ACCC’s resources, and also introduce a large and

²⁹⁹ Law Council of Australia, above n 277, 18.

³⁰⁰ *Re Howard Smith Industries Pty Ltd* (1977) 28 FLR 385.

³⁰¹ *Rural Press Limited v Australian Competition and Consumer Commission* [2003] HCA 75 at [41].

³⁰² Clarke, above n 48, 1.

³⁰³ The ACCC acknowledged that ‘the analytical framework underpinning the aggregation model is relatively complex, novel in part and presents significant conceptual difficulties.’ Australian Competition and Consumer Commission, above n 246, 30.

³⁰⁴ Business Council of Australia, above n 297, 6.

unnecessary cost or risk impediment to expansion or investment. It is agreed that any discouragement of investment that has a detrimental effect on the growth and robustness of the Australian economy is not desirable,³⁰⁵ and the model proposed in this article considered this.

Uncertainty is also an inescapable aspect of the operation of a section based upon speculative likelihoods. Even the current formulation of the test in s 50 gives effect to a kind of competition risk management policy. All antitrust actions require qualifying the difference between the actual and the counterfactual. Any effects-based analysis, including the counterfactual, has challenges. It involves consideration of what the future world would look like and the past might have been absent of the conduct. It is inherently a speculative exercise that will often give rise to various competing interests. Speculation imports uncertain judgments about the post-acquisition state of competition in the market where those judgments are required to be made before or after acquisition. Such judgments may require consideration of the likely responses of other rivals or potential rivals in the market.

Companies of sufficient size to risk being in breach of the merger provisions are already well acquainted in dealing with stringent regulatory requirements and some uncertainty. For example, the Australian Commissioner of Taxation has long been afforded the power to conduct audits and risk reviews on large corporations looking back four years, or, when serious cases of tax avoidance are suspected, the Commissioner has no limit on how far back the review period may be extended. Under other areas of taxation law companies are obligated to keep written evidence for five years and not doing so can result in significant penalties.³⁰⁶ Cases of continued neglect to meet this obligation may be referred to the Department of Public Prosecutions for prosecution.³⁰⁷ Likewise, the Corporations Act requires financial records be kept for up to seven years.³⁰⁸ These records must correctly record and explain the company's transactions and financial position

³⁰⁵ Business Council of Australia, above n 297, 2.

³⁰⁶ *Tax Administration Act 1953* (Cth), s 288–25.

³⁰⁷ ATO Practice Statement Law Administration 2005/2.

³⁰⁸ *Corporations Act 2001* (Cth), s 286(3).

and performance.³⁰⁹ As much of this information would overlap with the requirements of the ACCC under this provision, it is unlikely further risk or resourcing expense will need to be factored in.

To mitigate some of this uncertainty however, a more lenient two year specified period is proposed. This is considered a more reasonable and workable timeframe as it is unlikely competition and market dynamics would change drastically within this period.

From an administrative perspective, the substantial lessening of competition test, supported by this additional merger factor will still require that the acquisition, on the balance of probabilities, has a meaningful or relevant impact on the competitive process over time. The impact cannot merely be a short-term effect and is to be assessed by reference to commercial realities rather than hypothetical theories.³¹⁰ As with all merger factors there will also be a high level of discretion in the hands of the ACCC in relation to the significance and apportionment of weight placed on each merger factor. The ACCC may exercise its discretion in such a manner as to minimise possible extra costs and burdens. This will be determined on a case-by-case basis and will depend on the actual matter under investigation and the governance and compliance history of the company under review. If costs are a concern, the ACCC may examine whether in individual circumstances it is at all necessary or probative to consider previous acquisitions, and the extent that those acquisitions need to be examined. It may be the instance that only one merger in a chain of 10 mergers conducted over the two-year period is of concern, thus the ACCC may only require the target firm to retrieve information relating to that single case. Likewise, the ACCC may only be concerned with certain mergers conducted over an identified six-month period. In the same way, information of all transactions conducted over the full two-year limitation period may not always be necessary.

A two-year period is not a new or experimental concept amongst international merger regulation. As discussed in Chapter Four, Article 5(2) subparagraph 2 of the ECMR provides a specific rule that allows

³⁰⁹ Ibid s 286(1).

³¹⁰ *Australian Gas Light Co v Australian Competition and Consumer Commission (No 3)* (2003) 137 FCR 317.

the Commission to consider successive transactions taking place within a two-year period between the same persons or undertakings to be treated as one and the same concentration arising on the date of the last transaction irrespective of whether or not those transactions relate to parts of the same business or concern the same sector.³¹¹ Likewise, section 29 of the *Enterprise Act 2002* (UK) regulates the obtaining of control through successive acquisitions within a two-year period.

Thorough and clear guidelines increase certainty. Guidelines must explain the policy intent and provide necessary guidance to the ACCC and courts on how to operate. More readily interpreted regulation of anti-competitive creeping acquisitions will alleviate the burden arising from enforcement and compliance. Professor Allan Fels commented: 'It would be useful if the law more explicitly addressed creeping acquisitions'.

The addition of a merger factor explicitly addressing creeping acquisitions into s 50(3) of the CCA is the strongest model for addressing creeping acquisitions. It will strengthen the counterfactual tool and reduce 'regulatory oversight of small acquisitions over time'³¹² by widening the ACCC's parameters. The recommendation facilitates a more holistic snapshot of the market, and the acquirer's actions pre-merger to determine whether the mergers constitute creeping acquisitions that have the effect of substantially lessening competition. However, the proposed model should not be viewed as a universal remedy to address the complex issue of creeping acquisitions. As with any regulation, there may still be associated practical problems. To mitigate, the ACCC must conduct thorough consultation to reduce business uncertainty during the corporate planning process. This will reduce the risk that reforms will be abandoned and ensure immediate and ongoing compliance.

The remainder of this article will discuss ancillary safeguards aimed at mitigating, deterring and regulating this practice.

³¹¹ Article 5(2) of the European Commission Merger Regulation, European Council regulation No 139/2004 of 20 January 2004, OJ L 24. 29.1.2004.

³¹² Law Council of Australia, above n 277, 21.

C Legislative Amendments Beyond Section 50

Mandatory notification and Commissioner's declarations may provide further benefits.

1 Mandatory Notification

The 2008 Merger Guidelines merely encourage merging parties to notify the ACCC if 'the merged firm will have a post-merger market share greater than 20 per cent in the relevant market'. As this is purely voluntary,³¹³ in practice, parties are actually permitted to proceed with a transaction that exceeds the merger control thresholds without seeking any regulatory consideration.

As early as 1992, the Cooney Committee recommended a mandatory pre-notification scheme be introduced in Australia.³¹⁴ Notification thresholds screen out transactions that are unlikely to result in appreciable competitive effects in a given jurisdiction, thus avoiding unnecessary transaction costs as well as the commitment of competition agency resources without any corresponding enforcement benefit.³¹⁵ Currently, if the ACCC opposes a merger brought to it by voluntary notification, the merger parties are unlikely to proceed given the prospect of injunctions being brought by the ACCC under section 80(1A) of the CCA, and possible litigation. Moreover, 'the fast commercial pace of mergers and acquisitions is not conducive to lengthy litigation.'³¹⁶ Parties' preference for the administrative process of the ACCC, the informal clearance and authorisation procedures, result in the ACCC applying the Guidelines largely free from costly and time consuming judicial supervision.³¹⁷ Notification is a very effective tool. However, its voluntary nature limits its effectiveness. Introducing a regime of mandatory notification for mergers would be beneficial in the successful regulation of large firms participating in the practice of creeping acquisitions with the intention of circumventing s 50 of the CCA.

³¹³ Australian Competition and Consumer Commission, above n 108, 2.9.

³¹⁴ Senate Standing Committee on Legal and Constitutional Affairs, 'Mergers, Monopolies and Acquisitions (1991) xviii, 48–51 ('*Cooney Report*').

³¹⁵ International Competition Network, 'Setting Notification Thresholds for Merger Review' (Report to the ICN Annual Conference, Kyoto, Japan, April 2008), 4.

³¹⁶ Dave Poddar and Kate Newman, 'Stormy Seas Make Skillful Sailors: Changes to the Australian Merger Control Regime' (2008) 16 *Trade Practices Law Journal* 191, 192.

³¹⁷ John Duns and Arlen Duke, above n 231, 110.

Notification gives the regulator time to review a merger and seek modifications if necessary. The measure is not about punishment, but open and effective consultation. This is a proactive regime that acknowledges that it is often impossible to restore competition fully once an anti-competitive merger takes place. The benefit for the notifying entity is that it avoids the costly, embarrassing and complicated process of seeking an order through the courts to unwind a merger after it has occurred.³¹⁸

The dominant pre-merger notification model follows the US *Hart-Scott-Rodino Antitrust Improvements Act*, 15 USC 18a (1976) ('HSR Act'), which requires certain types of transactions to be notified to the FTC and the DoJ. The DoJ and the FTC jointly administer a statutory notification procedure for proposed mergers over a US\$50 million threshold. The HSR Act requires certain types of transactions to be notified to the FTC and DoJ before they occur.³¹⁹ The FTC or DoJ may then approve the merger – providing immunity from challenges – or seek a court order to veto it. The stated purpose of the HSR Act is to give the regulators 30 days' notice of substantial mergers, which permits either agency to seek an injunction or pursue further investigation. They may also, and often do, permit the merger to proceed in that time. Until those 30 days expire, parties may not complete the transaction unless the government has granted early termination of the waiting period. Whether a particular acquisition is subject to these requirements depends on the value of the acquisition and the size of the parties, as measured by their sales and assets. Fines are possible for failure to notify.

In the US, the program has been a success. Commentators have noted that '[i]t is not hyperbole that perhaps the greatest US export in the last decade has been the adoption of pre-merger review processes'.³²⁰ The FTC reports that compliance with the Act's notification requirements has been excellent and has minimised the number of post-merger

³¹⁸ Choe Chongwoo and Chander Shekher, 'Compulsory or Voluntary Pre-merger Notification? Theory and Some Evidence' (Working Paper No 13450, MPRA, 2009) 1.

³¹⁹ Federal Trade Commission, above n 137.

³²⁰ Michael H Byowitz and Ilene Knable Gotts (Wachtell, Rosen, Lipton & Katz), Submission to ICPAC Hearings, *Rationalizing, International Pre-Merger Review* (4 November 1998) 3.

challenges enforcement agencies have had to pursue.³²¹ Although the agencies retain the power to challenge mergers post-consummation, and will do so under appropriate circumstances, the fact that they rarely do has led many members of the private bar to view the program as a helpful tool in advising their clients about proposed acquisitions.³²² These same outcomes are likely to be reported in Australia.

In the EU Community, the requirements have been similar since 1990. The differences between the various notification procedures are mostly in details of thresholds for notification.

Interestingly, Hungary, when calculating turnovers and undertakings, considers acquisitions from the same group within two years preceding the acquisition if the acquisitions were at the time not subject to notification.³²³ In this circumstance, there is an incentive to notify from the outset or be exposed to more onerous thresholds later on.

In Australia, the relevant authority to be notified and undertake examination will be the ACCC. It is logical to continue to use thresholds already in use by the ACCC – ‘when the merged firm will have a post-merger market share of greater than 20 per cent in the relevant market’ or ‘in the case of concentrated markets any market where the HHI has exceeded 2000’ – to compel merging parties to notify.³²⁴ Alternatively, a threshold similar to that implemented by the US regime that requires notification when a specified monetary value of assets is involved in the merger could be developed. What is important is not the exact threshold, but that mergers susceptible to anti-competitive consequences are examined. For the most part, the majority of mergers will not be hindered or affected by the implementation of this regime, but those few that are of concern will be brought to the attention of regulators.

There is concern that introducing mandatory pre-merger notification would overload the ACCC’s resources resulting in significant delay. As such, a reasonable timeframe – not necessarily 30 days – will need to be

³²¹ Federal Trade Commission, The United States of America, ‘What is the Premerger Notification Program? – An Overview’ (Guide I, March 2009) 2. <<https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf>>.

³²² William J Gole and Paul J Hilger, *Due Diligence: An M&A Value Creation Approach* (Wiley Publishers, 2009), 259.

³²³ *Competition Act* (Hungary) s 24.

³²⁴ Australian Competition and Consumer Commission, above n 108, 2.9.

worked out. It is necessary for this timeframe to be codified in statute so as to afford protection to merging parties from undue delay.

The current absence in the CCA of a notification requirement is a major failure.

2 Commissioner's Declarations

Somewhat similar to the pre-merger notification regime is the Commissioner's declaration process. The declaration process confers power upon the Commissioner to declare concern for potential or actual competitive harm at the hands of a specific corporation or entire industry. The declaration process would give the ACCC power to keep a specified 'watching brief' on declared companies or industries that exceed certain market share thresholds or have the very real potential to participate in unscrupulous business practices. Such thresholds do not constitute an automatic declaration of market dominance, nor are they an automatic signal as to the existence of anti-competitive practices or of an abuse of power. They act instead as a warning beacon to the regulator to maintain a watching brief on the company or industry concerned.

Once triggered, the ACCC would notify the identified company that it must advise the ACCC of all market acquisition activity, with specific requirements to report to the ACCC annually. The ACCC could then, of its own volition, review the company or the industry concerned.³²⁵ At the discretion of the Commissioner, additional prohibitions for a set period of time may be declared upon corporations or industries. In the most severe cases, these extra regulatory interventions could take the form of price ceilings or price floors.

A price floor stipulates a minimum price that can be charged for a good or service. In the past, governments have imposed price floors to help the suppliers of goods and services. The Australian Government, for example, operated the Wool Price Stabilisation Scheme until 1991 to prevent the price of wool falling below a certain level. Likewise, in the

³²⁵ Senator Andrew Murray, 'Supplementary Remarks to the Report by the Joint Select Committee on the Retailing Sector' (1999).

labour market, the government requires employers pay workers a wage no less than the regulated minimum.³²⁶

Applying this to the grocery sector, during the Milk Wars of 2010 the Commissioner could have temporarily established a watching brief of the industry. In response to the price of milk dropping to \$1, the Commissioner could have declared a floor minimum price that a producer may not sell to a wholesaler, and a wholesaler may not sell to a retailer. Then the major supermarkets could not demand that farmers and wholesalers, including their own private label providers, supply milk to them cheaper than the minimum price regulated by the Commissioner. This type of price control could constrain the major supermarket chains from demanding such low supply prices and charging so little to consumers in an attempt to squeeze out competitors.

A price ceiling on the other hand, is a maximum price at which a good can be bought. Governments impose price ceilings in response to complaints that the market price is too high. The purpose is to help consumers who must pay the prices. For example, the US Government controlled oil prices in the early 1970s stipulating that US firms could not charge more than a stated maximum price of US\$5.25 per barrel of crude oil; the equilibrium price was well over US\$10 per barrel at that time.

Price ceilings have previously been utilised in the Australian National Electricity Market ('NEM'). The established specialised regulator is the Australian Energy Regulator ('AER') – a body of the ACCC. The AER's responsibilities include the economic regulation of electricity transmission and distribution networks in the NEM.³²⁷ Importantly, the AER sets a ceiling on the revenues or prices that an owner or operator of a transmission or distribution network can earn or charge during a five year regulatory period.³²⁸ In the NEM, the Transmission Network Service Provider must submit to the AER a revenue proposal and a proposed pricing methodology relating to its transmission services. The AER must assess whether the proposed pricing methodology is consistent with the pricing principles for prescribed transmission services outlined

³²⁶ Andrew Schotter, *Microeconomics* (Harper Collins, 2009), 59.

³²⁷ Australian Energy Regulator, *Our Role In Networks* <<http://www.aer.gov.au/networks-pipelines/our-role-in-networks>>.

³²⁸ Australian Energy Regulator, 'Framework and Approach Paper, Classification of Services and Control of Mechanisms, Energex and Ergon 2010–15' (2008).

in rule 6A.23 of the National Electricity Rules ('NER') and the AER's pricing methodology guidelines.³²⁹ Similar considerations will need to be taken into account when apportioning running costs and production costs to the final recommended price enforced by the grocery price regulator.

As an alternative, the Commissioner, using the Australian Bureau of Statistics ('ABS') Consumer Price Index ('CPI') or other industry relevant information, could set a recommended price percentile deviation within which suppliers are permitted to sell the same product to different retailers. This regulation would restrain the amount by which a price offered by a vertically integrated wholesaler to an independent retailer can deviate from that offered to a subsidiary retailer. By not fixing a price but rather a flexible median and deviation, the market is given room to fluctuate naturally whether from the effects of supply and demand or gradual inflation.

For the purpose of the above intervention, all levels of the supply chain – producer, wholesaler and retailer – within vertically integrated enterprises must be treated as separate entities. The object of this regulation would be to eliminate unfair price discrimination where vertically integrated firms supply their own downstream firms on more favourable terms than to competing independent firms. This would increase competition as the independent retailer will receive goods within a reasonable range of the price offered to vertically integrated networks.

In determining the revenues or prices that a supplier may charge, the regulator would be required to forecast the revenue requirement of a business to cover its efficient costs³³⁰ and provide a commercial return on capital.³³¹ The difficulty in defining costs has always been in deciding how operating costs might be apportioned to individual products. It is clear that the cost to a supplier of any product sold is a product of invention, not just of the purchase price paid for the product

³²⁹ Australian Energy Regulator, *Pricing Methodology – amendment to transmission guidelines* <<https://www.aer.gov.au/node/26637>>.

³³⁰ These include operating and maintenance expenditure, capital expenditure, asset depreciation costs and taxation liabilities.

³³¹ Australian Energy Regulator, above n 327.

in question, but also of the operating costs associated in bringing the product to the market – costs such as wages, light, heating, rent, rates, transport, insurance and so on. When all costs have been paid, whatever is left over is the net margin or profit.³³²

To make this workable and ensure the forces of competition are still at work in the market, it is important to note that suppliers would not be compelled to trade at that minimum price; it would merely set a limit below which they cannot reasonably sell a product. Standard terms and conditions in each individual supply contract would typically include supplier's price lists and credit terms for different classes of customers. This may include specific discounts and rebates that are available to reflect the quantity and value of goods purchased as well as economies and efficiencies in the production or distribution system. It may also include discounts for the promotion of individual products by the retailer, long-term agreements, and allowances for direct debit payments or for payment on time.³³³ Therefore, it is still possible for a large or more efficient retailer, by virtue of the size of its operation, to retain greater negotiating power than a less efficient competitor. To avoid 'secretive' discounts being placed off invoice for favoured retailers such as vertically integrated downstream firms, it would be a requirement that retailers are not permitted to sell at a price less than the price on the invoice provided by the supplier.

At the satisfaction of the Commissioner, a declared entity or industry may be 'undeclared' and alleviated of any additional compliance obligations conferred upon it by declaration. To ensure transparency and fairness, the legislation could include a maximum consecutive time period which an entity or industry may remain declared without review. This will prevent entities or industries from becoming stagnant or unappealing to potential future investment.

The declaration process is another proactive measure to prevent the market from reaching the point where concentration through creeping acquisitions is occurring. The threat of such regulatory intervention

³³² Department of Jobs, Enterprise and Innovation, *Off Invoice Discounting and the Prohibition of Sale Below Net Invoice Price* <<http://www.djei.ie/publications/commerce/2005/groceriesorder/chapter6.pdf>>.

³³³ *Restrictive Practices (Groceries) Order 1987* (Ireland), Article 2(1)(c).

alone may address many of the flow-on issues associated with creeping acquisitions.

Importantly, the Commissioner's declaration is not a laying of guilt, but merely a focus of extra attention upon those entities or industries displaying the conditions susceptible to this type of anti-competitive acquisition. A declaration does not prevent declared firms or industries from continuing to grow and expand. The primary objective of the declaration program is to shine light on problematic and potentially detrimental industries and firms. This extra attention is an incredibly persuasive deterrent should those with declared status contemplate anti-competitive conduct. Regardless of whether that be organic or through merger and acquisition, as long as it is within the bounds of Australia's competition law policy, it will be permitted to proceed. This policy only becomes restrictive where the growth is occurring by anti-competitive means.

D Conclusion

Economic growth and prosperity involve a continuing process of structural change. Robust and effective competition law is an important element of business regulation in Australia and careful market design and management can deliver market systems that maximise benefits of reforms while minimising costs and disruptions to consumers. It is vitally important that competition authorities have a means by which to regulate creeping acquisitions in order to protect consumers and promote competition without discouraging economic growth and development. Failing to deal with creeping acquisitions undermines competition and leaves Australia vulnerable to stagnating markets.³³⁴

Competition law is an economic law that must evolve with our understanding of how the economy functions. Adapting merger analysis to this purpose in the manner suggested above is a task which the ACCC and legislature must undertake.

³³⁴ Zumbo, above n 5, 31.

VI CONCLUSION

Creeping acquisitions find their livelihood in a loophole in Australia's current merger regime. In certain industries, firms with significant market power are able to use this practice to continue to grow in dominance often at the detriment of incumbents or, ultimately, consumers. Implementing a practice of creeping acquisitions conceals the true intention of the acquiring firm such that if the same dominance and detriment were to occur in a more rudimentary fashion of merger and acquisition, it would likely be contested and prohibited by the ACCC through the CCA.

In competition law theory, there seems no logical reason why a series of small mergers by a single entity that have the combined effect of substantially lessening competition should escape prohibition when a single merger having the same impact on the market does not.

Australia's competition authority, the ACCC, has repeatedly confirmed that creeping acquisitions are a concerning issue and they are not equipped with sufficient power under the CCA to address this practice. The ACCC affirmed that action would need to be taken in this regard to protect future markets and consumers.³³⁵

In the previous Chapter, recommendations to counteract this anti-competitive corporate behaviour have been presented. These revolved around the introduction of an additional merger factor (j) into s 50(3) of the CCA. This would enable the ACCC to assess the cumulative effect of the current and previous acquisitions. In such a situation, an acquisition notified to the ACCC would be judged, not only on the basis of its effect on competition, but on the cumulative effect of it and prior acquisitions. Ancillary recommendations have also been proposed. These include a contemporary interpretation that enlarges the objects of the CCA to explicitly permit prohibition based on anti-competitive intentions towards small enterprise, introducing a mandatory notification regime for mergers that breach high risk thresholds and Commissioner's declarations that bestow a watching brief and extra regulatory obligations on high risk entities or entire industries.

³³⁵ Grocery Inquiry, above n 78, 427.

The overarching theme is that Australia must have a competition and consumer law framework that adequately protects against the dangers inherent in creeping acquisitions. Appropriate regulation of creeping acquisitions is essential to ensure a practice that has been largely unregulated in Australia for over 30 years does not continue to interfere with the efficient functioning of markets.

WORKERS COMPENSATION: THE DEFENCE OF REASONABLE ADMINISTRATIVE ACTION

PHILIP EVANS*

ABSTRACT

Workers Compensation – Bullying – Psychiatric Injury – Reasonable Administrative Action

Recent studies have indicated a rise in mental stress issues amongst Australian workers, with a significant number of claims arising as a consequence of alleged workplace bullying by employers or management. Whilst employees may be subject to workplace stressors which allegedly result in mental health issues, not all work related causes of stress or mental injury may be deemed to be compensable for the purposes of workers compensation legislation.

Employers and managers have a legal right and obligation to monitor employees and provide feedback on performance, as well as initiate action in cases of poor performance or misconduct. Whilst these actions may directly cause stress or mental injury to an employee, they will not be deemed compensable if the interaction is reasonable and carried out in a reasonable manner (reasonable administrative action).

This paper discusses the defence of reasonable administrative action through an analysis of cases of alleged bullying or mental injury arising in claims brought under the Safety, Rehabilitation and Compensation Act 1988 (Cth) and The Workers Compensation and Injury Management Act 1981 (WA).

I INTRODUCTION

The National Survey of Mental Health and Wellbeing found that around 7.3 million, or 45% of Australians aged 16–85 will experience a high prevalence of mental disorders in their lifetime.¹

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¹ Australian Bureau of Statistics, National Survey of Mental Health and Wellbeing: Summary of Results (2007), 7 <[http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/6AE6DA447F985FC2CA2574EA00122BD6/\\$File/National%20Survey%20of%20Mental%20Health%20and%20Wellbeing%20Summary%20of%20Results.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/6AE6DA447F985FC2CA2574EA00122BD6/$File/National%20Survey%20of%20Mental%20Health%20and%20Wellbeing%20Summary%20of%20Results.pdf)>.

More recently, in 2014, a report prepared for Beyond Blue by the University of Wollongong, found that almost 50% of Australian employees will experience some form of workplace bullying during their lives and between 5–7% of these employees will have been bullied in the past six months. The report further identified that workplace bullying was estimated to cost Australian organisations between \$6 and \$36 billion a year.² The research also found people subjected to workplace bullying have higher rates of depression, anxiety and post-traumatic stress disorder, as well as physical health problems such as cardiovascular diseases, migraines and obesity. Further, witnesses and perpetrators are also at risk of mental health issues, career disruptions and poor job performance.

A number of studies have indicated that there is a trend of increasing stress in the workplace.³ According to Safe Work Australia's Key Work Health and Safety Statistics 2018, the number of serious workplace related claims in Australia totalled 106,260 in the 2016–2017 financial year with some 6675 claims (6%) attributable to mental stress.⁴

The causes are manifold, including job insecurity, downsizing and labour market changes where productivity requirements are increasing and the consequent pressures placed on employees to meet those productivity requirements have increased.⁵

² University of Wollongong, *Final Report: Workplace Bullying in Australia*, (30 May 2014) <<https://www.headsup.org.au/docs/default-source/resources/workplace-bullying-in-australia-final-report.pdf?sfvrsn=2>>.

³ Safe Work Australia, *Work-related Injury Fatalities – Key WHS Statistics Australia 2018* (31 October 2018) <<https://www.safeworkaustralia.gov.au/book/work-related-injury-fatalities-key-whs-statistics-australia-2018>>; Safe Work Australia, *Costs of work-related injuries and diseases - Key WHS statistics Australia 2018* (23 August 2018) <<https://www.safeworkaustralia.gov.au/book/costs-work-related-injuries-and-diseases-key-whs-statistics-australia-2018>>; Safe Work Australia, *Work-related injury and disease - Key WHS statistics Australia 2018* (31 October 2018) <<https://www.safeworkaustralia.gov.au/book/work-related-injury-and-disease-key-whs-statistics-australia-2018>>.

⁴ Safe Work Australia, *Key work health and safety statistics Australia 2018* (4 October 2018) <<https://www.safeworkaustralia.gov.au/book/key-work-health-and-safety-statistics-australia-2018>>.

⁵ See generally VicHealth, *Workplace Stress in Victoria: Developing a Systems Approach – A Summary Report May 2006 (May 2006)* <https://www.vichealth.vic.gov.au/-/media/ResourceCentre/PublicationsandResources/Economic-participation/WorkplaceStress/Workplace_stress_SUMMARY.pdf?la=en&hash=BF59FACF47FAA5745AB4866C0A7D26E2E6248BFF>.

In the Western Australian jurisdiction, WorkCover WA, in its Statistical Note 2016,⁶ stated that in the period 2012 to 2016 the number of work-related stress claims increased by 25%. In 2015–2016 there were 547 stress related claims lodged. In this period females accounted for 59% of these claims. The average claim cost was \$73,895. The top three industries involving stress related claims were; Health Care and Social Assistance (25%); Public Administration and Safety (24%); and Education and Training (16%).

In terms of the causes of stress related claims, WorkCover in its Statistical Note states that 39% of the claims are caused by work pressure; 23% by harassment and bullying, 19% by exposure to a traumatic event, 14% by exposure to workplace violence and 5% to other causes. No current figures are available from Comcare but over the four-year period to 30 June 2010, 10% of accepted Australian Government premium payer claims were attributed to mental stress; and 35% of the total claims costs related to this category.

Stress related claims in public sector workplaces are significant as shown in the recent statistics determined from the 2018 Insurance Commission of WA Annual Report which notes:

Although mental stress claims represent 9.1% of new workers' compensation claims in 2018, the estimated cost of mental stress claims for WA public sector agencies was 23.2% of the total estimated claims cost. The average estimated cost of mental stress claims received by RiskCover in 2018 was approximately \$65,882 compared to \$56,319 in 2017 (2016: \$50,000). The cost of mental stress claims continue[s] to increase and is well above the average cost of other workers' compensation claims due to the complexities of the injury and returning an individual to their pre-injury work environment.⁷

The report additionally noted that public sector workers across Australia continue to lodge mental stress workers' compensation claims at rates well above the private sector. In Western Australia alone approximately 50% of mental stress claims are lodged through Risk Cover⁸ despite

⁶ WorkCover WA, *Stress Related Claims: Statistical Note October 2016* (October 2016) <<https://www.workcover.wa.gov.au/content/uploads/2016/11/Stress-Related.pdf>>.

⁷ Insurance Commission of Western Australia, *Annual Report* (2018), 58 <https://www.icwa.wa.gov.au/__data/assets/pdf_file/0023/20759/2018-Insurance-Commission-of-Western-Australia-Annual-Report.pdf>.

⁸ RiskCover is the Government of Western Australia's self-insurance scheme which is administered by the Insurance Commission. RiskCover provides workers' compensation and commercial cover to Western Australian Government departments and agencies.

public sector employees only accounting for 10% of WA's workforce, with injured workers under mental stress claims taking on average 133 days off work in 2018 compared to 69 days for all other lost time injury claims. The report also noted that the cost of mental stress claims lodged with RiskCover in 2017 was \$28.1 million dollars.⁹

However, management liability with respect to mental illness is not strict. For a mental injury claim to be compensable, an employee must prove that the employment contributed to the injury to a significant degree. Put another way, in the case of mental injury or diseases caused by stress, the evidence must show that there was something associated with the employment which significantly contributed to the stress.¹⁰

At the same time, the respective legislation dealing with workplace stress or bullying claims provides a defence to allegations where the injury has resulted from 'reasonable administrative action' taken by an employer. The purpose of this defence, which is set out in s 5(4) of the Act (which will be discussed below) was noted in *Comcare v Martin*.¹¹

The purpose was described in the explanatory memorandum to the Bill for the Amending Act as being to 'ensure that the wide range of legitimate human resource management actions, when undertaken in a reasonable manner, do not give rise to eligibility for workers' compensation' and in particular, to prevent claims 'being used to obstruct legitimate management action by excluding claims where an injury (usually a psychological injury) has arisen as a result of' such action. In that way, the taking of administrative action in respect of an employee's performance was sought to be insulated from consideration of the psychological effect such a decision might have on the employee. This purpose would be defeated if the operation of the defence were dependent upon the subjective psychological drivers of the employee's reaction.

The cases discussed below are illustrative of the principles to be applied with respect to asserting and defending a compensation claim for workplace stress or seeking a preventative order in the case of bullying; however it is important initially to outline the respective legislative provisions in each of the jurisdictions.

⁹ Above n 8.

¹⁰ *Comcare v Martin* [2016] HCA 43, [45].

¹¹ *Ibid* [4].

II SAFETY, REHABILITATION AND COMPENSATION ACT 1988 (Cth)

Workers compensation benefits include the remittance of incapacity payments to compensate for lost earnings; medical expenses; and lump sum payments for permanent impairment or death. The relevant authority to determine stress related or mental injury claims in the Federal jurisdiction is Comcare which has been established under the *Safety, Rehabilitation and Compensation Act 1988 (Cth)* (SRC Act). Comcare provides all employers with an integrated safety, rehabilitation and compensation system, no matter what Australian State or Territory an employer operates in or where its employees are located. Workers compensation is payable to a worker who suffers an injury or disease arising from, or during, his or her employment.¹² The determinations of Comcare are carried out in accordance with the provisions of the SRC Act.

Section 14 of the SRC Act provides that Comcare is liable to pay compensation to an employee where an injury is suffered by the employee resulting in death, incapacity to work, impairment or if the employment caused, contributed to or aggravated the illness. The liability is not strict and for the claim to be successful, Comcare must be satisfied that issues or incidents in the course of the person's employment caused or contributed to the illness to a significant degree.

Where a claim has been denied, s 14 of the SRC Act confers the Administrative Appeals Tribunal (the AAT) power to review a decision made under s 64 of the SRC Act. The AAT has jurisdiction to consider the Comcare decision under s 25 of the *Administrative Appeals Tribunal Act 1975 (Cth)* (AAT Act). The hearing is not by way of a judicial review of the original Comcare decision but is a hearing de novo.¹³

¹² Australian Government Comcare, *Overview of the Comcare scheme* (22 January 2018) <https://www.comcare.gov.au/the_scheme/overview_of_the_comcare_scheme>.

¹³ In law, the expression trial de novo means a "new trial" by a different tribunal (de novo is a Latin expression meaning "afresh", "anew", "beginning again", hence the literal meaning "new trial").

In the AAT a de novo hearing requires that a new decision is determined on the 'merits'. The difference between judicial review and merits review can be seen in the following:¹⁴

The role of the Tribunal in the system of administrative law is to review administrative decisions on the merits: that is, to consider afresh the facts, law and policy relevant to a decision under review and decide whether that decision should be affirmed, varied or set aside. It has many times been said that the Tribunal stands in the shoes of the original decision-maker in making its substituted decision.

In undertaking its task, the Tribunal is frequently required to review the exercise of discretionary powers. This is reflected in the phrase which is usually used to describe the decision-making function of the Tribunal, namely that the Tribunal must make the 'correct or preferable decision'.¹⁵ The conjunction is used to accommodate the difference between a matter susceptible to only one decision, in which the 'correct' decision must be made, and a decision which requires the exercise of discretion or a selection between more than one available option, in which case the word 'preferable' is appropriate.¹⁶

S 43(1) of the AAT Act requires the Tribunal to make a decision in writing:

- (a) affirming the decision under review;
- (b) varying the decision under review; or
- (c) setting aside the decision under review and:
 - (i) making a decision in substitution for the decision so set aside;

or

- (ii) remitting the matter for reconsideration in accordance with any directions or recommendations.

In conducting the review, s 33 of the AAT Act sets out the procedures to be followed. Relevantly the proceedings must be:

... (b) conducted with as little formality and technicality, and with as much expedition, as the requirements of this and of every other relevant enactment and proper consideration of the matters before the tribunal permit;¹⁷

¹⁴ Administrative Appeals Tribunal, *The Administrative Appeals Tribunal - Its Role in the Regulation of the Insurance Industry* (11 April 2006) < <http://www.aat.gov.au/about-the-aat/engagement/speeches-and-papers/the-honourable-justice-garry-downes-am-former-pre/the-administrative-appeals-tribunal-its-role-in> >.

¹⁵ *Drake v Minister for Immigration and Ethnic Affairs* (1979) 24 ALR 577, 591 (Bowen CJ and Deane J).

¹⁶ Above n 15.

¹⁷ *Administrative Appeals Tribunal Act 1975* (Cth) s 33(1)(b).

and

(c) The Tribunal is not bound by the rules of evidence but may inform itself on any matter in such manner as it thinks appropriate.¹⁸

III IS THE INJURY DISEASE OR WORK RELATED?

One of the preliminary or threshold issues for the determination under s 14 of the SRC Act is whether the injury or disease is work related.

The definition of injury is provided in s 5A(1) of the SRC Act as:

(a) a disease suffered by an employee;

or

(b) an injury (other than a disease) suffered by an employee, that is a physical or mental injury arising out of, or in the course of, the employee's employment;

or

(c) an aggravation of a physical or mental injury (other than a disease) suffered by an employee (whether or not that injury arose out of, or in the course of, the employee's employment), that is an aggravation that arose out of, or in the course of, that employment; but does not include a disease, injury or aggravation suffered as a result of reasonable administrative action taken in a reasonable manner in respect of the employee's employment. (emphasis added).

IV REASONABLE ADMINISTRATIVE ACTION

In the workplace, stress claims may arise, among other factors, as a consequence of informal meetings, staff appraisals, counselling, or discussions relating to underperformance. However, as noted above, stress claims arising as a result of 'reasonable administrative action' which is 'taken in a reasonable manner' by an employer, are not compensable under the SRC Act. The requirements of 'reasonable administrative action' and 'taken in a reasonable manner' are separate and distinct.

Further, s 5A(2) of the SRC Act provides that:

For the purposes of sub-s (1) and without limiting that subsection, reasonable administrative action is taken to include the following:

- (a) a reasonable appraisal of the employee's performance;
- (b) a reasonable counselling action (whether formal or informal) taken in respect of the employee's employment;
- (c) a reasonable suspension action in respect of the employee's employment;
- (d) a reasonable disciplinary action (whether formal or informal) taken in respect of the employee's employment;

¹⁸ Ibid s 33(1)(c).

(e) anything reasonable done in connection with an action mentioned in paragraph (a), (b), (c) or (d);

The reference to disease in s 5A(1) is defined in s 5 B(1) to mean:

- (a) an ailment suffered by an employee; or
- (b) an aggravation of such an ailment;
 - that was contributed to, to a significant degree,¹⁹ by the employee's employment by the Commonwealth or a licensee.

The issue of ailment or aggravation is considered in s 5B(2):

- (2) In determining whether an ailment or aggravation was contributed to, to a significant degree, by an employee's employment by the Commonwealth or a licensee, the following matters may be taken into account:
 - (a) the duration of the employment;
 - (b) the nature of, and particular tasks involved in, the employment;
 - (c) any predisposition of the employee to the ailment or aggravation;
 - (d) any activities of the employee not related to the employment;
 - (e) any other matters affecting the employee's health.

This subsection does not limit the matters that may be taken into account.

V WORKERS' COMPENSATION AND INJURY MANAGEMENT ACT 1981 (WA)

In Western Australia, a Workers' Compensation and Injury Management Scheme exists to help workers return to work successfully following a work-related injury or illness. Under the scheme workers are compensated for lost wages, medical expenses and associated costs while they are unable to work. Matters in dispute relating to workers' compensation are determined in accordance with the provisions of the *Workers' Compensation and Injury Management Act 1981 (WA)* (WCIMA).

Workplace injury claims for physical or mental injury are determined by WorkCover under the Workers' Compensation Arbitration Service. This is done through a formal arbitration process conducted in proceedings at which evidence is heard and where a legally qualified Arbitrator makes binding determinations regarding workers' compensation disputes.

The Workers' Compensation Arbitration Service consists of a Registrar and Arbitrators (assisted by a team of administrative support

¹⁹ In the SRC Act, section 5B(3) states *significant degree* means a degree that is substantially more than material.

staff) who determine matters in dispute in accordance with the *Workers' Compensation and Injury Management Act 1981* and *Workers' Compensation and Injury Management Arbitration Rules 2011*, without attempting to resolve it by conciliation.

However, a dispute must firstly have been conciliated by the Workers' Compensation Conciliation Service (or a certificate issued by the Director of Conciliation advising the matter is not suitable for conciliation) before an application can be made to the Arbitration Service.²⁰

An appeal from a determination by an arbitrator may be made to the District Court of Western Australia, where a question of law is involved and where defined financial thresholds are met; or where a question of law is involved and, in the opinion of the District Court the matter is of such importance that, in the public interest, an appeal should lie.²¹

As can be seen below the respective provisions in the WA Act essentially mirror those found in the SRC Act.

S 18(1) of the WCIMA provides that if an injury to a worker occurs, the employer shall, subject to this Act, be liable to pay compensation in accordance with Schedule 1. The term 'injury' is defined in s 5 of the Act to mean:

- (a) a personal injury by accident arising out of or in the course of the employment, or whilst the worker is acting under the employer's instructions; or
- (b) a disease, because of which an injury occurs under section 32 or 33; or
- (c) a disease contracted by a worker in the course of his employment at, or away from, his place of employment, and to which the employment was a contributing factor and contributed to a significant degree; or
- (d) the recurrence, aggravation, or acceleration of any preexisting disease where the employment was a contributing factor to that recurrence, aggravation, or acceleration and contributed to a significant degree; or
- (e) a loss of function that occurs in the circumstances mentioned in section 49, but does not include a disease caused by stress if the stress wholly or predominantly arises from a matter mentioned in subsection (4) unless the matter is mentioned in paragraph (a) or (b) of that subsection and is unreasonable and harsh on the part of the employer;

²⁰ See Workcover WA, *Workers' Compensation Arbitration Service* < <https://www.workcover.wa.gov.au/resolving-a-dispute/workers-compensation-arbitration-service/>>.

²¹ *Workers Compensation and Injury Management Act 1981* (WA) s247(1).

What constitutes a disease for the purpose of the SRC Act is defined in section 5 and includes; ‘any physical or mental ailment, disorder, defect, or morbid condition whether of sudden or gradual development’.

Section 5(4) of the WCIMA in turn relevantly states:

- (4) For purposes of the definition of *injury*, the matters are as follows —
- (a) the worker’s dismissal, retrenchment, demotion, discipline, transfer or redeployment; and
 - (b) the worker’s not being promoted, reclassified, transferred or granted leave of absence or any other benefit in relation to the employment; and
 - (c) the worker’s expectation of —
 - (i) a matter; or
 - (ii) a decision by the employer in relation to a matter, referred to in paragraph (a) or (b).

S (5) further provides;

- (5) In determining whether the employment contributed, or contributed to a significant degree, to the contraction, recurrence, aggravation or acceleration of a disease for purposes of the definitions of injury and relevant employment, the following shall be taken into account —
- (a) the duration of the employment; and
 - (b) the nature of, and particular tasks involved in, the employment; and
 - (c) the likelihood of the contraction, recurrence, aggravation or acceleration of the disease occurring despite the employment; and
 - (d) the existence of any hereditary factors in relation to the; and
 - (e) matters affecting the worker’s health generally; and
 - (f) activities of the worker not related to the employment.

VI RECENT DECISION

The following two cases are illustrative of the principles to be applied with respect to asserting and defending a compensation claim for workplace mental injury under the provisions of the relevant legislation: the *Safety, Rehabilitation and Compensation Act 1988* (Cth); and the *Workers Compensation and Injury Management Act 1981* (WA).

A Case Example 1 – Nguyen and Comcare [2018] AATA 1623

1 The background

Ms Nguyen was a qualified electrical engineer who had worked in defence-related industries for about 20 years and commenced her employment with the Department of Defence. In 2007 she became Deputy Senior Design Engineer in the Aeronautical Life Support

Logistics Management Unit (ALSLMU). Ms Nguyen subsequently alleged she had developed a mental injury (depression and stress) in her workplace as a result of bullying and mismanagement by her supervisors and lodged a worker's compensation claim stating that Comcare was liable to pay her compensation for her injury pursuant to s 14 of the *Safety, Rehabilitation and Compensation Act 1988* (Cth) (the SRC Act). Whilst Comcare accepted that Ms Nguyen suffered from a disease within the meaning of s 5B of the SRC Act, it denied liability on the basis that her disease was suffered as a result of 'reasonable administrative action' within the meaning of s 5A(2). Comcare denied that Ms Nguyen was bullied or mismanaged but rather that she was unhappy arising from a performance review and a subsequent decision to downgrade her engineering authority.²² Ms Nguyen then sought a review of the Comcare decision in the AAT.

2 Issues for the Tribunal

The issues for the Tribunal were firstly; was Comcare liable for Ms Nguyen's condition; and secondly, whether the administrative action taken was reasonable. The relevant administrative actions to be considered were a mid-cycle review of Ms Nguyen's performance on 2 March 2015 and a formal enquiry conducted on 15 December 2015.

In her evidence Ms Nguyen stated that she had experienced considerable friction in the workplace for some time commencing in late 2014. Details of a range of incidents are discussed in the decision in paragraphs [4] to [13]. The meeting of 2 March 2015 was preceded by events in 2014 starting with a request from Ms Nguyen to start work at 9:30am in order to take her children to school. The request was refused and around the same time Ms Nguyen refused new instructions from her supervisor relating to her reporting line. What is described as a mid-cycle review was conducted at the 2 March meeting where her supervisor raised the issues of her unpredictable attendance and confirmed the new reporting line.

Later, on 7 March 2015, Ms Nguyen saw her general practitioner about her psychiatric symptoms, stating she was 'trembling and having difficulties in functioning at work'. She also claimed she was having

²² *Nguyen and Comcare* [2018] AATA 1623, [1]-[3].

difficulty sleeping and felt depressed. As a result she was prescribed anti-depressant medication.²³

The Tribunal found, particularly in view of the medical evidence, that the mid-cycle review was nevertheless the specific event that precipitated the onset of Ms Nguyen's symptoms that were diagnosed as a psychiatric condition. At the same time, it also held that the mid-cycle review could be characterised as administrative action. The Tribunal noted that this was despite any other events in Ms Nguyen's life (including her work and personal life) which might have also contributed to her illness over time.²⁴

The Tribunal noted:²⁵

I have already found the onset of the applicant's condition was connected with her mid-cycle review in March 2015. While I accept the applicant may have been experiencing some symptoms of depression before that point, the symptoms clearly became clinically significant in response to the mid-cycle review. The mid-cycle review was *administrative action* within the meaning of s 5A. A performance review of that kind was clearly an *appraisal of the employee's performance* within the meaning of s 5A(2)(a). It was, in any event, conduct *in respect of* the applicant's employment as opposed to conduct occurring in the course of or pursuant to the employment relationship: see *Commonwealth Bank of Australia Ltd v Reeve* [2012] FCAFC 21 at [60] per Rares and Tracey JJ. (I would add that the earlier wrangling over the applicant's working hours and her request for flexible hours would relate to a benefit obtained *in connection with her employment* – and thus also within the definition of *administrative action* under s 5A(2)(f)).

By way of defence, Comcare submitted that Ms Nguyen's psychiatric condition emerged in March 2015 in response to the mid-cycle review, and that the review amounted to *reasonable administrative action* within the meaning of s 5A of the SRC Act.²⁶

Even though the Tribunal determined that the mid-cycle review was an administrative action, it was necessary for the Tribunal to determine if the actions and behaviours of the supervisors at the meeting and their

²³ Ibid [17].

²⁴ Ibid [18].

²⁵ Ibid [61].

²⁶ Ibid [19].

conduct were reasonable. The Tribunal noted that to determine this question an evaluation was required of (a) the motivation behind the action (was the action reasonable in conception?) and (b) the conduct of the action (was it reasonable in execution?).²⁷

The Tribunal found that, whilst Ms Nguyen was not managed perfectly or with great sensitivity, the standard of reasonableness is not a standard of perfection and the motivation behind the review and the conduct of the review were reasonable.

The Tribunal noted:²⁸

The standard of reasonableness means I am not concerned whether the employer is managing the applicant wisely or especially sympathetically, or if the employer's human resource strategy and management culture permits it to properly accommodate the needs of professionals or any other group. I am not considering whether there was a healthy professional culture in which professionals were nurtured. The question is whether the particular administrative action – in this case, the mid-cycle review which focused on the applicant's hours of work – was *reasonable administrative action*.

Having determined that mid-cycle review was reasonable administrative action, it was necessary to determine if the review had been conducted in a reasonable manner. Upon consideration of the evidence, the Tribunal noted that Ms Nguyen's supervisor (Mr Snook) had good reason to address the issue of working hours and communications with her in the mid-cycle review. The mid-cycle review was a scheduled event and it was not the case that Mr Snook arbitrarily decided to commence a review. There was also nothing in his written communications with the applicant to suggest he was behaving unreasonably in his execution of the review and the Tribunal was not persuaded that 'Mr Snook had done anything inappropriate or which suggested animus towards the applicant'.²⁹

3 The formal enquiry of 15 December 2015

On 2 October 2015 Ms Nguyen's new supervisor (Mr McGrath) made a number of allegations by email to Mr Barton, the Chief Engineer

²⁷ Ibid [62].

²⁸ Ibid [63].

²⁹ Ibid [65].

of MPSPPO, relating to Ms Nguyen's fitness to hold the engineering authority. Mr Barton said he would inform her of the outcome of his inquiry within seven days. The investigation took much longer than seven days. Mr Barton did not present his findings until 15 December 2015. On that day, Ms Nguyen was called to a meeting where she was advised that following an enquiry her engineering authority had been removed. With reference to the need for a formal enquiry, it was stated:

Mr Barton explained why he decided to proceed with a formal investigation in the course of cross-examination. He said it was an unusual situation: one senior engineer had raised questions about the competence of another. He made clear in his outline of evidence (exhibit 22 at [8]) that the stakes were high: the organisation's focus on safety meant the engineers *must* be competent. Incompetent engineers could make mistakes that cost lives. He added it was appropriate to undertake a formal process because of the seniority and experience of Mr McGrath and Ms Nguyen. The fact they had not been able to resolve the issues suggested the whole question needed to be considered in a more formal way. He also said he thought a formal enquiry was the fairest course.³⁰

Ms Nguyen left work on 15 December 2015 and following the meeting she reported to her doctor complaining of symptoms of stress and depression. The Tribunal noted 'It appears she experienced significant decompensation at that point'.³¹

The Tribunal was satisfied that Mr Barton had carefully considered whether it was appropriate to commence a more formal enquiry. Whilst the Tribunal noted that another manager might have dealt with the matter in a different way occasioning Ms Nguyen less stress, his decision to commence the process was not unreasonable as questions had been raised over Ms Nguyen's performance and competence that needed to be addressed. The Tribunal accepted that Mr Barton was conscious of the issue's significance and that he had sound reasons for commencing the process. Whilst the Tribunal was critical of the fact that the enquiry took much longer than the anticipated 7 days and that Ms Nguyen was not informed of the reviews progress or delay, it was 'not persuaded

³⁰ Ibid [50].

³¹ *Nguyen and Comcare* [2018] AATA 1623, [58]. In the psychiatric sense, decompensation means the failure to generate effective psychological coping mechanisms in response to stress, resulting in personality disturbance.

those shortcomings suggest the enquiry was conducted in a way that was unreasonable, even if it was less than ideal'.³²

A serious deficiency in the conduct of the review, which at first sight appears to be somewhat indicative of unreasonableness, is the fact that despite the effect of an adverse finding with respect to Ms Nguyen, she was not afforded a proper opportunity to respond to the allegation made against her.

The Common Law recognises a duty to accord a person procedural fairness or natural justice when a decision is made that affects a person's rights, interests or legitimate expectations.³³ However the Tribunal noted;

The fact the enquiry concluded hurriedly with adverse findings against the applicant even though the applicant did not have an extensive opportunity to respond is also problematic, but I accept Mr Barton's evidence that the evidence pointed to shortcomings that had to be addressed as a matter of urgency. In all the circumstances, his professed concern for aviation safety took precedence over questions of procedural fairness.³⁴

4 *The orders*

Whilst the Tribunal was criticised regarding several aspects of the employer's conduct towards Ms Nguyen, it was satisfied that the actions which brought on her health conditions were properly attributable to reasonable administrative action. Consequently, the reviewable decision was affirmed and Comcare was not liable to compensate Ms Nguyen for her condition.

5 *Comment on the decision*

A number of important principles can be seen in this decision. Pursuant to s 14 of the SRC Act, even if the Tribunal finds or the employee accepts that the worker suffers from a work related *disease* within the meaning of s 5B of the SRC Act there will be no liability if the disease was suffered as a result of *reasonable administrative action* within the meaning of s 5A(2).

A supervisor is not necessarily behaving unreasonably if he or she becomes angry and displays frustration in the course of an interaction with an employee. Supervisors are not expected to exhibit endless

³² *Nguyen and Comcare* [2018] AATA 1623, [71].

³³ *Kioa v West* (1985) 159 CLR 550.

³⁴ *Nguyen and Comcare* [2018] AATA 1623, [71].

patience, nor are they required to conduct themselves with perfect poise. Much will depend on the circumstances.

The standard of reasonableness is not a standard of perfection and it does not require the employer to manage an employee wisely or sympathetically. It also does not require the employer's human resource strategy and management culture to properly accommodate the needs of professionals or any other group.

The decision is also interesting in that whilst an AAT hearing is held *de novo* and is not by way of a judicial review, where the defence of reasonable administrative action is raised by an employer, as can be seen in this decision, the Tribunal has to consider the behaviour of the supervisor and the conduct of the hearing or review in order to determine the reasons for the review and its overall reasonableness.

Finally, the failure of management to avoid procedural fairness to an employee in the situation as described above would normally result in any determination adversely affecting the employee to be set aside.³⁵

However, the requirement to afford a person natural justice is not inflexible. Whilst Ms Nguyen was not provided the opportunity to adequately respond, the seriousness of the issues, and the requirement for a quick resolution as a consequence of safety considerations outweighed the absence of procedural fairness. As can be seen, even if the deficiencies with respect to procedural fairness had been remedied, it was unlikely that there would have been a different outcome arising from the meetings.

³⁵ *Jimenez v Accent Group T/A Platypus Shoes (Australia) Pty Ltd* [2016] FWC 5141.

B Case Example 2 – Pilbara Iron Company (Services) Pty Ltd v Suleski [2017] WADC 114

1 The background

In August 2014, Mr Spase Suleski (Mr Suleski) claimed against his employer, Pilbara Iron Company (Services) Pty Ltd (Pilbara), workers' compensation payments for total incapacity. The date on which the injury was alleged to have occurred was 22 August 2013 and his injury was described as stress and anxiety caused by bullying and threats made by management during the period 22 August to 10 December 2013. The nature of the stress was described as an adjustment disorder which was contracted between 22 August and 15 December 2013.³⁶

Liability for the claim was denied by Pilbara and the application proceeded to arbitration by WorkCover on various dates between 23 February and 28 October 2015. On 19 August 2016 the arbitrator delivered written reasons for his decision allowing Mr Suleski's application and ordering Pilbara to pay Mr Suleski workers' compensation payments for total incapacity together with statutory allowances.³⁷

Pilbara subsequently appealed the arbitrator's decision in the Western Australian District Court pursuant to s 247 of the *Workers' Compensation and Injury Management Act 1981* (the WCIM Act) and sought the orders made by the arbitrator to be quashed.

2 The arbitration hearing

The claim arose as a consequence following a meeting on 22 August 2013 between Mr Suleski, and his superintendent, Ms Bufton. At the meeting he was formally advised that he would be placed on a Performance Management Plan (PMP) due to a number of performance issues identified in the preceding six months. The PMP was implemented from the meeting and included a term stating that it 'may result in disciplinary action up to and including termination of employment'.

In the arbitration hearing there was no dispute that Mr Suleski suffered from a psychiatric disease that rendered him incapacitated for work on 22 August 2013 and that his employment contributed to a significant degree to his disease. Whilst Mr Suleski accepted that the

³⁶ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [1].

³⁷ *Ibid* [2].

meeting on 22 August 2013 related to performance issues, and that the meeting was a contributing factor to his psychiatric disease (stress), he maintained that:

- (a) the meeting was not discipline;
- (b) if it was, the meeting was not the whole or predominant cause of his incapacity; and
- (c) if it was, then Pilbara Iron's actions on 22 August 2013 were unreasonable and excessively harsh.

In response, Pilbara argued that Mr Suleski's psychiatric disease arose wholly or predominantly from:

- (a) Mr Suleski's expectation of discipline, in which case, the arbitrator should not have turned his mind to whether Pilbara Iron's conduct was unreasonable and harsh as this concept cannot apply to an expectation citing *McPherson v State Print*³⁸ or,
- (b) actual discipline which was not unreasonable and harsh.

3 *The determination of the arbitrator*

The findings of the arbitrator are detailed in paragraph [14] of the District Court judgement. By way of summary, the arbitrator firstly found that Mr Suleski's psychiatric condition arose wholly or predominantly from an excluded matter in s 5(4) of that Act as a consequence of the implementation of the PMP at the 22 August meeting. Secondly, applying the principles found in *FAI General Insurance Co Ltd v Goulding*,³⁹ he found the meeting was disciplinary in nature. Lastly, he concluded that the reasons given by Pilbara for implementing the PMP were unreasonable and harsh. To understand why the arbitrator determined the unreasonableness and harshness issue, it is necessary to reproduce the reasons verbatim from the written determination, namely:⁴⁰

it was unreasonable for Pilbara Iron to not accept (or to disregard) Mr Suleski's explanations in relation to issuing warnings to subordinates and instead implement the PMP [100(a)];

there was no reasonable opportunity for Mr Suleski to complete the role description for transport operator and that it was unreasonable for Pilbara Iron not to accept (or to disregard) Mr Suleski's explanations in relation to the provision of the role description and to instead implement the PMP [100(b)];

³⁸ *McPherson v State Print* (Unreported, Western Australia Supreme Court, Wallwork AJ, Steytler P and Parker J, 5 December 1996).

³⁹ [2004] WASC 167.

⁴⁰ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [4].

it was unreasonable for Pilbara Iron not to accept (or disregard) Mr Suleski's explanations and instead to implement a PMP in circumstances where [100(c)]:

- (i) Mr Suleski had not been provided with ... any adequate leadership training [88(b)];
- (ii) Mr Suleski's mid-year performance review was selectively downgraded on Ms Bufton's email instruction [88(c)]; and
- (iii) Pilbara Iron departed from its own procedures in managing Mr Suleski and placing him on a PMP instead of a development plan [88(f)].

For these reasons the arbitrator allowed Mr Suleski's application and ordered Pilbara to pay Mr Suleski workers' compensation payments for total incapacity together with statutory allowances for the period 22 August to 10 December 2013.

4 The District Court appeal

Pilbara's grounds of appeal are stated in paragraphs 15(1) to (8) of the District Court judgment. The principal grounds were that:

1. The learned Arbitrator was wrong in law in finding that the actions of the Appellant in implementing a Performance Management Plan (PMP) in respect of the Respondent on 22 August 2013, was the cause of the stress related illness and was harsh and unreasonable.
2. The learned Arbitrator was wrong in law in finding that the injury arose as a consequence of actual disciplinary action and should have found the injury arose as a result of the Respondent's 'expectation of' disciplinary action which is an excluded factor for recovery of payments under Section 5 of the Act.
3. The learned Arbitrator was wrong in law in that he failed to consider properly or at all, whether the discipline as compared to the expectation of discipline, was the whole or predominant cause of the stress related injury, the onus in respect of which lies on the Respondent.

5 The results of the appeal

Herron DCJ noted that in the arbitrator's determination, the arbitrator relied significantly on the decision in *Department of Education v Azmitia*⁴¹ (*Azmitia*) and this is discussed in some length in the appeal decision.⁴² His Honour found that *Azmitia* had no application in this case as *Azmitia* was concerned with a causation test in determining whether

⁴¹ [2014] WADC 85.

⁴² *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [43]-[95].

employment was a significant contributing factor to the contraction of a disease. This was not the issue with respect to Mr Suleski. It was not in dispute before the arbitrator that Mr Suleski suffered from a psychiatric disease that rendered him incapacitated for work on 22 August 2013 and that his employment was a significant contributing factor to his disease.⁴³

However, as noted above, in the arbitration hearing Pilbara argued that Mr Suleski's psychiatric disease arose wholly or predominantly from his expectation of discipline, in which case the arbitrator should not have turned his mind to whether Pilbara's conduct was unreasonable and harsh as this conduct cannot apply to an expectation, citing *McPherson v State Print*.⁴⁴

In his determination, Judge Herron commented that Mr Suleski's perception of whether he had been treated unfairly in comparison to whether he had actually been treated unfairly was not relevant to the issues to be determined.

His Honour noted that whilst the arbitrator incorrectly applied the principles in the *Azmitia* case this did not lead to an error in law in finding that the PMP's implementation arising from the 23 August meeting was in fact disciplinary and was the predominant cause of Mr Suleski's psychiatric condition. With respect to the PMP His Honour stated;

In my view the arbitrator's finding that the implementation of the PMP was disciplinary was correct. His finding that the PMP was not merely a training tool but was similar to the warning letter the employer provided in *FAI General Insurance Co v Goulding*⁴⁵ is correct.⁴⁶

Specifically in *FAI General Insurance Co* Ms Goulding was provided with a letter which was critical of her work performance and set out performance standards that she was required to maintain. Additionally, she was advised that her performance would be reviewed and if her behaviour did not comply with those standards her position would also be reviewed with the possibility of termination. Put simply, by comparison, the purpose of the PMP and the language of it were very similar to the letter which was provided to Ms Goulding by her employer.

⁴³ Ibid [6].

⁴⁴ *McPherson v State Print* (Unreported, Western Australia Supreme Court, Wallwork AJ, Steytler P and Parker J, 5 December 1996).

⁴⁵ [2004] WASCA 167.

⁴⁶ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [122].

6 *Was the conduct of Pilbara unreasonable and harsh?*

In determining this issue His Honour firstly considered the legal definition of the phrase ‘unreasonable and harsh’. Because of the significance of this issue His Honour’s comments are reproduced verbatim rather than paraphrased. He states:

I now turn to consider the challenge to the arbitrator’s finding that the employer’s actions in implementing the PMP were unreasonable and harsh. The words in the expression ‘unreasonable and harsh’ in the definition of ‘injury’ in s 5 must be given their ordinary and natural meaning.⁴⁷

‘Unreasonable’ means ‘not guided by reason or good sense; not based on or in accordance with reason or sound judgment; exceeding the bounds of reason; immoderate; exorbitant’: *Macquarie Dictionary* (5th ed). It can also mean ‘irrational, not based on or acting in accordance with reason or good sense, going beyond what is reasonable or equitable, excessive’: *New Shorter Oxford English Dictionary*.

‘Harsh’ means ‘unpleasant in action or effect’: *Macquarie Dictionary* (5th ed). It can also mean ‘an action which is severe, rigorous, cruel, unfeeling’: *New Shorter Oxford English Dictionary*.⁴⁸

His Honour further states:

Whether discipline of a worker is unreasonable and harsh on the part of an employer is a question of fact and degree: *Housing Industry Association Limited v Murten* (Le Miere J)[33]. However, the true scope of the inquiry undertaken by an arbitrator in deciding whether a worker’s discipline is unreasonable and harsh on the part of the employer must be ascertained on a proper construction of the Act and therefore does involve a question of law. It is not to the point that the ultimate decision as to whether the discipline was unreasonable and harsh on the part of an employer also involves questions of fact: *Jenkins v Western Australian Department of Training* [1999] WASCA 199 [35] (Anderson J (Malcolm CJ & Ipp J agreeing); *Bednarczyk v Natcorp Investments Limited* (Unreported, FCt WASC, Library No 970363, 23 July 1997) [5] – [6] (Franklyn J).⁴⁹

In applying these principles to Mr Suleski’s case, His Honour found:

... whether the employer’s actions were unreasonable and harsh must be judged by having regard to all of the circumstances that I have earlier outlined, including the circumstances leading up to the decision to implement the PMP, the way in which the decision was made and how Mr Suleski was informed of it, in the context of any work policies or procedures or codes of conduct and how it impacted upon Mr Suleski personally.⁵⁰

⁴⁷ Ibid [155]-[156].

⁴⁸ Ibid [155]-[159].

⁴⁹ Ibid [166].

⁵⁰ Ibid [174].

His Honour added⁵¹ that in focussing on Mr Suleski's belief or perception that he was being unfairly treated, the arbitrator failed to have regard to the purpose of section 5(4) which entitles an employer to take administrative action in order to manage its workforce. On the evidence, the arbitrator had failed to consider all of the circumstances relevant to whether the discipline was unreasonable or harsh.⁵²

7 Results of the appeal

His Honour found that the arbitrator was not wrong in law in finding that the implementation of the PMP was the cause of Mr Suleski's stress. However, the appeal alleging the arbitrator was wrong in law in finding that the implementation of the PMP was unreasonable and harsh was upheld and the arbitrator's finding was set aside on that issue. The arbitrator's order that weekly compensation be paid by Pilbara was also set aside.⁵³

His Honour then considered the considerations⁵⁴ applicable in determining if an appeal was upheld, the matter could be remitted to an arbitrator. The provisions of section 247(7)(a) of the WCIM Act provides that the court may;

affirm, vary, or quash the decision appealed against or substitute and make in addition any decision that should have been made in the first instance.

His Honour determined that the demands of justice in the circumstances of this case required an order that the issue of whether the implementation of the PMP was unreasonable and harsh should be remitted to a different arbitrator for determination.⁵⁵

8 Comment

This case provides a detailed consideration of the law relating to reasonable administrative action with respect to section 5 of the WCIM Act. It emphasises that the purpose of the section 5(4) exclusions is to allow an employer to take reasonable managerial decisions and that they have a legal right to direct and control how work is done together

⁵¹ Ibid [175].

⁵² Note, the failure of the arbitrator to correctly apply the statutory construction of the meaning of unreasonable and harsh in the definition of injury was an error of law.

⁵³ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [176]-[179].

⁵⁴ See *Bobic v City of Armidale* [2013] WADC 126. [52]-56]; *McKay v Commissioner of Main Roads* [2013] WASCA 135.

⁵⁵ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [185].

with a responsibility to monitor workflow and to provide feedback on performance.

With respect to the onus of proof, the onus of proving that an excluded matter is not wholly or predominantly the cause of the stress is on the worker.⁵⁶ Additionally the onus of establishing that any discipline was unreasonable and harsh is also on the worker.

The test for causation in a claim for stress arising from an administrative decision or action is not whether objectively a reasonable person of normal fortitude would suffer stress. The causal connection is met if without taking the administrative action the worker would not have suffered the disease.

The term discipline was considered in some detail by the court,⁵⁷ but put simply it is to be given its ordinary meaning. Here the court referred to a number of dictionary definitions and noted that it should not be construed narrowly. The court summarised the issue in the context of employment by stating

that it involves instruction designed to train to proper conduct, to subject a person to rules of conduct of behaviour or to maintain a state of order by training and control or to bring to a state of order and obedience by training and control.⁵⁸

What is reasonable will be determined objectively, rather than based on the worker's perception and as stated earlier, management actions do not need to be perfect or ideal to be considered reasonable. The issue will also be determined from a consideration of whether the management action was a significant departure from established policies or procedures, and if so, whether the departure was reasonable in the circumstances.

⁵⁶ *Catholic Education Office of WA v Granitto* [2012] WASCA 266.

⁵⁷ *Pilbara Iron Company (Services) Pty Ltd v Suleski* [2017] WADC 114, [121]-[150].

⁵⁸ *Ibid* [150].

VII CONCLUSION

The purpose of the exclusionary provisions in both the workers' compensation federal and state legislation have been introduced to ensure that the widest range of legitimate management actions, when undertaken in a reasonable manner, do not give rise to eligibility for workers' compensation. In particular, they are to prevent claims being used to obstruct legitimate management action by excluding claims where an injury, which is generally in the form of a psychological injury, has arisen as a result of management action.

At the same time each of the cases discussed emphasise that the management action must result from a proper purpose and must be taken in a reasonable manner. They also highlight the problems with respect to management by email. Further, whilst a tribunal will consider all of the specific incidents and the respective supervisors' or managers' behaviour in determining whether the subsequent administrative action is reasonable, it will not examine every decision in order to determine if those decisions could have been made differently or better. However, the adoption and application of appropriate policies and procedures together with documentation that is transparent and consistently applied will assist in a successful, reasonable, administrative action defence.

VIII ACKNOWLEDGMENTS

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REFORMING BUREAUCRACY IN INDONESIA: THE LEGAL CHALLENGES OF REORGANISATION

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ABSTRACT

Administrative Reform – Reorganisation – Legislative Bureaucracy – Governance

This article identifies legal challenges to bureaucracy reform at the national level in Indonesia. In the world of administrative governance, nothing has become more constant than change; most governments continuously receive pressure to reform, or radically change and transform. The problems of bureaucracy are often structural. Reorganisation is therefore a logical step. The blocks of organisations are rearranged to improve symmetry, logical grouping, coordination and efficiency. However, there are legal impediments to conducting reorganisation. Due to the large structure of the Indonesian Central Government, there is significant duplication of function among ministries and agencies, in part due to entrenchment in legislation. This has led to ineffective government structures. There is also significant overlap in function between existing institutions, and newly created ones. Reorganising these institutions poses difficulties due to the process required to amend legislation related to such institutions. This article takes a qualitative approach to examining such issues. Sociological concepts are combined with legal ones, merging political sciences, public policy and management concepts with legal research in administrative law.

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I INTRODUCTION

Government organisations must be effective and efficient.¹ Reorganisation and reform serve an important role in achieving this. However, reform in Indonesia is often impeded by its complex legal framework. Reform in the public sector may be possible if the challenges posed by these complexities can be overcome and legislation passed to effect reform.

The Indonesian government has conducted administrative reform, involving organisational changes, in various areas.² However, the central government is still a large organisation with 34 ministries, 29 non-ministerial agencies, and 103 independent agencies.³

The large number of government organisations risks the duplication of functions between agencies and inefficiency in public expenditure.

The problems of red tape and disharmony between legislation and policy often constrain any potential for reform. Azhar Kasim has argued that the Indonesian administration must overcome such problems to establish effective reform.⁴

Additionally, there is legislation in place preserving the existence and functions of certain ministries and agencies.⁵ Reform, therefore, often requires amendment of the enabling legislation of the relevant organisations, which in turn requires consensus between government and parliament.⁶ This is often a lengthy process. Reorganisation is not purely legal in nature, but also requires political consensus. As stated by Kettl and Fesler,⁷ reorganisation often depends on political considerations more than pursuit of bureaucratic efficiency.

¹ Noble Fahnbulleh, 'The Future of Electronic Government' (2005) 29(1/2) *Futurics* 7, 7; The World Bank, 'Development in Practice – Governance – The World Bank's Experience' (publication, World Bank, May 1994) 43. <http://documents.worldbank.org/curated/en/711471468765285964/pdf/multi0page.pdf>

² See Yogi Suprayogi Sugandi, 'Sustainable Administrative Reform Movements Policy in Joko Widodo's Administration' (2017) 20(2) *Jurnal Ilmu Sosial Dan Ilmu Politik* 117, 118.

³ See Yogi Suprayogi Sugandi, 'Sustainable Administrative Reform Movements Policy in Joko Widodo's Administration' (2017) 20(2) *Jurnal Ilmu Sosial Dan Ilmu Politik* 117, 121, 122.

⁴ Azhar Kasim, 'Bureaucratic Reform and Dynamic Governance for Combating Corruption: The Challenge for Indonesia' (2013) 20(1) *International Journal of Administrative Science and Organisation* 18, 19.

⁵ Undang-Undang Nomor 39 Tahun 2008 [Law 39 of 2008] art 20-21.

⁶ See Ibid.

⁷ Donald F Kettl and James W Fesler, *The Politics of the Administrative Process* (CQ PR 3rd ed, 2005), 139.

The extent to which legal aspects shape governance of the Indonesian public sector and its reorganisation has not been the subject of thorough study. This article identifies legal issues pertaining to institutional reform and suggests solutions to the challenges of administrative reform.

It has been argued by Sam Agere that a country's legal framework plays a key aspect in governance.⁸ This argument is further supported by Lynette J Chua,⁹ and is frequently discussed in the socio-legal literature pertaining to Southeast Asian countries. Despite this, there is a paucity of literature discussing the legal constraints of reorganisation in Indonesia.

The aim of this article is to investigate structures for administrative reform in Indonesia, particularly reorganisation, and examine the extent to which legal aspects influence and constrain reform of the Indonesian administration.

II METHODS

This article takes a qualitative approach in identifying legal constraints to reform and examines the extent to which such challenges have shaped the governance structure of the Indonesian Administration.

Carl Auerbach and Louise Silverstein describe the qualitative approach as hypothesis-generating research.¹⁰ John Creswell defines it as a research process that uses inductive data analysis to understand issues.¹¹

This paper combines political science, public policy and management, and legal research concerning administrative law to form its conclusions. Data were collected through a combination of desk-based study and interviews.

A desk-based study is necessary to understand the legislative elements of the Indonesian administration. Secondary literature relating to the Indonesian public sector is also informative on these legal issues.

⁸ Sam Agere, *Promoting Good Governance: Principles, Practices and Perspectives* (Commonwealth Secretariat, 2000), 9.

⁹ Lynette J Chua, 'Charting Socio-Legal Scholarship on Southeast Asia: Key Themes and Future Directions' (2014) 9(1) ASJCL 5, 7.

¹⁰ Carl Auerbach and Louise Silverstein, *Qualitative Data: An Introduction to Coding and Analysis (Qualitative Studies in Psychology)* (NYU Press 1st ed, 2003), 4.

¹¹ John W Creswell, *Qualitative Inquiry and Research Design: Choosing Among Five Approaches* (SAGE Publications 3rd ed, 2012), 4.

Interviews have been undertaken with: the Minister of Administrative Reform of the Republic of Indonesia; the Deputy Minister of Administrative Reform – Institutional Affairs and Governance; Top-level Bureaucrats from the Ministry of Administrative Reform, Ministry of State Secretariat, Ministry of Trade, and Ministry of Finance; Commentators from the University of Indonesia and University of Brawijaya; a representative from a Non-Governmental Organisation ('NGO') relevant to public sector reform; and a member of parliament.

This article is part of an ongoing research project. Hence, the data presented are not exhaustive, nor are the conclusions permanent.

III LEGAL CHALLENGES OF REORGANISATION

A *The Legal Framework of the Indonesian Administration*

The Indonesian legal framework is based on the civil law legal system, inherited from Dutch colonialism.¹² Legislation is therefore the main source of administrative power in Indonesia.¹³ Legislation is declared by the House of Representatives (Dewan Perwakilan Rakyat - DPR) (as the legislative power) and the President (executive).¹⁴ However, acts usually only contain general provisions, and lack the implementation of both definitions and specific measures. They are better described as normative declarations of will or brief guidelines.¹⁵ Regulations are needed to implement the legislation, and these take the form of governmental, presidential, ministerial and regional regulations.

The executive has the power to decide how the legislation applies and is responsible for making administrative decisions under the legislation.¹⁶ Such decisions in Indonesia are in the form of regulations and decrees which provide further details on the implementation of the

¹² Yeni Salma Barlinti, 'Inheritance Legal System in Indonesia: a Legal Justice for People' (2013) 3(1) *Indonesia Law Review* 23, 24.

¹³ See Hesti Settowati, M. Toengkagie and S Harris, 'Introduction to the Indonesian Legal System: Major Developments in the Past Decade' (2006-2007) 13 *Yearbook of Islamic and Middle Eastern Law* 57, 60.

¹⁴ *Ibid* 59-60.

¹⁵ See Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 5 and art 10 [Act 12/2011].

¹⁶ See Hesti Settowati, M. Toengkagie and S Harris, 'Introduction to the Indonesian Legal System: Major Developments in the Past Decade' (2006-2007) 13 *Yearbook of Islamic and Middle Eastern law* 57, 59.

legislation.¹⁷ The executive consists of the President, ministers, heads of agencies and government departments, and public servants.¹⁸

Article 7 of Act 12/2011 on the Formulation of Laws and Regulations sets forth the hierarchy of the Indonesian legal framework as follows:¹⁹

- 1) The 1945 Constitution (*Undang-Undang Dasar 1945* or UUD 1945);
- 2) The People's Consultative Assembly Decisions (*Ketetapan Majelis Permusyawaratan Rakyat*);
- 3) Law (*Undang-Undang* or UU) and Government Regulation in Lieu of Law (*Peraturan Pemerintah Pengganti Undang-Undang* or *Perpu*);
- 4) Government Regulation (*Peraturan Pemerintah* or PP);
- 5) Presidential Regulation (*Peraturan Presiden* or *Perpres*);
- 6) Regional – Province Regulation
- 7) Regional – Regency/City Regulation.

As previously mentioned, most legislation is general in nature and only provides general principles. *Perpu*, on the other hand, are Government Regulations made by the president and hold the same weight as *Undang-Undang* (the law) and may substitute certain laws made by the People's Consultative Assembly in situations such as times of crisis.²⁰

Government regulations provide specifics for the implementation of laws and are drafted and discussed between ministries and then signed by the president.²¹ Presidential Regulations are issued by the President as the head of the executive branch of government.²² Regional regulations are passed by provincial or city governments with agreement from the regional House of Representatives in that region.²³

Additionally, Article 8(1) of Act 12/2011 establishes that regulations promulgated by the executive, legislative or judicature are binding

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 7 [Act 12/2011].

²⁰ See Hesti Settowati, M Toengkagie and S Harris, 'Introduction to the Indonesian Legal System: Major Developments in the Past Decade' (2006–2007) 13 *Yearbook of Islamic and Middle Eastern Law* 57, 59.

²¹ Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 1 para 4 [Act 12/2011].

²² Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 1 para 6 [Act 12/2011].

²³ See Hesti Settowati, M Toengkagie and S Harris, 'Introduction to the Indonesian Legal System: Major Developments in the Past Decade' (2006–2007) 13 *Yearbook of Islamic and Middle Eastern Law* 57, 65–66.

provided they were made under the directive of higher statutes or regulations or made under its respective authority.²⁴ Article 8(1) of Act 12/2011 (translated into English) states:

Other rules than those stated in Article 7 paragraph (1) cover the regulations stipulated by the People's Consultative Agency, House of Representatives, Regional Representatives Council, the Supreme Court, the Constitutional Court, the State Audit Board, the Judicial Commission, Bank of Indonesia, the Minister, agency, institution, or same level commission established by Law or Government on the instruction of Law, Provincial Regional House of Representatives, Governor, Regency/Municipality Regional House of Representatives, Regent/Municipal Government, the Village Head or the equivalent.

These promulgating bodies include:²⁵

- (i) The People's Consultative Assembly;
- (ii) The House of People's Representative (Parliament)
- (iii) The Supreme Court;
- (iv) The Constitutional Court;
- (v) The State Audit Board,
- (vi) The Judicial Commission;
- (vii) The Bank of Indonesia;
- (viii) Ministers, agencies, institutions or commissions established by law;
- (ix) Regional Parliaments; and,
- (x) Governors, Regents or Mayors.

In practice, there are also administrative decisions in the form of decrees, instructions and letters such as:²⁶

²⁴ Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 8 [Act 12/2011]. The Supreme Court is the highest court for civil and criminal proceedings whilst the Constitutional Court is the first and final court for reviewing the constitutionality of laws (Article 24 of the 1945 Constitution). However, Article 8(1) of Act 12/2011 states that the Supreme Court and Constitutional Court may issue regulations (*Peraturan Mahkamah Agung (Perma)* and *Peraturan Mahkamah Konstitusi*) to support their roles and professional activities. Hundreds of regulations have been issued by the Supreme Court and the Constitutional Court. For example, recently the Supreme Court has issued Supreme Court Regulation 3/2018 on the E-Administration of Cases, Supreme Court Regulation 2/2018 on the Establishment of Special Judges for General Election Disputes, and Supreme Court Regulation 1/2018 on the Procedures for the Criminal Proceedings of General Election Related Crimes.

²⁵ Ibid.

²⁶ Undang-Undang Republik Indonesia Nomor 30 Tahun 2014 (Indonesia) art 1 para 7 [Act 30/2014].

- Presidential Decrees (*Keputusan Presiden*);
- Presidential Instructions (*Instruksi Presiden* or *Inpres*);
- Ministerial Decrees (*Keputusan Menteri* or *Kepmen*);
- Regional Government – Governor’s Decrees (*Keputusan Gubernur*);
- Regional Government – Regent or Mayor’s Decrees (*Keputusan Bupati/Walikota*); and
- Circulation Letters (*Surat Edaran*).

These decrees, instructions and letters can and do conflict with each other at times. Ministerial and other lower decrees do not have the same binding power as regulations.²⁷ However, they are binding in their respective sector as administrative decisions.²⁸ If there is a conflict between one authority in the hierarchy and a lower one, the higher authority will prevail.²⁹ For example, in a conflict between a Ministerial Decree and a higher authority such as a Presidential Regulation, the higher Presidential Regulation prevails.

B *Legislation: a problem for Administrative Reform?*

The preservation of certain ministries and agencies in Indonesia is provided by statute. They establish the nomenclature and authority of certain administrative bodies in Indonesia.³⁰ This means that the creation of these institutions occurred through consensus between the executive and the House of Representatives. Reforming these ministries and agencies therefore requires amendment of the statute that created the organisation or preserves it, which can be a lengthy and difficult political process.

Therefore, restructuring cannot be regarded as a purely administrative measure. This view is supported by Donald Kettl and James Fesler, who argue that a vast assortment of legal rules and political forces have exercised too much control over the discretion of administrators, causing

²⁷ Undang-Undang Republik Indonesia Nomor 30 Tahun 2014 (Indonesia) elucidation section [Act 30/2014].

²⁸ Undang-Undang Republik Indonesia Nomor 30 Tahun 2014 (Indonesia) elucidation section [Act 30/2014].

²⁹ Undang-Undang Republik Indonesia Nomor 12 Tahun 2011 (Indonesia) art 7 [Act 12/2011].

³⁰ See Undang-Undang Republik Indonesia Nomor 39 Tahun 2008 (Indonesia) art 5.

difficulties for the Indonesian Government to effectively manage its programs.³¹

Asman Abnur, the Minister of Administrative Reform of the Republic of Indonesia, agreed with this in an interview conducted for this article, arguing that political interests of existing political parties are embedded in legislation and have contributed to the mushrooming of administrative bodies.³² He states:

... currently, there are ten political parties in Indonesia, each of them has their own agenda for this country. Their political interests dominate our parliament. In every hearing to discuss a bill, their vested interests are reflected in every draft law. The problem is that their interests are often incompatible with the government's organisational needs. That is why we have so many agencies, because they are embedded in the law. These agencies are often a consequence of interference by political parties in the legislative process through their members in the parliament. It was hard to do the reform because of the presence of such political interests. This is unavoidable in a democratic country like ours.³³

This aligns with arguments made by Donald Kettl and James Fesler that decisions for reorganising the administration often depend on political considerations more than administrative efficiency.³⁴ Also in line with this are Nancy Young's arguments that legislation has played a significant role in the mushrooming of Indonesia's administration.³⁵ Legislation and its associated regulations have contributed to bloating and fragmentation in government institutions, with many duplications of function across different authorities.

Most legislation in Indonesia comes from bills proposed by the House of Representatives. Asman Abnur has argued that one of the difficulties facing administrative reform in Indonesia stems from the

³¹ Donald F Kettl and James W Fesler, *The Politics of the Administrative Process* (CQ PR 3rd ed, 2005), 4.

³² Personal Communication from Asman Abnur to Mas Pungky Hendra Wijaya, 26 April 2017.

³³ Personal Communication from Asman Abnur to Mas Pungky Hendra Wijaya, 26 April 2017.

³⁴ Donald F Kettl and James W Fesler, *The Politics of the Administrative Process* (CQ PR 3rd ed, 2005), 139.

³⁵ Nancy Beck Young, 'The Politics of Bureaucracy' (2015) 43(2) *Reviews in American History* 327, 328.

government not having a stronger position in addressing the House of Representatives and negotiating passage of bills.³⁶

Under article 17 of the 1945 Constitution, the President holds power over the administration and may appoint ministers and heads of agencies.³⁷ However, some ministries and agencies are established by statute. This not only makes reform difficult, but also reduces constitutional prerogative power vested in the president to manage their administration.

The reforming of ministries is also difficult in Indonesia. The State Ministries Act lists 46 functions of the executive which should be handled by ministries.³⁸ However, the act provides that the number of ministries shall not exceed 34.³⁹ This requires some ministries to manage more than one administrative function, such as: the Ministry of Laws and Human Rights; the Ministry of Education and Culture; the Ministry of Science, Research and Higher Education; the Ministry of Energy and Mineral Resources; the Ministry of Forestry and Environment; and the Ministry of Transmigration and Development of Rural Area.

Reforming ministries is difficult because the nomenclature of administrative bodies is stated in the relevant statute and there are limitations on the President's ability to determine and establish the functions of the ministries. The names of the ministries cannot deviate significantly from the 46 functions set out in Act 39/2008.⁴⁰ Furthermore, to provide certain mandates and authorities, almost all ministries are mentioned in their sectoral legislation, and this not only preserves these ministries, but also impedes reform. For example: the Ministry of Defence is mentioned in the Civil Reserve Act, Defence Act, and Defence Industry Act;⁴¹ the Ministry of Foreign Affairs is mentioned in the International Relations Act, International Agreements Act, and Placement and Protection of Indonesian Workers in Foreign

³⁶ Personal Communication from Asman Abnur to Mas Pungky Hendra Wijaya, 26 April 2017.

³⁷ *Undang-Undang Dasar Republik Indonesia 1945* [Constitution of the Republic of Indonesia 1945] art 17.

³⁸ *Undang-Undang Nomor 39 Tahun 2008* [Law 39 of 2008] art 5(2).

³⁹ *Ibid* art 15.

⁴⁰ See *Undang-Undang Nomor 39 Tahun 2008* [Law 39 of 2008] art 5(2), 8, 9.

⁴¹ See *Undang-Undang Nomor 56 Tahun 1999* [Law 56 of 1999] art 1 para 8, *Undang-Undang Nomor 3 Tahun 2002* [Law 3 of 2002] art 1 para 14, and *Undang-Undang Nomor 16 Tahun 2002* [Law 16 of 2002] art 8 (2).

Country Act,⁴² and the Ministry of Home Affairs is mentioned in the Local Governments Act, Election of Local Governments Act 8/2015.⁴³ This also applies to the other ministries, most of which have their own legislation.

Therefore, the President does not have the flexibility or discretion to merge or decommission ministries. Such actions would require statutory amendment, which has the same requirements as passing new law.⁴⁴ Constitutionally, this action will require another political consensus between the executive and parliament.⁴⁵

In line with this, the Minister for Administrative Reform has argued that the legal framework in Indonesia, both statute and regulations, often curbs the bureaucracy and therefore is a major impediment to effective reform.⁴⁶ He further states that, ‘the biggest constraint is always the law, since we always tried to solve problems by creating a new law’.⁴⁷

In addition to the current 34 Ministries, the Indonesian Government also has 29 non-ministerial agencies (*Lembaga Pemerintah Non-Kementerian*) (‘LPNK’), 15 of which are established under statute.⁴⁸

There are also 105 independent agencies (*Lembaga Non-Struktural*) (‘LNS’), 85 of which are established under legislation.⁴⁹ These bodies function as state auxiliary agencies, and are either responsible for the implementation of public policies similar to the ministries of LPNKs, or perform oversight functions.⁵⁰ These agencies were established by

⁴² See Undang-Undang Nomor 37 Tahun 1999 [Law 37 of 1999] art 1 para 4, Undang-Undang Nomor 24 Tahun 2000 [Law 24 of 2000] art para 9, and Undang-Undang Nomor 39 Tahun 2004 [Law 39 of 2004] art 78.

⁴³ See Undang-Undang Nomor 23 Tahun 2014 [Law 23 of 2014] art 1 para 44, and Undang-Undang Nomor 1 Tahun 2015 [Law 1 of 2015] art 1.

⁴⁴ See *Undang-Undang Dasar Republik Indonesia 1945* [Constitution of the Republic of Indonesia 1945] art 20(1).

⁴⁵ *Ibid* art 20.

⁴⁶ Personal Communication from Asman Abnur to Mas Pungky Hendra Wijaya, 26 April 2017.

⁴⁷ Personal Communication from Asman Abnur to Mas Pungky Hendra Wijaya, 26 April 2017.

⁴⁸ Ministry of Administrative Reform of the Republic of Indonesia, ‘Policy Paper: Restructuring the Structures of Bureaucracy – Recommendation on the Structure of Central Government Using the Concept of Machinery of Government’ (Ministry of Administrative Reform of the Republic of Indonesia, 2014), 57.

⁴⁹ *Ibid*, 58.

⁵⁰ Undang-Undang Nomor 39 Tahun 2008 [Law 39 of 2008] art 25.

legislation, and therefore the executive government cannot dissolve them if such amendment would breach the terms of the enabling legislation. Furthermore, if the entities were dissolved, questions would arise as to how their statutory functions would be re-implemented in the institutions' absence. Therefore, in conducting institutional restructuring, it is critical to fully examine the institutions' enabling legislation.

Yuki Fukuoka has argued that political transactions are often behind the creation of new institutions, and the executive is often powerless to prevent the growth and establishment of new agencies within themselves.⁵¹ Often, members of the House of Representatives urge the establishment of these new agencies through the bills they have initiated. Commonly, when a new law is passed to address a specific issue, the bill will also instruct the establishment of a new agency to administer that issue, despite it also falling under the responsibility of existing agencies.⁵² This has become the root of inefficiency in the Indonesian executive government and has resulted in a large overlap in authority and functions between institutions.

The Deputy Minister for Administrative Reform of Issues in Institutional Affairs and Governance, Rini Widyantini, is also of the view that legislation often acts as a constraint to reforming agencies. This is because the legislation focuses on addressing certain issues but does not provide specifics on its implementation.⁵³ She further states:

I will illustrate this: there was a time when our ministry was requested to restructure the independent agencies (LNS). Since 85 of 105 LNSs are statutorily established, it was not easy for us to reorganise their organisations. Similarly, reforming ministries and non-ministerial agencies is also not an easy task since many of them have their own sectoral legislation. As an example, it was difficult for us to restructure the directorate general of taxation (DG Tax) since the Taxation Act stipulates explicitly the name of the DG Tax into its provisions. Hence, we may not

⁵¹ See Yuki Fukuoka, 'Politics, Business and the State in Post-Soeharto Indonesia' (2012) 34(1) *Contemporary Southeast Asia: A Journal of International and Strategic Affairs* 80, 94.

⁵² See Yogi Suprayogi Sugandi, 'Sustainable Administrative Reform Movements Policy in Joko Widodo's Administration' (2017) 20(2) *Jurnal Ilmu Sosial Dan Ilmu Politik* 117, 129.

⁵³ Personal Communication from Rini Widyantini to Mas Pungky Hendra Wijaya, 4 May 2017.

be able to upgrade the DG Tax into an agency or a ministry. As such, when we need to restructure an organisation to achieve our development goals, it may be difficult if we do not firstly amend the laws.⁵⁴

She acknowledges that often mentioning the nomenclatures of a ministry or agency in their sectoral law is used as a device to preserve their existence and enlarge their power.⁵⁵ She further argues that there is a tendency for government agencies to expand their powers and function through legislation.⁵⁶ She also indicates that often a new agency is established with the purpose of providing a high-rank position in the public sector for certain people who are affiliated with a certain political party.⁵⁷ In addition, she opines that the President often does not have full discretion to develop their own administration or restrict the rampant creation of new agencies established under statute. This is in part due to lack of support from the House of Representatives for reform, despite a limited state budget.⁵⁸

The Head of the Division for Religion, Education and Technology at the Ministry of State Secretariat of the Republic of Indonesia, Diah Arianti, has expressed similar opinions. She argues that new parliamentary bills often contain proposals to establish a new agency, despite the relevant functions already being performed by an existing agency.⁵⁹ She further opines that the swollen Indonesian administration was the result of pressure and interference from the House of Representatives in the public administration through bills initiated in the House itself.⁶⁰ Additionally, she argues that proposals to create new agencies under statute may constrain attempts at institutional reform, stating:

⁵⁴ Ibid.

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Personal Communication from Rini Widyantini to Mas Pungky Hendra Wijaya, 4 May 2017; See also Yogi Suprayogi Sugandi, 'Sustainable Administrative Reform Movements Policy in Joko Widodo's Administration' (2017) 20(2) *Jurnal Ilmu Sosial Dan Ilmu Politik* 117, 119.

⁵⁸ Personal Communication from Rini Widyantini to Mas Pungky Hendra Wijaya, 4 May 2017.

⁵⁹ Personal Communication from Diah Arianti to Mas Pungky Hendra Wijaya, 20 April 2017.

⁶⁰ Ibid.

... the harmonisation of laws and regulations is difficult. For example, if an organisation is statutorily established, it can be difficult to reform it, even for just a small unit of technical service delivery in a relevant ministry. Frequently, it was not easy for us to reorganise the 'mother' ministry of that technical unit since the name of such technical unit is mentioned in the law. Thus, without changing the law related to that unit, its 'mother' ministry cannot be reorganised.

... as most ministries and agencies wanted to preserve their existence, they develop their sectoral legislation to achieve preservation, not only in the statute but also in the form of Presidential Regulations. That is why it is difficult to harmonise our laws and regulations. When the mandates of a ministry, role, and functions are mentioned in the statute, we need the consent from the Parliament (in form of the law amendments) to abolish or reduce the organisation of such ministry.⁶¹

The other major problem created by legislation is disharmony between statutes. Rini Widyantini has argued that such discrepancies between legislations has produced dissonant business processes as well as sectorial ego and ineffective governance. She further argues that existing legislation does not provide any significant support for institutional reform.⁶²

This aligns with arguments made by Azhar Kasim who argues that one of the major problems in Indonesia's public governance is disharmony between new and existing laws and regulations.⁶³ Whilst the focus of administrative reform in Indonesia has been the creation or amendment of laws, policy and regulations, civil servants face difficulties in the implementation of such laws due to incoherency in statutes and policy documents. Therefore, to establish effective reform, the Indonesian government must solve this disharmony which constitutes a further constraint on reformation of the public sector. Disharmony is often in the form of excessive red tape around administrative procedures and regulations.

Special Staff for the Minister of Administrative Reform of the Republic of Indonesia, Teguh Widkinarko, has argued that sectorial

⁶¹ Ibid.

⁶² Personal Communication from Rini Widyantini to Mas Pungky Hendra Wijaya, 4 May 2017.

⁶³ Azhar Kasim, 'Bureaucratic Reform and Dynamic Governance for Combating Corruption: The Challenge for Indonesia' (2013) 20(1) *International Journal of Administrative Science and Organisation*, 19.

ego also forms a major challenge to reform as ministries and agencies attempt to preserve themselves through the passage of legislation.⁶⁴ He further argues that reform in the public sector is difficult with the presence of such practices, and is limited due to the mention of ministry nomenclatures in sectorial legislation.⁶⁵ He states:

We always have that vested interest; the main reason is to strengthen the position of their institution. It mostly happened to non-ministerial agencies, as they want recognition of their existence; as such, they endeavour to have a relevant provision in the legislations.⁶⁶

Additionally, Teguh Widjinarko argues that legislation plays an important role in shaping public sector organisations.⁶⁷ However, he clarifies that legislation should not form a constraint to reform.⁶⁸ To some extent, administrative bodies need legislation as the legal basis to exercise power. However, in order not to impede reform, Teguh asserts that legislation should not mention specific nomenclature or name ministries or agencies in their provisions.⁶⁹ For flexibility of governance, he suggests legislation should be phrased in general terms without naming specific bodies, which the executive government is then responsible for implementing.⁷⁰

Erni Murniasih, a Project Manager of KOMPAK (*Kolaborasi Masyarakat dan Pelayanan untuk Kesejahteraan* – Public Collaboration and Services for Welfare), argues that coordination between ministries and agencies in the central government is poor, as legislation often creates too many administrative bodies addressing the same issue.⁷¹ This article supports Erni Murniasih's views where she states:

In the rural area, to implement the Rural Laws, from its financial aspect, the formulation of the rural fund is the responsibility of the Ministry of Finance. The determination of the allocation of those funds is the Ministry of Rural Areas (responsibility); its assistance facility is held by

⁶⁴ Personal Communication from Teguh Widjinarko to Mas Pungky Hendra Wijaya, 18 April 2017.

⁶⁵ Ibid.

⁶⁶ Ibid.

⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ Personal Communication from Erni Murniasih to Mas Pungky Hendra Wijaya, 28 April 2017.

the Kemendagri; we also had the Coordinating Ministry of Human and Culture Development as the orchestra leader of those activities. Hence, the field is too crowded. We have so many institutions working on a single issue and sometimes we also had an institution (that) didn't do anything to solve the problems.⁷²

Ahmad Muqowam, a Politician from the Unity of Development Party ('PPP'), Member and the Head of Committee I of the House of Regional Representatives ('DPD') and former member of Commission II of DPR, is of the opinion that having a number of institutions which are responsible for administering the same particular issue will have significant implications for the budget, functions, and performance.⁷³ However, he also argues that inflation of agencies through legislation is a common result of the political process.⁷⁴ He posits that the legislature should not be solely blamed for the mushrooming of administrative bodies under legislation.⁷⁵ Ahmad Muqowam argues that the House of Representatives can agree to not create a new agency under a proposed bill if provided sufficient reasons not to do so by the executive government.⁷⁶

Therefore, in addressing Parliament, it is important for the executive government to be able to argue strongly against the creation of new agencies by the House of Representatives on the basis that an adequate agency already exists which currently performs the same or similar roles.

All interviewees for this article agreed that the executive and legislature should share a strong commitment to administrative reform.

C How to overcome Legal Impediments of Reorganisation?

Rini Widyantini (Deputy Minister for Administrative Reform for the Issues of Institutional Affairs and Governance) has argued that institutional reform in Indonesia faces many difficulties since the Indonesian government has no overarching design for a reformed administrative structure.⁷⁷ The same views have been expressed by

⁷² Ibid.

⁷³ Personal Communication from Ahmad Muqowam to Mas Pungky Hendra Wijaya, 3 May 2017.

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ Ibid.

⁷⁷ Personal Communication from Rini Widyantini to Mas Pungky Hendra Wijaya, 4 May 2017.

Eko Prasodjo, a former Vice Minister of Administrative Reform of the Republic of Indonesia (2011-2014) and currently Dean of the Faculty of Social and Political Sciences at the University of Indonesia.⁷⁸ He argues that the commitment to institutional reform has only been partial, since there is no clear objective to bureaucratic reform or overarching concept to model the reform of the Indonesian executive government.⁷⁹ He has also stated:

... reform was fragmented and partial, it was just like extinguishing the fire when there is a fire. We did something without having the comprehensive picture of it; and our assessment was fragmented and partial, limited to what we can do just to examine non-structural agencies which may not be functioning properly. But we never discussed the main design for the organisation of the government, how many ministries we need, how many non-ministerial agencies, independent agencies. Thus, the results (of reform) were partial and do not have long-term strategic value.⁸⁰

Legislation was and is often used to establish new institutions and enlarge the bureaucracy. This has caused the executive government to become swollen and its governing laws fragmented due to each sector of administration having an independent organisation. Eko Prasodjo argues that to address organisational bloating effectively, Indonesia's legal framework must also be addressed, and the Indonesian government must have a guiding structure for effective reform. He further stipulates that such an overarching design should be expressed in legislation since administrative reform needs strong political will and commitment to succeed.⁸¹

This article supports Eko Prasodjo's views that a new legal framework is required for effective reform that sets out requirements for the establishment of new agencies in the future. This would reduce the fragmentation of the Indonesian administration by preventing and reducing the number of unnecessary agencies. This would help reduce duplication of functions between departments.

⁷⁸ Personal Communication from Eko Prasodjo to Mas Pungky Hendra Wijaya, 3 May 2017.

⁷⁹ Ibid.

⁸⁰ Ibid.

⁸¹ Ibid.

The Assistant to Deputy Minister for Institutional Affairs and Governance and the Director for the Institutional Assessment in the Area of Human Capital and Cultural Development of the Ministry of Administrative Reform, Vera Yuwantari has made similar arguments.⁸² She agreed that the impediments to institutional reform are often statute-based, and the mushrooming of the bureaucracy is a result of pressure and interference from the House of Representatives.⁸³ She further argues that the public sector often uses legislation to enlarge an organisation with the purpose of increasing their budget and power.⁸⁴

Boon Siong Neo and Geraldine Chen argue that public sector organisations should be dynamic and flexible to be able to deliver efficient and cost-effective public service.⁸⁵ Therefore, legislation which curbs administrative efficiency is disadvantageous to government. As sectoral ego manifested in sectoral laws has caused disharmony between legislation and created constraints to reform, this article suggests that the Indonesian government should develop a new legal framework to form the basis of institutional reform. This new legal framework should provide more discretion to the executive government in managing public bodies. This aligns with the views of Bambang Supriyono, Professor of Public Administration and the Dean of the Faculty of Administration at Brawijaya University, who opines that legislation should not address the managerial aspects of public administration.⁸⁶

IV CONCLUSION

Administrative reform in Indonesia depends on the capability to overcome the legal impediments of reorganisation. The large Indonesian public sector has significant duplication of functions between agencies, resulting in ineffective and inefficient governance. Certain ministries

⁸² Personal Communication from Vera Yuwantari to Mas Pungky Hendra Wijaya, 17 April 2017.

⁸³ Ibid.

⁸⁴ Ibid.

⁸⁵ Boon Siong Neo and Geraldine Chen, *Dynamic governance: embedding culture, capabilities and change in Singapore* (New Jersey: World Publishing Company, 2007), 61.

⁸⁶ Personal Communication from Bambang Supriyono to Mas Pungky Hendra Wijaya, 21 April 2017.

are protected from reform or dissolution by legislation, which requires often long political processes to amend or repeal. A functional public sector should be efficient and adaptive, which requires it to have an efficient institutional configuration. This article concludes that reform may succeed if the laws are redesigned to overcome the challenges to reform.

In this regard, establishing a new overarching legal framework to regulate the size and functions of public sector institutions and setting conditions to the creation of new agencies are important steps for effective reorganisation and successful administrative reform in Indonesia.

THE UNCONSCIONABILITY EXCEPTION – HAS UNCONSCIONABLE CONDUCT EMERGED AS AN EXCEPTION TO THE PRINCIPLE OF AUTONOMY IN DOCUMENTARY LETTERS OF CREDIT IN AUSTRALIA?

MASAYU LYNN MASAGOES*

ABSTRACT

Documentary Letters of Credit – Unconscionable Conduct – International Trade Financing – International Sales – Principle of Autonomy – Exception – Australian Law – Australia – Singapore – Olex Focas Pty Ltd v Skodaexport Co Ltd – Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd

This comment broadly examines the doctrine of the principle of autonomy and the use of documentary letters of credit as an international trade finance mechanism in Australia. Following the Competition and Consumers Act 2010, and the cases of Olex Focas Pty Ltd v Skodaexport Co Ltd and Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd, it appears that ‘unconscionable conduct’ has become an exception to the principle of autonomy. A brief comparison of the Australian and Singaporean case law also highlights the potential for this exception within Australia.

I INTRODUCTION

International trade financing plays a fundamental role in international sale contracts.¹ In such contracts, documentary letters of credit are

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¹ *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146, 155-156 (Kerr J): ‘the life-blood of international commerce’, cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 917 [4]-[5]; *Agritrade International Pte Ltd V Industrial Commercial Bank Of China* [1998] 3 SLR 211 (Selvam J): ‘sacrosanct’, cited in Rosmawani Che Hashim, Ahmad Azam Othman And Akhtarzaite Abdul Aziz, ‘Principle Of Autonomy In Letter Of Credit: Malaysian Practice’, (2011) 19 *International Islamic University of Malaysia Law Journal*, 221 [3].

often used as a payment mechanism.² The use of letters of credit may be seen to facilitate international trade – without letters of credit, international commerce may be significantly hampered.³ Any barrier to or hampering of international trade is clearly unfavourable where the goods in question are perishable. In a typical scenario, sellers and buyers may lack sufficient knowledge regarding the other party to warrant trust in that party's credit standing and integrity. This results in the competing desire of each party to protect their respective interests: the seller would prefer to obtain payment before the goods are shipped, while the buyer would prefer to make payment only after he receives the goods as ordered. Unless one party shoulders the risk of performing his obligation first, whether by releasing payment or shipping the goods, the trade would come to a standstill. However, where parties incorporate the use of a documentary letter of credit as a payment mechanism, they are able to overcome their mutual lack of trust and proceed with the sale contract.⁴ In a rapidly globalising world, this is becoming increasingly important with the growth of international trade.

Payment using documentary letters of credit is based on the principle of autonomy.⁵ This principle directs that the contract for the sale of goods and the contract for payment be dealt with separately.⁶ Therefore, where goods delivered do not meet the standards or specifications in the sale contract, or where there is a disagreement between the seller and buyer regarding the underlying contract, the contract for payment is not affected and payment is still made, provided that the relevant

² Peter Jones, 'Can the letter of credit be saved? A proposal to the ICC Banking Commission' (*Online*), 19 January 2005, accessed at 10 May 2015, <http://www.forwarderlaw.com/library/view.php?article_id=220>.

³ LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 866 [3].

⁴ Dr Serguei A. Koudriachov, 'The Application of The Letter of Credit Form Of Payment In International Business Transactions', (2001) 10 *Currents: International Trade Law Journal* 37, 39 [IV].

⁵ *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159, 170 –171 (Lord Denning), cited in *Hortico (Australia) v Energy Equipment Co (Australia)* NSWLR 545, 551 [2] – [3].

⁶ See, eg, *Hamzeh Malas & Sons v British Imex Industries Limited* [1958] 2 QB 127, cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 865–866; International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits* ('UCP 600'), Art 4–5; *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 All ER 1071.

documents conform to the mandate of the buyer.⁷ In other words, payment is made against conforming documents without concern to the underlying sales contract.⁸ It should be noted that the buyer and seller are not disadvantaged in such a situation – they may still pursue litigation or alternative dispute resolution to resolve their dispute based on the underlying sales contract.⁹

The autonomy principle is supplemented by the doctrine of strict compliance, both of which have been incorporated in the *Uniform Customs and Practice for Documentary Credits 600*.¹⁰ Under strict compliance, the banks are not tasked to look beyond the information provided on the face of the documents, and they are not concerned with the performance of the contract of sale – if the documents comply with the mandate of the buyer, the banks simply honour the call for payment when made by the seller.¹¹

The independence of the contract of sale from the contract for payment performs a key function: it instils public trust in the payment mechanism.¹² It also acts to protect the interests of the buyer and seller: the buyer is assured that payment will only be released upon the receipt of conforming documents, and the seller is assured of payment when he ships the goods and presents complying documents, resulting in the

⁷ *Hamzeh Malas & Sons v British Imex Industries Limited* [1958] 2 QB 127, cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 865–866; *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 (Lord Denning), cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 867; *Power Curber International Ltd v National Bank Of Kuwait* [1981] 1 WLR 1238, [1241] (Lord Denning), cited in Charles Chatterjee and Anna Lefcovitch, ‘The Principle Of Autonomy Of Letters Of Credit Is Sacrosanct In Nature’, (2003) 5(1) *Journal of International Banking Regulation*, 72.

⁸ Roy Goode, ‘Symposium New Developments in The Law of Credit Enhancement: Domestic and International, Abstract Payment Undertakings In International Transactions’, (1996) 22(1) *Brook. J. International* 1, 4 [1].

⁹ *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146, 155–156 (Kerr J), cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 917.

¹⁰ International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits 600*, Art 4, 5, 7(a), 7(c), 8(a), 8(c), 15(a), 15(b).

¹¹ LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 857.

¹² Above n 9.

advanced receipt of payment before the buyer has received possession of the goods.¹³ It is likely due to these mutual benefits to the parties that letters of credit are so often used in international trade. In addition, this independence facilitates the efficiency of international trade.¹⁴ The seller will often receive payment before the buyer has received possession of the goods, thereby allowing the seller to fulfil his own payment obligations promptly. If the seller had to wait for the buyer to have possession of the goods before payment is initiated, this could lead to a significant delay of weeks or months in the movement of the funds. The buyer, on the other hand, can sell the goods whilst they are still afloat, as he has already received title to the goods even though he has not received physical possession. Therefore, the use of documentary letters of credit results in the swift transfer of funds between the parties and the swift transfer of ownership in the goods.

With the security of payment provided to the seller, it is submitted that the effect of the autonomy principle is to shift the trust required in the other party to trust in the banking institutions instead. It is this trust in the payment mechanism and the banking institutions that must be upheld if the utility of this mechanism is to be protected. It is submitted that this protective attitude is the reason that the autonomy principle is held in such high regard by the courts who prefer to adopt a non-intrusive approach whenever possible.¹⁵

Notwithstanding the importance of the autonomy principle, the law and banking practices must adapt to changing times. As different factual situations come to light, it is necessary that law and banking practices develop to ensure that a fair result is achieved in varied situations. An example of this adaptation is the evolution of the doctrine

¹³ Dr Serguei A. Koudriachov, 'The Application of The Letter of Credit Form Of Payment In International Business Transactions', (2001) 10 *Currents: International Trade Law Journal* 37, 39 [IV].; *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)* [1983] 1 AC 168 (Lord Diplock), cited LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 869.

¹⁴ Dixon, William M, 'As Good as Cash? The Diminution of The Autonomy Principle', (2004) 32(6) *Australian Business Law Review* 391, 394 [2].

¹⁵ *Hortico (Australia) v Energy Equipment Co (Australia)* [1985] NSWLR 545, 553 [8].

of strict compliance, which is arguably less strict today.¹⁶ In tandem, the exceptions to the principle of autonomy have developed as well. This comment will explore whether unconscionable conduct has emerged as a new exception to the principle of autonomy in Australia by examining the *Trade Practices Act 1974* (Cth) (now renamed the *Competition and Consumer Act 2010* (Cth)), and the cases of *Olex Focas Pty Ltd v Skodaexport Co Ltd* ('*Olex Focas*'),¹⁷ and *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd* ('*Boral Formwork*').¹⁸ The amendments made by the *Trade Practices Amendment (Australian Consumer Law) Act 2010* (Cth) and the *Competition and Consumer Legislation Amendment Act 2011* (Cth) will be assessed to determine if any significant changes have been made to the relevant sections to affect the unconscionable conduct exception. Finally, a brief comparison of the Australian approach to unconscionable conduct will be made with the Singapore approach to explore the potential that this limited exception could hold in the future.

II THE PRINCIPLE OF AUTONOMY IN AUSTRALIA

The autonomy principle was affirmed in the Australian case of *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd*.¹⁹ In this case, Young J recounted English authority such as *Edward Owen Engineering Ltd v Barclays Bank International Ltd*²⁰ and *Elian and Rabbath v Matsas*,²¹ before affirming that the general rule the Courts follow with respect to letters of credit, bank guarantees and performance bonds, is to respect the independence of the bank's obligation to pay from the underlying contract for sale of goods.²² As a result, the courts

¹⁶ See, eg, International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits 600*, Art 14(e), (j); *Hing Yip Hing Fat Co Ltd v Daiwa Bank Ltd* [1991] 2 HKLR 35, cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 860; *Kredietbank Antwerp V Midland Bank Plc* [1999] 1 All ER (Comm) 801, cited in LS Sealy and RJA Hooley, *Commercial Law: Text, Cases, and Materials* (Oxford University Press, 4th ed, 2008), 860–861.

¹⁷ [1998] 3 VR 380.

¹⁸ (*In Administrative Receivership*) & *Another* [2003] NSWSC 713.

¹⁹ [1985] NSWLR 545.

²⁰ [1978] QB 159.

²¹ [1996] 2 Lloyd's Rep 495.

²² Above n 15, 551 [2]–[5], 552 [7].

are typically reluctant to interfere when applications for injunctions are made to restrain the honouring of such payment mechanisms by the banks.²³ In recognising the utility of these payment mechanisms to commerce,²⁴ Young J opined that the only equitable grounds on which the Courts would be able to interfere would be where actual fraud or gross unconscionable conduct could be shown to exist.²⁵

III THE RECOGNISED EXCEPTION OF FRAUD

England has identified the fraud exception as the sole exception to the principle of autonomy.²⁶ In the case of *Themehelp Ltd v West*,²⁷ it was established that fraud is the only situation where the banks would be able to refuse to honour the letter of credit.²⁸ However, the fraud exception is notoriously difficult to prove. In *Edward Owen Engineering Ltd v Barclays Bank International Ltd*,²⁹ Browne LJ and G Lane J determined that fraud must be proven and not merely claimed or assumed,³⁰ and the relevant fraud must be 'clear and obvious to the bank'.³¹ It is a further requirement that the party benefitting under the letter of credit must also be the party who had committed the fraud.³²

It is perhaps this difficulty in proving fraud that acted as the catalyst for the emergence of a new exception to the principle of autonomy. Indeed, it has been remarked that the unconscionable conduct exception

²³ Ibid.

²⁴ *Intraco Ltd v Notis Shipping Corporation* [1981] 2 Lloyd's Rep 256 (Donaldson LJ), cited in *Hortico (Australia) v Energy Equipment Co (Australia)* [1985] NSWLR 545, 552 [7].

²⁵ Above n 15, 554 [4].

²⁶ Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 391.

²⁷ *Themehelp Ltd v West and Others* [1996] AC 84.

²⁸ Charles Chatterjee and Anna Lefcovitch, 'The Principle Of Autonomy Of Letters Of Credit Is Sacrosanct In Nature', (2003) 5(1) *Journal of International Banking Regulation*, 72,76.

²⁹ [1978] 1 All ER 976, cited in Alan Davidson, 'Fraud, the Prime Exception to The Autonomy Principle in Letters of Credit', (2003) VIII *International Trade & Business Law Annual* 23, 36.

³⁰ See also, *Discount Records v Barclays Bank* [1975] 1 WLR 315, 319.

³¹ *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1979] 1 Lloyd's Rep. 166, 174, cited in K G White, 'Bankers Guarantees and the Problem of Unfair Calling' (1979) 11(1) *Journal of Maritime Law and Commerce* 121, 129.

³² *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168, cited in Alan Davidson, 'Fraud, the Prime Exception to the Autonomy Principle in Letters of Credit', (2003) VIII *International Trade & Business Law Annual* 23, 40.

is one that may arise in factual situations where it would be difficult to successfully prove fraud.³³ In the case of *Elian and Rabbath v Matsas*,³⁴ Danckwerts LJ remarked that where an ‘irretrievable injustice’³⁵ may be made to a party, the courts may depart from the autonomy principle and grant an injunction to restrain payment. The plaintiff in this case, being the seller of goods, had issued a guarantee to the defendants who were the shipowners when the defendants had exercised a lien over the goods and refused to release them. Upon the issuance of the bank guarantee to secure the release of the goods, the defendants exercised another lien over the goods and again refused to release the goods.³⁶ Denning LJ in his judgement stated that when the guarantee was provided, it was based on the implied understanding and legitimate expectation of the plaintiff that another lien would be not exercised.³⁷ Therefore, the defendants were not able to call for payment under the guarantee, as their conduct was not in good faith. It would appear that this case is preventing the defendant from benefitting from his unconscionable conduct. However, this appears to be the only case decided on this ground, as this case was later distinguished from application by its ‘very special facts’.³⁸ Hence, the position remains that fraud is the only recognised exception to the principle of autonomy in England.

As Megarry J expressed in *Discount Records v Barclays Bank*,³⁹ the courts will refrain from intervening in the payment obligation under letters of credit ‘unless a sufficiently grave cause is shown’.⁴⁰ Perhaps Australia considers that unconscionable conduct constitutes a severe enough basis for the courts to depart from the seemingly impregnable autonomy principle?

³³ Matthew Bisley and James Mok, ‘Unconscionable Demands Under Letters Of Credit, Performance Bonds And Bank Guarantees’, (2005) 16 *JBFLP* 197, 207.

³⁴ *Elian and Rabbath (Trading as Elian & Madas) v Matsas and Matsas* [1996] 2 Lloyd’s Rep 495.

³⁵ Above n 34, 498, cited in Justice LP Thean, ‘The Enforcement of A Performance Bond: The Perspective of the Underlying Contract’, (1998) 19 *Singapore Law Review* 389, 393.

³⁶ Above n 27, 392 [2].

³⁷ Above n 27, 393 [1].

³⁸ Above n 27, 393 [3].

³⁹ [1975] 1 WLR 315.

⁴⁰ Above n 39, 316 [2].

IV THE TRADE PRACTICES ACT 1974 (CTH)

Unconscionable conduct in equity has been recognized as a ground to grant relief in commercial dealings in Australian common law from as early as 1956.⁴¹ Examples of unconscionable conduct have encompassed the following: the dishonest exploitation of a weaker party,⁴² fraudulent conduct,⁴³ undue influence or exploitation of a mistaken belief,⁴⁴ and economic duress.⁴⁵

An often-cited case for unconscionable conduct in Australia is the case of *Commercial Bank of Australia Ltd v Amadio* ('Amadio').⁴⁶ In this case, an elderly couple who were not fluent in the English language were convinced to provide a guarantee for their son's business venture. However, the guarantee was obtained under the couple's mistaken belief that the guarantee given would last for six months only and that it was limited to the value of \$50,000AUD. It was held in *Amadio* that it would be unconscionable conduct on the bank's part to benefit from the situation. In this situation, the bank ought to have had knowledge of the 'special disadvantage(s)' of the parents; however the bank had failed to provide the couple with independent professional advice prior to securing the guarantee.⁴⁷ *Amadio* established that the elements of unconscionable conduct comprise of:

⁴¹ *Blomley v Ryan* (1956) 99 CLR 362, cited in Daniel Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Australian Bar Review*, 34.

⁴² *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447, 461 (Mason CJ), cited in Daniel Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Australian Bar Review*, 35.

⁴³ Above n 42, 39 [2].

⁴⁴ *Garcia v National Australia Bank Limited* [198] HCA 48, cited in Daniel Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Australian Bar Review* 34, 41–43.

⁴⁵ *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1997] 1107 FCA, cited in Daniel Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Australian Bar Review* 34, 61.

⁴⁶ (1983) 151 CLR 447.

⁴⁷ Brenda Marshall, 'Liability for Unconscionable and Misleading Conduct in Commercial Dealings: Balancing Commercial Morality and Individual Responsibility', (1995) 7(2) *Bond Law Review* 43.

- (i) a 'special disadvantage' suffered by the inferior party;
- (ii) the superior party had actual or constructive knowledge of this 'special disadvantage';

and

- (iii) the superior party exploited this 'special disadvantage' for his own benefit.⁴⁸

The original enactment of the *Trade Practices Act* in 1974 did not include provisions on unconscionable conduct.⁴⁹ These provisions were incorporated subsequently: s 51AB in 1986, followed by s 51AA in 1992 and s 51AC in 1998 respectively.⁵⁰ Of particular relevance are sections 51AA and 51AC as these were the sections relied on in the cases of *Olex Focas and Boral Formwork* as a ground under which the Courts could depart from the principle of autonomy in dealing with payment mechanisms.

S 51AA was a general provision that prohibited unconscionable conduct by corporations, and incorporated into the statute the common law meaning of unconscionable conduct.⁵¹ S 51AC was a specific prohibition of unconscionable conduct by a person or corporation against business consumers or suppliers in business transactions relating to the actual or possible supply of, or the actual or possible acquisition of, goods and services from another.⁵² In determining what would amount to unconscionable conduct, factors that could be considered by the Courts were listed in s 51AC(3), and included amongst others, the relative bargaining strengths of the parties, the understanding of the documents related to the business transaction, the presence of undue influence or pressure and whether the parties had acted in good faith.⁵³

⁴⁸ Ibid.

⁴⁹ Cristina Cecere and Piper Alderman, 'Australia - Section 51AC of the Trade Practice Act: Impact on Franchising Sector', (2003) 1 *Int'l J. Franchising L.* 8, 9.

⁵⁰ Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No.2) 2010, 41 [4.4]; Cristina Cecere and Piper Alderman, 'Australia - Section 51AC of the Trade Practice Act: Impact on Franchising Sector', (2003) 1 *Int'l J. Franchising L.* 8, 9, 11.

⁵¹ *Trade Practices Act 1974* (Cth) s51AA(1); *ACCC v Samton Holdings Pty Ltd* (2002) 117 FCR 301, cited in Matthew Bisley and James Mok, 'Unconscionable Demands Under Letters Of Credit, Performance Bonds And Bank Guarantees', (2005) 16 *JBFLP* 197, 202–203; Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No.2) 2010, 48 [4.21].

⁵² *Trade Practices Act 1974* (Cth) s51AC(1), (3).

⁵³ *Trade Practices Act 1974* (Cth) s51AC(3)(a), (c), (d), (k).

V OLEX FOCAS PTY LTD V SKODAEXPORT CO LTD⁵⁴

The plaintiff in this case was an Australian company that supplied and provided the service of installing telecommunication and tele supervisory equipment to the defendant, a Czech Republic company that had been contracted to build a pipeline in India.⁵⁵ Two bank guarantees were provided in this case: a mobilisation guarantee and a performance guarantee.⁵⁶ The relevant guarantee for the purposes of this comment is the mobilisation guarantee, under which the defendant had advanced monies to the plaintiff for the acquisition of materials. The mobilisation guarantee was issued to secure the reimbursement of the advanced monies.⁵⁷

There were several matters of dispute between the parties in the underlying contract of supply and installation, which were being resolved by arbitration.⁵⁸ During the process of arbitration, the defendant threatened to demand payment under the bank guarantees if the parties were not able to settle the dispute.⁵⁹

The plaintiff applied for an injunction to restrain payment under the mobilisation guarantee on the following grounds: fraud by the defendant by trying to call on the guarantees despite not being sure that it had any right to do so, or on the grounds of unconscionable conduct as prohibited by s 51AA, or that the call on the demand was prohibited under the underlying contract.⁶⁰

Batt J relied on both English and domestic authority before commenting that that demand and performance guarantees are akin to letters of credit, and so the autonomy principle also governs such guarantees.⁶¹ Batt J opined that the exceptions to the autonomy principle are fraud or illegality of the underlying contract, and severe unconscionable conduct not amounting to actual fraud is not an exception in equity.⁶²

⁵⁴ *Olex Focas Pty Ltd and another v Skodaexport Co Ltd and Another* [1998] 3 VR 380.

⁵⁵ *Ibid* 382.

⁵⁶ *Ibid* 382.

⁵⁷ *Ibid* 385, 387.

⁵⁸ *Ibid* 390 – 391.

⁵⁹ *Ibid* 391.

⁶⁰ *Ibid*.

⁶¹ *Ibid* 395, 396, 397, 393.

⁶² *Ibid* 395, 400.

On the facts before him, Batt J determined that there was no distinct and definite fraud as the defendant was contractually entitled to call on the demand.⁶³ On the issue of unconscionable conduct relevant to the *Trade Practices Act 1974* (Cth) ('*TPA*'), Batt J agreed that the underlying contract and the bank guarantee were within the meaning of international trade as stipulated in s 6(2)(i) of the *TPA* as there was a connection between either Prague or the Czech Republic and Australia.⁶⁴

Although Batt J commented on the defendant's belief that he was legally entitled under contract to call on the full guarantee amount, Batt J determined that the defendant's conduct was in contravention of moral standards and unconscionable within the meaning of s 51AA as the plaintiff had largely repaid the advanced monies by the time the demand was made.⁶⁵

It was recognised by Batt J that the threat of calling on the performance guarantee was a normal practice used in trade or a settlement tactic to coerce the other party to settle the dispute,⁶⁶ and if the outstanding advanced amount owed by the plaintiff was claimed instead of the full amount, this would not be considered unconscionable within the meaning of s 51AA.⁶⁷

In his judgement, Batt J remarked that unconscionable conduct amounted to a significant encroachment on the principle of autonomy,⁶⁸ thereby demonstrating that unconscionable conduct has been used as an exception to the principle by virtue of the *TPA*. Batt J held that unconscionable conduct amounts to conduct that is not morally correct, rational or sensible,⁶⁹ or unjust conduct going against what is considered legitimate expectations.⁷⁰

⁶³ Ibid 398.

⁶⁴ Ibid 401 – 402

⁶⁵ Ibid 403.

⁶⁶ Ibid 403.

⁶⁷ Ibid 404.

⁶⁸ Ibid 404.

⁶⁹ Ibid 402.

⁷⁰ Ibid 402.

VI BORAL FORMWORK & SCAFFOLDING PTY LTD V ACTION MAKERS LTD⁷¹

Boral had purchased scaffolding equipment from the defendant through the use of a standby letter of credit but upon receiving the goods, found that the equipment was not in accordance with their requirements stipulated in the underlying sales contract.⁷² Boral had then written to the defendant to inform them of the defects, the probable cost of the rectification works, their preference to rectify the equipment through their own means and offsetting the rectification costs from the invoice amount.⁷³ Boral followed up with electronic mail to inform the defendant that the repairs were almost done and included the additional costs relating to the repairs.⁷⁴ However, the defendant did not respond to the correspondence and instead the administrative receivers demanded payment due under the standby letter of credit.

Boral applied for an injunction, claiming that the defendant was restricted under the supply agreement from demanding the full original invoice amount under the standby letter of credit, or alternatively that such demand was unconscionable within the meaning of s 51AA or AC of the *TPA*.⁷⁵

In his judgement, Austin J affirmed that the principle of autonomy applied to demand guarantees (termed standby letters of credit in this case),⁷⁶ and found that it was unconscionable for the defendant to call for full original invoice amount as the funds rightfully due to the defendants in receivership were the undisputed amount only (the original amount less the modification costs).⁷⁷ As such, the defendants had contravened s 51AC by their dishonest reliance on what it had perceived they were legally entitled to do in claiming for the full amount.⁷⁸

⁷¹ *(In Administrative Receivership) & Another* [2003] NSWSC 713.

⁷² *Ibid* [1 – 3].

⁷³ *Ibid* [16].

⁷⁴ *Ibid* [17].

⁷⁵ *Ibid* [29 – 30].

⁷⁶ *Ibid* [32 – 37].

⁷⁷ *Ibid* [71].

⁷⁸ *Ibid* [90], [70].

Austin J notably remarked that statute must take precedence over the autonomy principle.⁷⁹ Thus, based on the *TPA*, unconscionable conduct amounts to an exception to the principle of autonomy in Australia.

Austin J followed the explanation of unconscionable conduct given in the case of *Hurley v McDonald's Australia Ltd* wherein unconscionable conduct encompasses conduct that is not in accordance with reason and conscience.⁸⁰ The judges in that case confirmed that the meaning of the term 'unconscionable conduct' was the same as its definition in the dictionary.⁸¹

VII THE COMPETITION AND CONSUMERS ACT 2010 (Cth)

The *TPA* was renamed the *Competition and Consumers Act 2010* (Cth), which came into effect in January 2011.⁸² On a preliminary reading, it appears the original enactment of the *Competition and Consumers Act 2010* (Cth) ('*Original 2010 Act*') merely reproduced the unconscionable conduct provisions of section 51AA, s 51AB and section 51AC in sections 20, 21 and 22 of the 2010 Act respectively, with simple renumbering of the provisions and the addition of a pecuniary penalty.

However, when the *TPA* and the Original 2010 Act are examined and compared in greater detail, it ought to be noted that while the *TPA* prohibited unconscionable conduct by both corporations and persons,⁸³ the Original 2010 Act prohibits such conduct by persons only.⁸⁴ S 51AC(6) of the *TPA* makes reference to factors that the Courts may consider in determining if corporations or persons have contravened this section, as opposed to s 22(4) – (6) of the Original 2010 Act which made mention to persons only. In addition, the term 'person' is not defined in the Original 2010 Act. Therefore, in viewing the Original 2010 Act on its own, it does not appear to include corporations within the meaning of person in ss 20 to 22. Perhaps it is also telling that ss 20 to 22 were located in sch 2 of the Original 2010 Act, which is titled

⁷⁹ Ibid [74].

⁸⁰ [2000] ATPR 41, 741 at 4,845, cited in *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd v (In Administrative Receivership) & Another* [2003] NSWSC 713, [88].

⁸¹ Ibid.

⁸² *Trade Practices Amendment (Australian Consumer Law) Act (No.2) 2010* (Cth).

⁸³ *Trade Practices Act 1974*, s51AC(1), (2).

⁸⁴ *Competition and Consumer Act 2010*, s22(1).

‘Australian Consumer Law’, and there is no comparable provision in any part of the Act that prohibits unconscionable conduct with a focus on corporations. It would seem therefore that the omission of corporations was not merely accidental.

S 11A was inserted into the *Fair Trading Act 1987* (WA) to mirror s 51AC of the *TPA*.⁸⁵ The Explanatory Memorandum of the *Trade Practices Amendment (Australian Consumer Law) Bill* confirms this.⁸⁶ However, it seems that section 11A mirrors s 22 of the Original 2010 Act instead by its omission of corporations in the provision.⁸⁷

As such, if reliance is placed on the ordinary layperson understanding of the terms ‘person’ and ‘consumer’, then this is a reference to humans and individuals who had acquired something for their own personal and not commercial use.⁸⁸ It would be presumed then that only individual consumers can rely on these sections to protect themselves against unconscionable conduct, and legal entities such as companies are excluded from relying on these sections.

There does not appear to be any subsidiary legislation to the Original 2010 Act that could help to shed light on the meaning of the term ‘person’. Statutory interpretation dictates that where terms are not defined in the relevant statute, then the term will be used in its common understood meaning unless it has been defined by case law.⁸⁹ There does not appear to be any case that has attempted to clarify the meaning of persons as used in the Original 2010 Act. Based on the ordinary understanding of the term ‘person’, it would appear that the reference to person in the legislation is a reference to individuals and not to corporations, as the

⁸⁵ Explanatory Memorandum, *The Retail Shops and Fair Trading Legislation Amendment Bill 2005* (WA), 2, 11 – 13.

⁸⁶ Explanatory Memorandum, *Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010* (Cth).

⁸⁷ Above n 86, 41 [4.5].

⁸⁸ Oxford Dictionaries, *Person* (at 31 December 2018) <<https://en.oxforddictionaries.com/definition/person>>; Oxford Dictionaries, *Consumer* (at 31 December 2018) <<https://en.oxforddictionaries.com/definition/consumer>>.

⁸⁹ Government of Western Australia: Parliamentary Counsel’s Office, *How to read legislation, a beginners guide* (1 May 2011) Government of Western Australia: Department of Justice 13, 26, <https://department.justice.wa.gov.au/_files/How_to_read_legislation.pdf>.

recognition of a company as separate legal person from an individual is a legal concept.⁹⁰

Nonetheless, the first point of reference should be the *Interpretation Act 1901* (Cth) (*Interpretation Act*).⁹¹ S 1A of this Act confirms the objective of the Act is to act as a handbook of terms used by other Acts of Parliament. Therefore, other Acts of Parliament are to be read in conjunction with this Act where the terms have not been defined in the relevant Act.⁹² This does not apply where contrary intention appears in the relevant Act,⁹³ for example, where it is stated that a reference to persons is meant to exclude corporations. There is no contrary intention expressed in the Original 2010 Act that precludes the meaning of ‘person’ as defined in the *Interpretation Act*. Therefore, the definition of ‘person’ in the *Interpretation Act* should be used to aid the interpretation of ss 20 to 22 of the Original 2010 Act. As s 2C of the Acts *Interpretation Act* provides that a reference to person includes corporations, it is submitted that a reference to ‘persons’ in ss 20 to 22 includes a reference to corporations as well.⁹⁴

In addition, there is no mention in the Parliamentary speech of the *Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010* of a shift of protection afforded from both corporations and persons to just persons. At the second reading of this Bill, the objective behind the amendment of the legislation was expressed to merely refine and streamline the provisions so as to make the legislation more accessible to laypersons.⁹⁵ As an express change was not mentioned, and persons are defined in the *Interpretation Act* to include corporations, it is arguable that it is more probable that the rewording of the provisions to only persons was a step towards fulfilling the objective of clarification and accessibility only, and not to exclude protection of corporations against unconscionable conduct.

⁹⁰ *Salomon v A Salomon & Co Ltd* [1896] UKHL 1.

⁹¹ Above n 89, 13.

⁹² *Acts Interpretation Act 1901* (Cth), s 1A.

⁹³ *Ibid.*

⁹⁴ *Acts Interpretation Act 1901* (Cth), section 2C. For Western Australia, see *Interpretation Act 1984* (WA), s 5.

⁹⁵ Commonwealth, *Parliamentary Debates*, House of Representatives, 17 March 2010 2718-2723 (Dr Craig Emerson).

Furthermore, it was confirmed during the speech that no significant amendments would be made to the provisions, and the existing case law would also apply in relation to the new sections.⁹⁶ It is arguable that the removal of protection to corporations against unconscionable conduct would amount to a significant change. These reasons further support that a reference to persons in the Original 2010 Act includes corporations and businesses. Confirmation may be found in the Parliamentary speech of David Bradbury for the *Competition and Consumer Legislation Amendment Bill* where a reference to ss 21 and 22 of the Original 2010 Act included prohibitions against both individuals and businesses,⁹⁷ and on the Australian Competition and Consumer Commission website where it is stated that ‘businesses’ are restrained from engaging in unconscionable conduct.⁹⁸

Further amendment was made to the Original 2010 Act by the *Competition and Consumer Legislation Amendment Act 2011*(Cth) (‘2011 Act’). By virtue of the 2011 Act, ss 21 and 22 of the Original 2010 Act were amalgamated into a single section (the current s 21). A new s 22 was inserted.⁹⁹ The current s 21 is now a prohibition of unconscionable conduct in business transactions and in general, with the change intended to prevent a discrepancy in the development of the two sections.¹⁰⁰ The current s 22 now lists the relevant factors in determining what would amount to unconscionable conduct.¹⁰¹ The intent behind the 2011 amendment was expressed as an attempt to improve the statutory definition of unconscionable conduct,¹⁰² and make the legislation more

⁹⁶ Above n 95, [11–12].

⁹⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 15 June 2011, [43] (David Bradbury).

⁹⁸ Australian Competition and Consumer Commission, *Unconscionable Conduct* (at 15 May 2015) <<https://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct>>.

⁹⁹ Above n 97, 44.

¹⁰⁰ Above n 97, 43–46.

¹⁰¹ *Competition and Consumer Act 2010* (Cth) s 22(1)(a) – (l); s 22(2)(a) – (l).

¹⁰² Mary Anne Neilsen, *Competition and Consumer Legislation Amendment Bill 2011* (at 23 June 2011) Bills Digest, Law and Bills Digest Section (Online), <https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1011a/11bd149>.

accessible.¹⁰³ Admittedly, the amendments made were negligible,¹⁰⁴ and therefore do not affect the exception of unconscionable conduct. Unconscionable conduct would now come under s 21, with s 22 as an aid to determining if conduct was in contravention of s 21.

It is submitted that the fact that the Original 2010 Act and the current enactment of the *Competition and Consumer Act 2010* contained essentially the same provisions of the *TPA*, therefore the unconscionable conduct exception has received parliamentary approval and is a recognised exception to the principle of autonomy. As Austin J mentioned in *Boral Formwork*, the Courts cannot go against the intent of Parliament,¹⁰⁵ and must give effect to this exception where applicable.

VIII THE EXTENT OF THE UNCONSCIONABLE CONDUCT EXCEPTION – DOES IT APPLY TO LETTERS OF CREDIT?

It was opined that allowing exceptions to the autonomy principle would weaken the worth of such payment mechanisms.¹⁰⁶ However, it is clear that where fraud exists, a party who has committed fraud should not be able to benefit from his wrongdoing. In the same vein, where a party's conduct has been unconscionable, or against moral standards, it would be just for the courts to intervene to restrain that party from benefitting from his immoral conduct.

The cases decided thus far have yet to concern letters of credit. *Olex Focas* was a case concerning a mobilisation guarantee whilst *Boral Formwork* was a case regarding a demand guarantee (termed a standby letter of credit in the relevant documentation). The only other case that has attempted to rely on the unconscionable provision in the *TPA* is the case of *Clough Engineering Ltd V Oil & Natural Gas Corporation Ltd* ('*Clough Engineering*').¹⁰⁷ This case concerned a performance guarantee, although the courts did not find unconscionable conduct on the facts of this case.

¹⁰³ Above n 97, 34 – 42.

¹⁰⁴ Mary Anne Neilsen, *Competition and Consumer Legislation Amendment Bill 2011* (at 23 June 2011) Bills Digest, Law and Bills Digest Section (Online), <https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1011a/11bd149>.

¹⁰⁵ *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd v (In Administrative Receivership) & Another* [2003] NSWSC 713, [74].

¹⁰⁶ *Bolivinter Oil S.A. v Chase Manhattan Bank N.A.* [1984] 1 Lloyd's Rep. 251 [257] (Sir John Donaldson MR), cited in [1998] 3 VR 380, 395.

¹⁰⁷ [2008] FCAFC 136.

Unconscionable conduct as an exception to the autonomy principle clearly applies to mobilisation, demand and performance guarantees. Does it also apply to letters of credit? It is submitted that as the obligations and utility of these different payment mechanisms work in a similar fashion, the unconscionable conduct exception also applies to letters of credit.¹⁰⁸

There appears to be an opposing argument that the utility of the relevant payment instrument and impact on the beneficiary upon an injunction is not as severe under performance bonds as under a letter of credit, such that the underlying contract in the earlier payment transaction is not separate from the payment transaction at all.¹⁰⁹ However, this appears to propose that the autonomy principle does not apply to performance bonds in the first place. As confirmed by the judiciary multiple times in cases such as *Olex Focas*, *Boral Formwork*, *Edward Owen Engineering Ltd v Barclays Bank International Ltd*¹¹⁰ and *Wood Hall Ltd v Pipeline Authority*¹¹¹, the principle of autonomy applies to letters of credit as well as performance and bank guarantees.

As Thean J has stated, *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* was a case on performance bonds whereby the Courts had relied on the precedent of letters of credit in their decision,¹¹² thereby demonstrating that the courts also recognise that the payment mechanisms are similar.¹¹³ Thean J in his lecture reiterated the recognition by the judiciary that the duties on the banks under performance guarantees to pay are parallel to those under letters of credit in that the duty is one which is irreversible and unqualified, and there is an independence of the banking transaction and the underlying contract.¹¹⁴ The courts have also clarified that the banks

¹⁰⁸ Dixon, William M, 'As Good as Cash? The Diminution of the Autonomy Principle', (2004) 32(6) *Australian Business Law Review* 391, 398–399.

¹⁰⁹ Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 402–404, 416.

¹¹⁰ [1978] QB 159, 170 – 171.

¹¹¹ (1979) 141 CLR 443.

¹¹² [1978] 1 QB 146.

¹¹³ *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146, cited in Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 394 – 395.

¹¹⁴ Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 394.

are placed in a comparable position when dealing with letters of credit and performance guarantees, and that the bank's obligation is triggered on the relevant event and not influenced by anything else between the parties.¹¹⁵ The difference is the triggering event, where in letters of credit, the presentation of complying documents of title triggers the payment obligations,¹¹⁶ whilst it is triggered by a certificate issued by the beneficiary in performance bonds.¹¹⁷

Even though it appears that unconscionable conduct is a recognised exception to the autonomy principle, Bisley and Mok have opined that the unconscionable conduct exception pursuant to s 51AA and 51AC of the *TPA* appears to be a very narrow exception. This is because in the cases of *Olex Focas* and *Boral Formwork*, the dispute was already settled and therefore it was unconscionable to make the demand.¹¹⁸ If the underlying dispute had yet to be resolved, it was argued that it would not be unconscionable to make the demand.¹¹⁹

It would seem that despite the clarifications on what unconscionable conduct means,¹²⁰ only three cases have relied on this exception thus far: the cases of *Olex Focas*, *Boral Formwork* and *Clough Engineering*, although no unconscionable conduct was found in the latter case. Bisley and Mok therefore opined that there are limited factual scenarios in which a finding of unconscionable conduct could be made. In the case of

¹¹⁵ *Howe Richardson Scale Co Ltd v Polimex-cekop and National Westminster Bank Ltd* [1978] 1 Lloyd's rep 161, 165 (Roskill LJ), cited in Justice LP Thean 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract' (1998) 19 *Singapore Law Review* 389, 394.

¹¹⁶ Dixon, William M, 'As Good as Cash? The Diminution of The Autonomy Principle', (2004) 32 (6) *Australian Business Law Review* 391, 404 [3]; Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 404.

¹¹⁷ Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 404; *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd v (In Administrative Receivership) & Another* [2003] NSWSC 713, [50].

¹¹⁸ Matthew Bisley and James Mok, 'Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees', (2005) 16 *JBFLP* 197, 204.

¹¹⁹ *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, cited in Matthew Bisley and James Mok, 'Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees', (2005) 16 *JBFLP* 197, 205.

¹²⁰ Australian Competition and Consumer Commission, *Unconscionable Conduct* (at 31 December 2018) <<https://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct>>.

Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd,¹²¹ it was held that making a demand without informing the other party in advance was not unconscionable because the contract did not necessitate this even though this could arguably be considered morally reprehensible.

There is a high standard required for an application for injunction to be made on the ground of unconscionable conduct. It was stated in *Olex Focas* that proof of a 'serious question' of unconscionable conduct is required for such an application.¹²² On this issue, Bisley and Mok articulated that the applicant must demonstrate 'clear and obvious evidence of unconscionable conduct' for a successful application.¹²³

IX SINGAPORE'S APPROACH TO PERFORMANCE GUARANTEES – WHAT THE EXCEPTION OF UNCONSCIONABLE CONDUCT COULD BE

Although the exception appears to be of a restricted application to a specific set of situations like in *Olex Focas* and *Boral Formwork*, a contrast to Singapore is warranted to compare the different determinations of what could amount to unconscionable conduct. The comparison may provide some insight as to how this exception could potentially develop further in Australia.

Unconscionable conduct has been a recognised exception to the principle of autonomy in relation to performance guarantees in Singapore from as early as 1995.¹²⁴ In such situations, the courts would look beyond the pure payment transaction into the underlying contract to determine whether payment should proceed.

Similar to Australia, unconscionable conduct is usually raised as a ground for injunction to restrain payment and the unconscionable

¹²¹ [1999] VSC 17, as cited in Matthew Bisley and James Mok, 'Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees', (2005) 16 *JBFLP* 197, 205.

¹²² Above n 54, 405, [1].

¹²³ Matthew Bisley and James Mok, 'Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees', (2005) 16 *JBFLP* 197, 205.

¹²⁴ The Court of Appeal in the Singapore case of *Bocotra Construction Pte Ltd and Ors v Attorney General (No 2)* [1995] 2 SLR 733 stated that the only grounds for injunction to restrain payment on a performance bond would be fraud or unconscionability, per Karthigesu JA, 746, as cited Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 390–391.

conduct is by the party who is calling for payment. As confirmed by the Singapore courts, the principle of autonomy also applies to performance guarantees or bonds, as the obligations under such guarantees are similar to payment obligations under letters of credit.¹²⁵ The relevant cases in Singapore relate to construction cases, where performance bonds are commonly provided to secure performance of construction.¹²⁶

In the case of *Raymond Construction Pte Ltd v Low Yang Tong* and *AGF Insurance (Singapore) Pte Ltd*,¹²⁷ a performance bond was issued in favour of the owner of land by the contractor he had engaged to build a house. The guarantee was issued by an insurance company and the courts held that it was unconscionable for the owner to demand the guarantee because there was evidence that the owner was acting in bad faith. The owner had by his conduct displayed that he had no intention of fulfilling his end of the contract through his attempts to delay or to find a way out of fulfilling his payment obligations. As such, it would be unjust for the court to allow the owner to claim the benefit under the performance guarantee when he himself was unwilling to fulfil his obligations under the construction contract. In this case, the courts granted an injunction to restrain the insurance company from honouring the call under the performance guarantee.

Hiap Tian Soon Construction Pte Ltd v Hola Development Pte Ltd is another construction case where a performance bond was issued to secure the performance of the underlying contract.¹²⁸ It was held in this case that to call for the amount fixed under the performance bond originally was unconscionable as the parties had mutually agreed to lower the contract amount subsequent to the signing of the contract, which would in turn lower the claimable amount under the performance guarantee. In calling for the original amount despite this revision of price

¹²⁵ *Hiap Tian Soon Construction Pte Ltd v Hola Development Pte Ltd* [2003] 1 SLR 667.

¹²⁶ Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 390.

¹²⁷ High Court Suit No. 1715 OF 1995, 11 July 1996, unreported, cited in Justice LP Thean, 'The Enforcement of A Performance Bond: The Perspective of the Underlying Contract', (1998) 19 *Singapore Law Review* 389, 420–421.

¹²⁸ [2003] 1 SLR 667, cited in Chumah Amaefule, *The Exceptions to The Principle of Autonomy Of Documentary Credits* (PhD Thesis, University of Birmingham, 2011) 178.

in the contract, the defendant's conduct was unconscionable, and the court again restrained the honouring of payment under the guarantee.

The abovementioned two cases demonstrate that unconscionable conduct can encompass more than merely the factual matrix contained in *Olex Focas* and *Boral Formwork*. If reference is made to these Singapore cases as persuasive precedent, then the meaning of what could amount to unconscionable conduct may be expanded to more situations and allow more parties to be protected from unjust conduct.

It should be noted that by the recent decision of the Court in *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd*,¹²⁹ parties to a contract can mutually agree by contract to exclude the applicability of unconscionability as a ground to restrain the call on a performance bond.¹³⁰ Alternatively, parties can choose to use English law instead of the law of Singapore as the governing law of the contract so that the only exception allowed for the restraint on the call on the guarantee would be fraud, as used in the case of *Shanghai Electric Group Co Ltd v PT Merak Energi Indonesia*.¹³¹ These are the options available to the parties should they wish to protect themselves from the Court finding that their conduct was unconscionable.

X CONCLUSION

Unconscionable conduct has arisen as an exception to the autonomy principle of payment mechanisms by virtue of the reliance by the cases of *Olex Focas* and *Boral Formwork* on ss 51AA and 51AC of the *TPA*. It is submitted that although the cases of *Olex Focas* and *Boral Formwork* do not deal with letters of credit directly, the exception of unconscionable

¹²⁹ *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd and another* [2015] SGCA 24, cited in Kwang Guan, 'Restraining Payment under a Performance Bond: Validity of Clauses Limiting the Grounds for Injunctive Relief' on *Singapore Law Blog* (13 May 2015) [13], [16-17], <<http://www.singaporelawblog.sg/blog/article/110>>.

¹³⁰ See Kwang Guan, 'Restraining Payment under a Performance Bond: Validity of Clauses Limiting the Grounds for Injunctive Relief' on *Singapore Law Blog* (13 May 2015) <<http://www.singaporelawblog.sg/blog/article/110>>.

¹³¹ [2010] 2 SLR 329, cited in Kwang Guan, 'Restraining Payment under a Performance Bond: Validity of Clauses Limiting the Grounds for Injunctive Relief' on *Singapore Law Blog* (13 May 2015) <<http://www.singaporelawblog.sg/blog/article/110>>.

conduct is also applicable to letters of credit given the similar utility and effect of the differing payment obligations. Furthermore, the courts have continually confirmed that the principles governing letters of credit apply to bank and performance guarantees. On the same token, since the principle of autonomy also applies to these other guarantees, and unconscionable conduct is recognised as an exception in such guarantees, this exception should be extended to letters of credit as well.

Subsequently, in 2010, amendments were made to the *TPA*. It is submitted that the changes made to the *TPA* do not significantly alter the application or existence of the unconscionable conduct exception when read together with the *Interpretation Act*. In Parliament's substantial reproduction of the *TPA* into the *Competition and Consumer Act 2010* (Cth), it is submitted that Parliament has backed unconscionable conduct as an exception to the principle of autonomy in payment mechanisms.

A comparison of this exception in Australia and in Singapore has provided a brief insight as to the potential of the unconscionable conduct exception in Australia. As it stands now, it appears that the exception is a narrow one with limited application in Australia. Whether the Courts in Australia expand the unconscionable conduct remains to be seen.

THE CASE OF THE SHROPSHIRE PIANO TREASURE

GEOFFREY BENNETT*

ABSTRACT

Treasure – United Kingdom – Treasure Trove – Treasure Act 1996 (UK) – Limitation Act 1980 (UK) – Crown’s Title to Treasure – Coroners and Justice Act 2009 (UK)

In the more than twenty years since the Treasure Act 1996 (UK) c 24 came into force, there have been many dramatic discoveries of treasure.¹ The media frequently reports the results of remarkable finds usually made by metal detectorists in fields and open spaces. A unique, not to say bizarre, example, however, is the discovery of a cache of gold coins found concealed in a piano in Shropshire in 2016.² It makes the point that the old law of treasure trove still has a twilight existence in circumstances that are prone to recur.³

In 2016 Bishop’s Castle Community College in Shropshire had been presented with five pianos in response to an appeal. The most promising

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¹ The Act applies to England, Wales and Northern Ireland. The law in Scotland is governed by a different legal regime, see M. Guthrie, A comparative study of the Scottish law of Bona Vacantia and the English Law of Treasure, (2012) XVII(4) *Art, Antiquity and Law* 307.

² Jack Malvern, ‘Piano Tuner Strikes Classic Gold’, *The Times* (UK), 21 April 2017. A fuller account, which considers some of the conjectural possibilities raised by the case, can be found in a BBC 4 radio documentary, BBC Radio 4, ‘Treasure in the Piano’, *Punt PI*, 9 September 2017 (Neil McCarthy). I am particularly indebted to Peter Reavill, Finds Liaison Officer for Herefordshire and Shropshire, who generously provided me with additional information about the case. A detailed technical account of the find appears in the Portable Antiquities Scheme (PAS) records at: *HESH-F60DDB* (July 2018) Finds <<https://finds.org.uk/database/artefacts/record/id/911086>>; and *HESH-F5F412* (July 2018) Finds <<https://finds.org.uk/database/artefacts/record/id/911086>>.

³ An example might be the discovery of objects in articles of second-hand furniture, something which is not altogether unusual. An interesting example from the United States is discussed at Carol Christian, *Secret Drawer in Estate Sale Chest Yields Trove of Forgotten Treasures* (11 May 2015) *Houston Chronicle* <<https://www.chron.com/houston/article/Secret-drawer-in-estate-sale-dresser-yields-trove-6255839.php>>.

instrument was an old Broadwood upright piano which was selected to receive the attentions of Mr Backhouse, a piano tuner. Mr Backhouse discovered a problem: when he struck some of the keys they were partially seized up and not moving freely back to their original position after being depressed. This may well have been because the piano was previously stored in damp conditions, causing corrosion. By chance, Mr Backhouse was not just a piano tuner but also a piano technician. He therefore decided to lift some of the keys to investigate. When he did so he found a number of small packages precisely placed in the limited space between the keys and the hollow dustboard below. He initially thought he had found bags of mothballs. Further investigation revealed the largest haul of gold sovereigns ever found in Britain consisting of 913 coins dating from 1847 to 1915 and weighing some 6 kgs.⁴ In modern terms this represents a sum in excess of £350,000. The legal issue which this discovery posed was the ownership of the coins and, in particular, whether the hoard fell within the definition of ‘treasure’ under the *Treasure Act 1996* (UK) c 24 (‘1996 Act’).

The definition of treasure in s 1 is intricate but reasonably clear. As it relates to coins, s 1(1) requires that there must be, ‘at least two coins in the same find which are at least 300 years old at that time’ and be of at least 10% precious metal. Although the coins were undoubtedly of precious metal they clearly fell outside the modern definition of treasure under the Act since they were less than 300 years old. Section 1(1)(c) nevertheless provides that treasure includes, ‘any object which would have been treasure trove if found before the commencement’ of the Act.⁵ The curious question therefore became whether the find amounted to treasure under the old law of treasure trove which the 1996 Act was to replace because of its manifest shortcomings.⁶ The essential

⁴ The effect of s 3(6) of the 1996 Act is to raise a rebuttable presumption. An object such as a coin is presumed to be of the date shown on the coin unless shown not to be.

⁵ There is a similar saving provision in the recently enacted *Treasure Act 2017* (Isle of Man) s 6(3). The definition of treasure under this Act is nevertheless wider than that contained in the 1996 Act.

⁶ See eg Roger Bland, ‘Treasure Trove and the Case for Reform’, (1996) 1(1) *Art, Antiquity and Law* 11; Geoffrey Bennett and C Brand, ‘Conservation, Control and Heritage – Public Law and Portable Antiquities’, (1983) 12 *Anglo American Law Review* 141.

questions under the old law of treasure trove are: (1) is the article of gold or silver?; (2) was it deliberately hidden with the intention that the object be retrieved later?; (3) is there a claimant, such as the original owner or a successor in title, who has a better claim to the object than the Crown?

These issues were exhaustively explored in an inquest by the Shropshire Coroner which extended over three months and which, on 20 April 2017, declared the find to be treasure. The route to this conclusion was not, however, straightforward. Nobody could doubt that the hoard was of gold with a high degree of purity. One of the most problematic aspects of the old law was, and indeed as this case shows still is, the need to find an intention on the part of the person who deposited the item(s) to recover it or them at a later time. This, for example, would rule out something placed in the ground, or a river, as a votive offering. For this reason alone, the famous Sutton Hoo ship burial did not constitute treasure when it was discovered in 1939.⁷ Title in the finds resided in the landowner but for her generosity in subsequently donating them to the State. In the Shropshire case it was not stretching probability to infer from the circumstances that there was an intention to recover the money. The size of the hoard and the very deliberate care and skill with which it was concealed make it highly improbable that it was lost or abandoned.⁸ It seems improbable that it was intended as a votive offering to the Muse Terpsichore.

The most difficult issue in the case was the third criterion, whether there was an identifiable owner, or their heir, with a better title to the coins and this in turn led to an extensive review of the history of the piano and its contents. Probably the key piece of evidence was the packaging of the coins. This included cardboard used in the cartons for the breakfast cereal still known as ‘Shredded Wheat’ which was not produced by the factory in Welwyn Garden City before 1926. A close examination of the packaging is at least consistent with the possibility that it dates from the period 1936–38, which could link the deposit to

⁷ It would now be treasure under s 1(1)(i) of the 1996 Act. The range of objects brought within the definition of treasure would also now be enhanced by s 1(1)(d).

⁸ This point emerges very clearly from the details of the PAS Report, see above n 2.

the outbreak of war in 1939. The most probable inference seems to be that the entire hoard was concealed in the piano as a single event after 1936 but may have been packaged and concealed in another place before that. The piano itself was effectively dismantled in the course of the inquiry in a fruitless attempt to extract some clues and to check other cavities. It emerged that the piano had been given to the college by a Mr and Mrs Hemmings who in turn had acquired the piano in Saffron Walden in 1983. They had bought the piano from a firm that dealt with house clearances, but the firm no longer had records for that year. The case therefore makes the incidental point that even comparatively recent business records may be of no avail because they have been discarded and, not surprisingly, no member of the firm had any recollection of from where the piano had been sourced. A railway record showed its delivery from London to Saffron Walden in November 1906, but this still provided no clear link to ownership of the coins. The coroner received some 40 submissions from those either claiming the hoard or providing information but ultimately, he held that none of the claimants, on a balance of probabilities, could adduce satisfactory evidence of ownership. The surprising outcome is that it still remains a mystery who deposited the money and exactly when, or why, this was done. The result of a declaration of treasure is that the found property vests in the Crown but, where no museum expresses interest in the objects or at least all of them, as happened in this case, the bulk of the items were returned to be divided equally between the owner of the piano, namely the College, and the finder Mr Backhouse.

One issue suggested by the case, which has not yet arisen in the aftermath of a coroner's inquest, is what if a claimant subsequently appears with a compelling claim to the hoard? This of course is very unlikely in the case of ancient deposits but in this case the probable timespan in the region of 70–80 years, and the improbability of mislaying without trace 6 kg of gold, make it a less far-fetched possibility. One argument would be that a claim against the present possessor of the coins is still possible by virtue of s 4(1) of the 1996 Act. This states that treasure vests in the Crown, 'subject to prior interests and rights' and under the principle of *nemo dat quod non habet* the Crown cannot pass a better title to a party who subsequently acquires the goods than it itself possessed. A problem for a claimant might then be that, if this analysis is correct, there would presumably be nothing to prevent the present

owner or possessor from raising, in an appropriate situation, a defence under the *Limitation Act 1980* (UK). Suppose, for example, the person currently in possession of the coins had carried out work on them such as having them cleaned and then allowed them to be exhibited in a museum on indefinite loan. This might well start time running under s 3 of the 1980 Act so as to defeat a claim in conversion.⁹

Although this case is unique on its facts, a recent case which is comparable, and may well have served as a template for the Shropshire Coroner, is the Hackney Double Eagles case in 2007. That involved the discovery of 70 American Double Eagle gold coins unearthed in the back garden of a house in Hackney by a finder who was digging a pond. The coins were of 90% pure gold and dated between 1854 and 1913 so also fell outside the definition of treasure in s 1(1) of the 1996 Act because they were less than 300 years old. A coroner's inquest was held to ascertain whether the find was within the old law of treasure trove. Before the truth finally emerged, there was much, as it turned out, entirely plausible but utterly erroneous, conjecture that the hoard related, for example, to an American serviceman passing through Britain and killed in the First World War. In fact, the extraordinary story that the court heard involved a German Jewish banker from Frankfurt who had fled to London just before Kristallnacht in November 1938, subsequently settling in Hackney with his wife and children. On the outbreak of war, he was interned because of his German connection, survived a torpedo attack on a journey to Canada, and found himself eventually in Australia with other members of his immediate family interned on the Isle of Man. His remaining family, who were allowed to stay in the house, buried the coins in the garden apparently at least partly in fear of a Nazi invasion in the summer of 1940. The house was then destroyed in the Blitz and the occupants killed. The owner's son was nevertheless found, and in this case successfully claimed the coins as heir to the original owner so defeating what would otherwise have been a successful claim by the Crown to the coins as treasure trove. This case might also be thought to illustrate the unknown, and more often than not unknowable, drama that may lie behind many hoards, of whatever date.

⁹ *Tower Hamlets LBC v Bromley LBC* [2015] EWHC 1954 – the 'Old Flo' case is a case in point, discussed in: Alexander Herman and Kathrine Mason, 'Local Authority Ownership of Artworks' (2016) *XXI Art, Antiquity and Law* 83.

Coin hoards deposited in the late 19th and 20th centuries are not altogether unusual, and one example is the discovery of 216 gold sovereigns at a metal detectorists event in a field in Twinstead, Essex in 2011.¹⁰ The coins were dated between 1863 and 1912 and were declared treasure under the law of treasure trove. What makes this hoard unusual is that it was not found within, or in close proximity to, residential properties nor, as usually happens, discovered during renovations or extensions. At least ten such gold hoards are known for the period 1912–15. More discoveries involving s 1(1)(c) of the 1996 Act are therefore eminently foreseeable.

For the future it might be thought that the Shropshire case exposes yet again the difficulties encountered by coroners and those who assist them in operating the arcane law of treasure trove. In such a case much of the burden of assisting the coroner is likely to fall on the local Finds Liaison Officer who may need to devote extensive, unanticipated and unbudgeted time to the case over a prolonged period with no obvious reward for the effort. It is disappointing that s 25 of the *Coroners and Justice Act 2009* (UK) c 25 ('2009 Act'), which would create a single point to report treasure and a single specialist adjudicator familiar with the law, is still not yet in force. Even if the reason for this is financial constraint, it is hard to see why strengthening the criminal sanctions for failing to report a find of treasure in s 30 of the 2009 Act, which creates a new s 8A offence under the *Treasure Act 1996* (UK) combined with an extension to the normal six months' time limit for summary prosecution in such a case, could not be enacted forthwith without fear of incurring additional public expense. Failure to report a find of treasure is an offence that applies regardless of whether the find falls under the new 1996 Act's definition of treasure or under the retained law of treasure trove.¹¹

¹⁰ Laura McLean, ESS-644C25: *A Modern Coin Hoard* (2011) <<https://finds.org.uk/database/artefacts/record/id/475376>>.

¹¹ For a recent discussion of the problem of unreported finds see Adam Daubney, 'Floating Culture: the unrecorded antiquities of England and Wales' (2017) 23(9) *International Journal of Heritage Studies* 785.

**HENRY GAO, ‘E-COMMERCE IN ChAFTA:
NEW WINE IN OLD WINESKINS?’ IN COLIN B
PICKER, HENG WANG AND WEIHUAN ZHOU
(EDS) THE CHINA–AUSTRALIA FREE TRADE
AGREEMENT: A 21ST CENTURY MODEL, 2018**

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I INTRODUCTION

*The China–Australia Free Trade Agreement: A 21st Century Model*¹ examines the implications from the recently concluded China–Australia Free Trade Agreement (‘ChAFTA’).² The book contains 16 chapters covering the various implications of the FTA from Investor-State dispute settlement³ to trade in educational services.⁴ This book review focuses on chapter 14 written by Henry Gao, regarding ChAFTA’s implications for electronic commerce (‘e-commerce’).

II MAIN POINTS

Part I introduces the topic of e-commerce both in relation to the World Trade Organisations (‘WTO’) rules and the chapter dedicated to it in the ChAFTA.

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¹ Henry Gao, ‘E-Commerce in ChAFTA: New Wine in Old Wineskins?’ in Colin B Picker, Heng Wang and Weihuan Zhou (eds) *The China–Australia Free Trade Agreement: A 21st Century Model* (Bloomsbury, 2018) 283.

² *Free Trade Agreement between the Government of Australia and the Government of the People’s Republic of China*, Signed 17 June 2015, [2015] ATS 15 (entered into force 20 December 2015).

³ Lisa Burton Crawford, Patrick Emerton and Emmanuel Laryea, ‘Investor-State Dispute Settlement and the Australian Constitutional Framework’ in Colin B Picker, Heng Wang and Weihuan Zhou (eds) *The China–Australia Free Trade Agreement: A 21st Century Model* (Bloomsbury, 2018), 283.

⁴ Eva Chye, ‘Trade in Education Services under ChAFTA: What does it Mean for Australia?’ in Colin B Picker, Heng Wang and Weihuan Zhou (eds) *The China–Australia Free Trade Agreement: A 21st Century Model* (Bloomsbury, 2018), 283.

Part II discusses the existing legal regime prior to the passage of ChAFTA. This includes the WTO's first effort to regulate e-commerce, the Declaration on Global Electronic Commerce⁵ ('The Declaration'), which is notable for its introduction of a moratorium on imposing customs duties on e-commerce. This moratorium is currently extended until 2019.⁶ The second and third documents of note are the Work Programme on Electronic Commerce ('WPEC')⁷ adopted by the WTO in 1998 due to The Declaration and the General Agreement of Trade in Services ('GATS') Telecommunications Annex.⁸ Since the adoption of WPEC there has been little further progress, in part due to stalled negotiations in the Doha round of negotiations.

Gao identifies three main issues with the existing regulations under the WTO regime. Firstly, should e-commerce be classified under goods (and therefore covered by the General Agreement on Tariffs and Trade⁹ ('GATT')) or as services (Covered by the GATS)? Secondly, if covered under the GATS, due to its positive listing approach,¹⁰ countries are free to elect the level of liberalisation of their markets to other States. Thirdly, deviation from obligations under the GATS is possible due to the general exemption clauses of protecting public health and the environment,¹¹ and objection due to public morals.¹²

⁵ *The Geneva Ministerial Declaration on Global Electronic Commerce*, WT/MIN(98)/DEC/2 (25 May 1998).

⁶ *Work Programme on Electronic Commerce*, WT/MIN(17)/65 WT/L/1032 (18 December 2017) (Ministerial Decision of 13 December 2017).

⁷ *Work Programme on Electronic Commerce*, WT/L/274 (25 September 1998) (General Council Adoption of 25 September 1998).

⁸ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1B ('General Agreement on Trade in Services 1994').

⁹ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('General Agreement on Tariffs and Trade 1994').

¹⁰ The positive list approach is 'The voluntary inclusion of a designated number of sectors in a national schedule indicating what type of access and what type of treatment for each sector and for each mode of supply a country is prepared to contractually offer service suppliers from other countries': SICE Foreign Trade Information System, *Dictionary of Trade Terms* <http://www.sice.oas.org/dictionary/sv_e.asp>.

¹¹ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('General Agreement on Tariffs and Trade 1994') art XIV(b).

¹² *Ibid* art XIV(a).

The author then examines in detail the issues with classifying e-commerce into the pre-existing categories of services under the GATS, which is derived from the United Nations Provisional Central Product Classification¹³ ('UNPCPC') originally published in 1990. Due to the UNPCPC referenced by the GATS not being updated to match subsequent versions, there are difficulties in fitting certain e-commerce activities into its categories. Further, even if the most recent version was pasted in the GATS, issues would arise as there have been changes in numbering which would not pair with members' schedules of specific commitments. It is also noted that such a change would be met with reluctance by members to the GATS without lengthy negotiation and scrutiny.

Gao discusses, in detail, issues with classification under the GATS and problems caused by the positive listing approach, citing the *US–Gambling case*¹⁴ as a key example. He also points out issues with classifying the supply mode of e-commerce, given that it occurs in cyberspace. Two recommendations are made to combat these issues: firstly, a set of e-commerce scheduling¹⁵ guidelines by the WTO members; and secondly, the formation of regulatory principles setting minimum standards for e-commerce regulation.

The author examines the issues with the exemptions to commitments under the GATS, specifically the vague nature of the public morals' exception. A universal benchmark is suggested to determine what may qualify under public morals, having reference to the universal declaration of human rights as an indicator for its drafting.

Part II concludes with the observation that the GATS is not well equipped to regulate e-commerce, in particular on issues of classification, member obligations and exceptions.

Part III discusses the regulation of e-commerce under ChAFTA by examining the provisions of chapter 12 in three groups: articles derived

¹³ Department of International Economic and Social Affairs Statistical Office of the United Nations, *Provisional Central Product Classification*, ST/ESA/STAT/SER.m/77 (1991).

¹⁴ Panel Report, *United States – Measures Affecting the Cross-border Supply of Gambling and Betting Services*, WT/DS285/R (10 November 2004).

¹⁵ Members to the GATS specify their positive list commitments in a schedule to the agreement: *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1B ('General Agreement on Trade in Services 1994') art XVI.1

from WTO rules; articles derived from non-WTO rules (for example UNCITRAL model laws); and consumer protection rules.

Parts of chapter 12 of the ChAFTA draw heavily from the WTO rules, such as the moratorium on customs duties (article 12.3), prompt provision of requested information between the parties (article 12.4.2) and acceptance of electronic versions of trade administration documents (article 12.6). Gao highlights the non-binding nature of the moratorium post 2015 under ChAFTA, with the parties ‘reserve[ing] the right to adjust its practice’ in accordance with such WTO decisions, which means they have the right, but no obligation, to extend the moratorium¹⁶.

Articles 12.5 and 12.6 incorporate the UNCITRAL Model Laws on Electronic Commerce¹⁷ and Electronic Signatures¹⁸ respectively into the Agreement, which as noted by Gao, is a positive step towards making these provisions a global standard.

Articles 12.7 and 12.8 relate to consumer protection in e-commerce, and as noted by the author, are the only truly original inclusions in chapter 12 of ChAFTA. Article 12.7 states that each party ‘shall, to the extent possible and in a manner it considers appropriate, provide protection for consumers using electronic commerce that is at least equivalent to that provided for consumers of other forms of

¹⁶ Henry Gao, ‘E-Commerce in ChAFTA: New Wine in Old Wineskins?’ in Colin B Picker, Heng Wang and Weihuan Zhou (eds) *The China–Australia Free Trade Agreement: A 21st Century Model* (Bloomsbury, 2018), 283, 295 citing *Free Trade Agreement between the Government of Australia and the Government of the People’s Republic of China*, Signed 17 June 2015, [2015] ATS 15 (entered into force 20 December 2015) art 12.3.2.

¹⁷ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Electronic Commerce with Guide to Enactment 1996 with additional article 5 bis as adopted in 1998* (1999) United Nations: New York <http://www.uncitral.org/pdf/english/texts/electcom/V1504118_Ebook.pdf>; *Model Law on Electronic Commerce adopted by the United Nations Commission on International Trade Law*, GA Res 51/162, UN GAOR, 6th Comm, 51st sess, 85th mtg, agenda item 148, UN Doc A/RES/51/162 (16 December 1996).

¹⁸ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Electronic Signatures with Guide to Enactment 2001* (2002) United Nations: New York <<http://www.uncitral.org/pdf/english/texts/electcom/ml-elecsig-e.pdf>>; *Model Law on Electronic Signatures adopted by the United Nations Commission on International Trade Law*, GA Res 56/80, UN GAOR, 6th Comm, 56th sess, 85th mtg, Agenda item 161, UN Doc A/RES/56/80 (12 December 2001).

commerce'.¹⁹ As noted by the author, this inclusion is a positive first step, but arguably already exists under previous trade protections. Article 12.8 provides protection of consumer data; however, it uses permissive rather than prescriptive language and therefore does not create any obligations on the parties. Gao concludes by criticising the non-binding nature of articles 12.7 and 12.8, which he regards as having little practical application.

Part IV assesses the impact of ChAFTA's e-commerce provisions, criticising the FTA's use of soft language in chapter 12 as not creating substantive obligations. Gao is also critical of the exclusion of chapter 12 from the FTA's dispute resolution mechanism, making the chapter 'a loose collection of non-binding aspirations'.²⁰

Gao compares the ChAFTA with FTAs previously concluded by China and Australia. There are notable similarities between ChAFTA and the FTA formed between China and Korea,²¹ both being concluded very close in time to each other. It is observed that previous FTAs concluded by China tend to omit e-commerce, whereas Australia comparatively tends to include e-commerce provisions in its FTA's such as those with Japan,²² the United States of America (US),²³ Korea²⁴ and Malaysia.²⁵

ChAFTA appears to be a middle ground between China's exclusion and Australia's inclusion of e-commerce terms in FTAs.

¹⁹ *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China*, Signed 17 June 2015, [2015] ATS 15 (entered into force 20 December 2015) art 12.7.

²⁰ Henry Gao, 'E-Commerce in ChAFTA: New Wine in Old Wineskins?' in Colin B Picker, Heng Wang and Weihuan Zhou (eds) *The China–Australia Free Trade Agreement: A 21st Century Model* (Bloomsbury, 2018) 283, 298.

²¹ *Free Trade Agreement Between the Government of the People's Republic of China and the Government of the Republic of Korea*, signed 10 June 2015 (entered into force 20 December 2015).

²² *Agreement Between Australia and Japan for an Economic Partnership*, signed 8 July 2014, [2015] ATS 2 (entered into force 15 January 2015).

²³ *Australia–US Free Trade Agreement*, signed 18 May 2004, [2005] ATS 1 (entered into force 1 January 2005).

²⁴ *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea*, signed 8 April 2014, [2014] ATS 43 (entered into force 12 December 2014).

²⁵ *Malaysia–Australia Free Trade Agreement*, signed 22 May 2012, [2013] ATS 4 (entered into force 1 January 2013).

Comparisons are also made between ChAFTA and FTAs concluded by the US, the latter being more progressive in its coverage of e-commerce. For example, the FTA concluded between the US and Korea²⁶ includes: provisions for consumer protection; guaranteed freedoms in relation to e-commerce; and a prohibition on restricting the flow of information across borders. Gao also discusses the Trans-Pacific Partnership²⁷ (TPP) as it includes a prohibition on members requiring the use of local servers to conduct business in a territory, or obligation to provide the source code of software before its distribution in a country.

The author concludes by expressing three main concerns: firstly, the repetition of pre-existing obligations in many of ChAFTA's chapter 12 articles; secondly the passive, non-binding terminology used for obligations in regards to e-commerce under ChAFTA; and finally, that the entire chapter on e-commerce is excluded from the operation of the FTA's dispute resolution mechanism. These weaknesses are attributed to the conservative approaches of both China and Australia to e-commerce, and trade between the two States being heavily focused on manufactured goods and raw materials rather than the provision of services. Gao concludes that a new approach is needed, that ChAFTA's conservative approach is likely to hinder the development of e-commerce between the two States and draws an analogy of new wine (e-commerce) in old wineskins (ChAFTA's conservative approach and the WTO provisions).

²⁶ *Trade Agreement Between the United States of America and the Republic of Korea*, signed 30 June 2007 (entered into force 15 March 2012).

²⁷ *Trans-Pacific Partnership Agreement between the Government of Australia and the Governments of: Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States of America and Vietnam and associated side letters*, signed 4 February 2016, [2016] ATNIF 2 (not yet in force).

III ANALYSIS AND CONCLUSION

Henry Gao's conclusions regarding chapter 12 of ChAFTA are quite negative, viewing the provisions as ineffective and non-binding. Due to the soft language used and lack of substantive obligations under chapter 12, such a conclusion appears unavoidable. Nevertheless, such a lack of obligations does not prevent the parties, Australia and China, from choosing to take actions that encourage, enable and protect e-commerce traders and consumers.

Overall the chapter is very well written, showing how the regulation of e-commerce has progressed, from the work of the WTO and UNCITRAL in the 1990s to the stalling of negotiations in the Doha round negotiations, leading States to seek regional agreements and FTAs, of which ChAFTA is one. The comparison to other FTAs, particularly those concluded by the United States, show ChAFTA has missed some opportunities to create better consumer protection as a key obligation. Nevertheless, the inclusion of the e-commerce section in ChAFTA is a step forward, and comments made by Chinese Premier Li Keqiang in 2017 regarding potential revision and expansion of e-commerce coverage in the ChAFTA agreement gives hope for a greater focus on e-commerce in the future.²⁸ New wineskins may therefore exist sooner rather than later.

²⁸ Joshua D Blume, 'Reading the Trade Tea Leaves: A Comparative Analysis of Potential United States WTO-GATS Claims against Privacy, Localization, and Cybersecurity Laws' (2018), 49 *Georgetown Journal of International Law* 801, 839 Citing Kirsty Needham, *China wants to expand e-commerce trade with Australia* (21 March 2017) Sydney Morning Herald <<https://www.smh.com.au/business/companies/china-wants-to-expand-ecommerce-trade-with-australia-20170321-gv2xed.html>>; Trade Victoria, *China moves to strengthen e-commerce ties with Australia* (24 March, 2017)

Janet Austin, *Insider Trading and Market Manipulation – Investigating and Prosecuting Across Borders*

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We live in an era of profound change, where digital technology has replaced analogue systems. The stock market has been particularly affected by this revolution and, despite being poorly understood by most people, stock market changes have wide ranging consequences. In this context, Janet Austin has produced an engaging text, which individuals, from both a legal and non-legal background, can appreciate.

Insider Trading and Market Manipulation – Investigating and Prosecuting Across Borders is a text which provides the reader with a holistic view of the stock market; its importance in society, why abuse must be prevented and how this can be achieved. The context is an increasingly globalised market, where digital progress has eroded geographic borders and produced new challenges for regulators.

Austin's text clearly explains the role of the stock market in society, including how maintaining market integrity is central to an economy's health. The stock market promotes confidence and increases the flow of capital, thereby guaranteeing the conditions for economic growth to occur. Further, her excellent analysis of the theories underpinning market abuse and regulation enables the reader to measure what should be regulated and whether it is being done effectively. Her logical explanation enables the reader to appreciate why regulation matters, the complexities regulators face and how the problem of prosecuting market abuse has changed as markets have evolved.

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Chapter 3 describes how the marketplace has changed, principally since the 1970s and 1980s where markets consisted largely of physical trading floors, operated like monopolies and influenced by geographic boundaries. By the 2000s due to changes in technology and finance, such as the development of electronic trading, the merging of exchanges and the use of global trading platforms had produced a fundamentally more complex, shared market. Austin points out that most regulators have the same goals – maintaining market integrity and preventing abuse – but the task of achieving these goals has become significantly more difficult with complex, shared markets.

Chapter 4 provides an in-depth analysis of how regulators in five jurisdictions have undertaken investigation and enforcement, over a ten-year period (2006 – 2015). Austin considers regulation in the USA, UK, Canada, Germany and Australia, by comparing the different legal systems, the difficulties regulators have encountered and how they have responded. Austin argues that, with market changes, manipulation rather than insider trading is more likely to occur and that those perpetrating such abuse are extremely agile – able to manipulate a stock in one jurisdiction whilst being based in another. This is a useful chapter providing data and examples of the type of manipulative schemes that are used, the enforcement and surveillance methods applied to track them, and the success or failure experienced by various regulators. The need for a unified approach to market regulation and the exchange of data is well explained in Austin's text. Chapter 5 is devoted to case studies, which illustrate how complex market abuse occurs today and the need for a global response to this problem.

Having established how market regulation is no longer assured through rigorous enforcement within a single jurisdiction, Janet Austin uses her final two chapters to examine the establishment, role and possible future of global organisations for international securities regulation. She charts the history of the International Organisation of Securities Commissions ('IOSCO') from its inception in 1983 in North America to the international organisation it is today, with 126 ordinary members representing 95% of global capital markets. A key instrument produced by this organisation is a Memorandum of Understanding ('MoU'), to which most of its members have committed. Usefully, she explores the 'hard' and 'soft' powers of this organisation. Its hard powers are evident

through the terms of the MoU and the data sharing between regulators facilitated by the Memorandum. Soft power can be seen at play, by the way members are coerced into aligning their laws with one another, to achieve a more uniform regulatory framework. These chapters demonstrate the effectiveness of this regulatory network and the MoU, which have fostered co-operation, shared goals and similar legislation. However, Austin also recognises the limitations of the IOSCO in that it depends on goodwill rather than obligatory compliance. The reader is left with a sense that as markets develop further, the IOSCO will be an increasingly relevant global organisation, that should be provided with the support it requires to perform an important role.

Lastly, it is worth commenting on Janet Austin's literary style. She always maps out what she will consider and how she will develop her theory. The reader is left in no doubt as to what she will cover and why that is significant. Her writing charts a clear pathway through dense, complex subject matter to illustrate to the reader exactly what they need to understand and why.

