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How the ACCC is changing the shape of Competition in Australia

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INTRODUCTION

The Australian Competition and Consumer Commission is responsible for enforcing the competition provisions of the *Trade Practices Act* but that is not a static duty, far from it. Court action instigated by the Commission can produce judgements that extent its powers under the Act. This has been particularly true with section 46. That section prohibits a company with a substantial degree of market power from using it to damage a competitor.

Later, I will talk about judgements that have enhanced the Commission's power under s.46 especially in combating predatory pricing.

New technology is transforming the modern economy at an incredible rate. While the Internet and e-commerce are promoting competition and consumer welfare through greater choice and improved delivery and payment services, they give rise to new sources of market power and new forms of anti-competitive behaviour. A challenge for the Commission is not only to combat e-scams as they surface in Australia but also to cooperate, as never before, with overseas regulators to fight them on an international level.

Globalisation has and will continue to have an enormous impact on business, consumers, government and regulators such as the ACCC. Along with freer international trade, it has been a major factor in the increase in cartels that attempt to divide the world up in market segments, fix market shares and prices.

Globalisation is also impacting on mergers and takeover. Large Australian firms are claiming that you have to get bigger to gain the economies of scale necessary to combat the multinationals in the domestic market and to compete successfully on world markets. It is the Commission's task to examine proposed mergers for their likely impact on competition and the public good. It is not always swayed by the arguments of the proponents of mergers. I will talk in more detail about mergers later.

In the 1990s the Council of Australian Governments (COAG) gave the Commission powers and responsibilities to regulate the non-competitive sectors of the electricity and gas industries while the competitive sectors were made subject to the general competition and consumer protection provisions of the *Trade Practices Act*, administered by the Commission. The outcome has been substantial declines in electricity prices in NSW and Victoria and to a lesser

extent Queensland. Gas industry reforms are yet to bring lower prices.

The Commission is concerned that the reform process is losing momentum putting efficiency gains at risk. But more later.

The telecommunications industry presented the challenge of introducing competition rather than simply protecting it. In July 1997 the Federal Government introduced a package of regulation that began a transformation of industry structures and operations and increased the duties of the Commission. Under amendments to the *Trade Practices Act*, the Commission was given responsibility for applying the regulation that established an access regime and it was given special powers in relation to anti-competitive conduct. We will return to this.

COMPETITORS OR PREDATORS

The question sometimes asked is why can't big business be stopped from crushing smaller competitors? It can be with greater use of s.46 of the *Trade Practices Act*.

Section46 prohibits a company with a substantial degree of market power using it to eliminate or substantially damage a competitor, prevent a new market entrant or deter or prevent a person engaging in competitive conduct in any market.

Free enterprise does not mean freedom for large firms to crush smaller competitors. There are some companies that believe market power should be used to gain undue market dominance. When this happens, competition weakens and both consumers and suppliers get a worse deal.

The main tool used to drive a smaller competitor out of the market place is predatory pricing. The term "predatory" is most apt. The predator closes in on the victim by selling below cost until it is driven out of business.

Consumers may cheer the initial drop in prices but this is short term. Once the competition has been eliminated prices will rise once again, more probably higher than they originally were. In addition there could be less choice.

Innovative, cost-effective companies trying to secure a foothold in a market will be buoyed by recent decisions of the Federal Court recognising that predatory pricing can constitute a misuse of market power and therefore unlawful under s.46 of the *Trade Practices Act.*

In February this year, the Federal Court declared unanimously that Boral Besser Masonry Ltd's pricing below manufacturing cost breached s.46. The Commission described the decision as "landmark" in determining that s.46 was as vital in the quest for a competitive economy as other sections of the Act dealing with cartels and company mergers.

The Commission took Court action against Boral alleging it had slashed prices below manufacturing cost to drive the smaller and innovative C&M bricks out of

the concrete masonry products market. Justice Finklestein went further declaring that "psychological pressure" had accompanied predatory pricing. Boral not only sold below cost but also publicised the fact that it was increasing manufacturing capacity. Boral was signalling to its rivals that it was willing to wage the price war for some time and could bear the losses.

The Federal Court's interpretation of predatory prices is stronger than that of the United States and Europe. There, predatory pricing only becomes a court matter where a business charges excessive prices to recoup losses once rivals are eliminated. In Australia, this later recoupment of losses is not essential to contravene s.46.

Another important Court decision concerns Melway Publishing Pty Ltd and its refusal to supply Robert Hicks Pty. Ltd. with its Melbourne street directory for distribution arguing that it had a long established, exclusive distribution system in place. While the High Court said that Melway had not breached s.46 the important point is that the Court appears to have accepted the Commission's submission that it is sufficient to establish that the existence of market power made it easier for the firm to act in a prohibited manner. This lowers the threshold for breaching the Act.

In South Australia, Rural Press Ltd. was found to have misused its market power under s.46. The Commission took Court action when it became clear that Rural Press had not only succeeded in getting a small publisher to stop competing with one of its own newspapers but got the publisher to contravene the *Trade Practices Act* by entering into an anti-competitive agreement with Rural Press.

Rural Press had threatened to drive the other paper out of business. The decision was another important one in clarifying the law in relation to a misuse of market power.

The Court decisions are a warning to companies tempted to use their muscle to crush their competitors or prevent market entry.

MERGERS & BIG BUSINESS

Let me begin with two very pertinent points. First, the Commission is not anti-merger as claimed by some people in the big end of town. Second, strong merger law is essential to the development of internationally competitive Australian companies.

The Commission only opposes those mergers which lead to a substantial lessening of competition. Very few have this effect.

In 1997-98 it reviewed proposed 176 mergers and opposed five. It was a similar story the following year,185 mergers and seven opposed. Last financial year, 1999-2000, the figures were 208 and four. It is hardly a tale of outright rejection or a vendetta against big business.

The virulence and persistence of the attacks on the Commission raises the

question of motive. Do the attackers want the unfettered right to establish monopolies so they can dominate the market and, by raising prices, earn greater profits? This may bring cheers from shareholders but not necessarily from consumers or other companies that buy inputs from the monopolies. Australia is far from alone in its interest in mergers and the critics should realise that governments worldwide have created strong laws to prevent the creation of cosy cartels. They have also empowered strong anti-trust agencies to enforce laws to protect consumers and small business.

If the critics, notably the Business Council of Australia, were serious about promoting the development of large internationally competitive Australian companies they would acknowledge the benefits of competition. Would Australia's big companies be internationally competitive if they had to secure their raw materials, such as coal and petrol, from a monopoly supplier? How would they fare if they had to export their goods through a monopoly transport company and raise finance from a monopoly bank?

It is claimed that if we don't change the merger provisions of s.50 of the *Trade Practices Act* then Australian companies will be prevented from reaching a size big enough to compete in global markets. This is called the "national champion" argument.

The national champion proponents ignore the fact that obstacles to export growth are not necessarily overcome by firms developing dominance in the domestic market. A certain size is not a prerequisite to export success, a fact often demonstrated by the overseas success of moderate-sized and even small Australian firms. Observers of the rural economy have noted the drive and initiatives of rural cooperatives and individual farmers to secure export markets following the dismantling of statutory marketing arrangements. The great export success of Australian wine companies did not come from domestic monopoly.

Domestic rivalry is the critical factor in export success. It is more important than rivalry with foreign competitors because strong domestic competitors create highly visible pressures on each other to improve. Domestic firms are under pressure to export so they can grow. There is also pressure to innovate.

Where local companies have faced significant import competition the Commission has not opposed mergers even when the merger led to a domestic production monopoly. Take the following example: Email's acquisition of Southcorp's whitegoods manufacturing facilities. In this case, the presence of imports from Europe and New Zealand was sufficient to alleviate any competition concerns.

Here is another: in November 1993 the Commission did not oppose the acquisition by Amcor Ltd. of Associated Pulp and Paper Mills Ltd. despite the fact that it made Amcor the only domestic manufacturer of paper (other than newsprint) and gave it ownership of four of the five largest paper merchants in Australia. The Commission, after extensive inquiries, concluded that strong import competition at the manufacturing end of the market put substantial downward pressure on prices. It is also interesting to note that despite the often

repeated claims by big business of the need for scale, Amcor subsequently split itself into two separate companies.

The potential or real import competition is considered important because of globalisation. If import competition is an effective check on the exercise of market power it is unlikely the Commission will intervene in a merger. It has not rejected any merger where imports, independent of the merged parties, have been sustained at more than 10 per cent of the market.

Barriers to market entry are examined. If there are no significant barriers to new entry, incumbent firms are likely to be constrained by the threat of entry and behave as if the market is competitive. A concentrated market often indicates high barriers to new entrants.

Often a merger is allowed to proceed if undertakings are given. In May last year the Commission decided not to oppose the acquisition of Colonial Limited by the Commonwealth Bank subject to significant undertakings to minimise any decline in competition.

Authorisation provisions of the Act are available to those firms that want to ensure international competitiveness through acquisition. A merger can be authorised despite that fact that it will lessen competition providing there are compensating public benefits. Since 1993, the Act has explicitly stated that export generation, import replacement or contributions to the international competitiveness of the Australian economy are public benefits.

In deciding whether to authorise a merger the Commission considers all potential public benefits. Under the Act, public benefits are specified as a significant increase in the real value of exports and significant import substitution. The Commission must also consider all relevant matters relating to the international competitiveness of Australian industry. They include whether a proposed merger would have an adverse impact on the ability of smaller companies to expand or develop export markets.

It is possible to satisfy merger ambitions by applicants amending the original proposal. There is the example of the merger between British American Tobacco's Australian subsidiary WD and HO Wills and Rothmans. With only three cigarette manufacturers in Australia (the other being Philip Morris) and imports accounting for less than one per cent of the market, the initial ACCC reaction was "no". The two companies responded by selling 17 % of their combined brands to Imperial Tobacco, which became a strong competitor on the Australian market. The merger went ahead with no resort to the courts and increased market competition.

The impact of anti-competitive mergers and joint ventures can be profound with costs to the economy such as loss of consumer welfare and an adverse impact on the costs of affected industries. It must be kept in mind that once industry structures are in place, they are difficult to alter and may lead to higher prices, lower quality, poor service and a dearth of innovation

The Commission is not a barrier to company growth. However, this has not stopped the Business Council trying to water down merger law at every opportunity. The latest tactic is to claim that Australia will develop a branch office economy as firms shift head offices offshore.

MOVING OFFSHORE

It's inevitable with globalisation that more Australian companies will move offshore. The Business Council should be aware that the company names it supplied the media as likely to head off overseas have had few problems with the Commission. They include BHP which acquired New Zealand Steel without objection, AMP which acquired GIO, Brambles, Lend Lease and NAB none of whom have had a merger blocked.

There is no evidence that companies have been forced overseas because the Commission knocked back their mergers.

There are a variety of reasons why firms go offshore and merger policy is at the bottom of the list. One reason claimed is taxation policy, others are the need to get closer to customers and that gaining market entry may be difficult for offshore suppliers.

It is claimed that company chiefs, who would like to merge, will not come forward because they fear an inevitable knockback. The figures on mergers I mentioned earlier put paid to this. With a rejection rate of less than five per cent, arguments that companies will not come forward are wrong. If companies are interested in a merger they will quickly sound out the Commission in one way or another.

In applying the merger guidelines, the Commission recognises that many Australian firms operate in a global environment and must consider the global competitive conditions applying in Australian markets. Domestic mergers of Australian firms are not generally opposed where there is a clear and identifiable constraint from offshore.

The anti-competitive conduct provisions of the *Trade Practices Act*, including the merger provisions, are an attempt to enact economics as law. For this reason, interpretation of the Act is always going to be somewhat controversial and the

Commission's decisions on some mergers will attract criticism and debate. This is the nature of things and we can live with it.

What should be remembered is that the Commission is the administrator and enforcer of an Act of Parliament introduced to protect the public against anti-competitive forces. The Courts are the final arbiters on whether breaches of the Act have occurred. Further, the Commission's authorisation decisions can be appealed to the Australian Competition Tribunal. There are ample safeguards for businesses that disagree with the Commission.

However, I should jointly warn the critics that while is often challenged in Court,

it tends to win most cases.

GLOBALISATION & CARTELS

"Competition is our friend, remember? Customers are the enemy." Mark Whitacre, president of the bio-products divisions Archer Daniels Midland Corporation told a meeting with competitors as quoted in Kurt Eichenwald's *The Informant: A True Story*.

These chilling words give an insight into the way too many businesses think – particularly when they are operating as part of a cartel. The concern is that as globalisation gathers pace, the number of cartels will multiply. The reason is free trade. Companies that have monopolised national markets are now facing competition as barriers to entry come down. Their international counterparts are feeling the same way and so they are finding it profitable to meet and agree to market sharing arrangements and price fixing. The theory is that if they collude they will stop free trade producing more competition.

In the United States there are 25 grand jury investigations into cartels and cartels are active in Europe, which is the principal source of a multinational vitamin cartel, covering most countries, including Australia.

The Federal Court recently fined the Australian branches of three multinational companies – Roche Vitamins Australia, BASF Australia and Aventis Animal Nutrition - $26 million for price fixing and market sharing. The court imposed a four year ban on company representatives meeting to discuss market pricing. Now the customers of the three companies will proceed with a $100 million class action to claim compensation for unfair and anti-competitive prices that were fixed. A majority of customers were farmers and their higher costs of production would have been passed on to the consumers of their meat and dairy products.

The previous Australian record penalty for price fixing occurred in 1995 when Pioneer, Boral and CSR were fined $21 million.

Until the Archer Daniels Midland case in the US, it was difficult for regulators to understand how cartels worked and why they worked. However, the confessions of a high level informant, Mark Whitacre, lifted the lid. He was a key player in cartel meetings and provided the authorities with extensive tapes he secretly recorded of cartel meetings and numerous phone calls involving company executives and international co-conspirators.

This case will be studied for years to come in law schools and I hope in economic departments and business schools as an example of how cartels work.

Economic textbooks of recent decades have down played the adverse impact of cartels. They argue that they do not last and they have little effect. The truth is that during the 1990s we have seen extremely powerful cartels at work and they raised prices significantly.

The international animal feed vitamin cartel, for example, appears to have raised

prices worldwide by about 75% and to have operated in a stable fashion for nine years. The Archer Daniels Midland case shows how blithely firms and senior executives were prepared to break the law.

As globalisation increases so does the likelihood of cartels. However, exposure is now more likely due to more effective leniency programs. Under the new US rules, if a member of a cartel informs the regulator that his/her company is involved in a cartel, the company is exempt from fines. In a recent US vitamin case, the informant Rhone Poulenc paid no fines, while the other members of the cartel paid $US1 billion.

These leniency programs are effective because they appeal to the self-preservation side of human nature and works on the "prisoner's dilemma" theory. This means that while participants are all better off if they honour the cartel agreement, the introduction of an escape clause for informants raises the fear that one of them may soon inform the regulators. This fear is causing more cartel participants to come forward quickly and confess to anti-trust authorities before the others beat them to it.

What are the lessons for Australia? Do we have the same sorts of behaviour here? There is evidence of a significant level of cartel activity occurring in Australia. Recently there have been a number of serious cases including the Queensland fire protection industry where companies and individuals have been fined for operating a cartel that caused sprinkler installation costs to rise by about 10 per cent and alarm installations by 5 to 15 per cent.

Cartels are insidious and must be stopped. They work to the detriment of customers, suppliers and act as barriers to the entry of new players. The upshot is the economy as a whole suffers.

UTILITIES & REGULATION

There are substantial benefits to be derived through the extension of competition principles to the electricity and gas industries. Cheaper power greatly assists economic development.

Under reforms outlined in the 1993 Hilmer report and later adopted by the Council of Australian Governments (COAG), it was proposed to open up public monopolies and certain other facilities to competition. Where competition was not possible services were to be regulated to ensure that service providers did not hinder competition in related industries by extracting monopoly rents.

The regulator is the Commission working under the guiding principle that access to certain facilities with natural monopoly characteristics, such as electricity grids and gas pipelines, is needed to encourage competition in electricity generation and gas production. Problems can arise when the owners can inhibit or distort competition in upstream or downstream markets.

The national electricity market (NEM) includes Queensland, NSW, the ACT, Victoria and South Australia with Tasmania expected to follow. NEM has been

operating since 1998 and while many issues remain to be resolved, major benefits have been delivered to electricity consumers.

Prices have fallen dramatically since reform began with both NSW and Victoria gaining reductions of around 50 per cent at the wholesale level. The gains in Queensland have been lower while South Australia still awaits price cuts. Electricity prices in Australia have improved relative to the rest of the world and this is good for productivity.

Gas reforms are yet to bring price reduction but they remain low on the international scale.

Unfortunately the reform process is losing momentum in Australia and the Commission is concerned that the benefits gained so far could be jeopardised and further benefits not realised unless all players remain committed. Less commitment could mean Australia quickly falling behind other industrialised countries and forfeiting opportunities to grow and prosper.

COMPETITION IN TELECOMMUNICATIONS

Until 1991, Telstra (then Telecom Australia) operated as a monopoly but in 1991 Optus was licensed as a second carrier. Subsequently, Vodafone became the third carrier, offering digital mobile phone services. As mentioned earlier, in 1997 the Government introduced legislation for open competition.

The legislation removed regulatory barriers to market entry, revised technical regulation of the industry and introduced into the *Trade Practices Act* telecommunications-specific competitive safeguards and an access regime.

Regulatory arrangements were restructured so that the Commission would have responsibility for competition and economic regulation while technical regulation would rest with the Australian Communications Authority (ACA).

These measures changed the competitive environment of the telecommunications market in Australia in three major ways.

They removed restrictions which previously limited the number of carriers and the installation of telecommunications infrastructure. Anyone may now apply for a carrier licence, subject to certain conditions. By April 2001, 72 new carrier licences had been issued.

A telecommunications access regime was established allowing carriers to access each other's network facilities where the Commission believed it promoted the long-term interests of end-users. It was recognised that duplicating network elements could be inefficient, but that retail competition depended on access to 'bottleneck' facilities on reasonable terms. Also, it was important to achieve any-to-any connectivity of subscribers on different networks. Originating and terminating services for the fixed, mobile and ISDN networks, together with certain data, transmission and other services and a local carriage service, have

been ‘declared’ by the Commission under the access regime.

Anti-competitive conduct provisions provided additional remedies for anti-competitive conduct. This was necessary because of Telstra’s market power and because of the vulnerability of new entrants both to anti-competitive conduct and to delays in resolving it. The Commission may issue competition notices where it believes a carrier or carriage service provider has engaged in anti-competitive conduct, and has done so in two cases. This action stopped conduct without the need for judicial enforcement processes. The Commission has also taken action in a number of other cases.

Telecommunications competition legislation is being reviewed by the Productivity Commission. However, the Minister for Communications, Senator Richard Alston, recently indicated that he would consider early intervention to resolve delays and other difficulties experienced in dispute resolution.

E-COMMERCE

New technology is transforming the modern economy at incredible rate. The Internet and, with it e-commerce, provides a much greater choice of goods and services for consumers, improved efficiency in ordering and payment and a new means of distribution, including downloading some products. While the new forces are generally promoting competition they can give rise to new sources of market power and new form of anti-competitive behaviour.

Both buyers and sellers should realise that trading in cyberspace does not transport you beyond the orbit of the *Trade Practices Act*. On line shopping and marketing is like any other commercial undertaking; businesses have the same responsibilities under the Act and consumers the same rights of protection.

Competition regulators worldwide are facing up to the new challenges. The Commission, after examining 299 Australian websites (as part of a 3000 site sweep by 48 agencies worldwide), found that they sites rated well on contact details such as physical addresses and telephone numbers with 90 per cent accuracy. However, only 30 per cent of e-tailers accepted product returns, exchanges and refunds. This is a statutory right for Australian consumers under the Act.

It is business as usual for the Commission in the so-called "New Economy" generally applying the rules and regulations originally designed for the "Old Economy" but new challenges have emerged.

When buyers sit down at their computers they can, at the press of a button, compare prices and support services on offer anywhere in the world. This can stimulate competition but there are problems for regulators.

To undertake investigations the Commission must invest in the technical expertise essential in tracking down the location of websites, the identities of the operators and in capturing, securing and presenting electronic information in the event of Court proceedings. For example, evidence contained within a piece of

software code must be decrypted and translated into English to be understood by a Court.

In some instances we need the assistance of other regulators to obtain evidence and establish dialogue on international policy issues and coordinate investigations. The Commission is already active and one outcome is co-operative agreements with the United States.

Of course, e-commerce is more than business to consumer, it is also business to business, known in cyberspace jargon as B2B. Regulators, including the Commission, have been seriously considering the treatment of B2Bs under competition laws. When a group of competitors get together to create a central communications centre, known as an electronic hub, there may be more opportunities for price manipulation. Questions to be asked include:

Will the hub owners be able to see whom their competitors are dealing with and the prices charged? Will this initiate price fixing or collusion? Will hub owners be able to exclude competitors from the hub or develop rules that favour them? Can small businesses afford to join a hub? If the strongest players in an industry form a hub, will this prevent the development of competing hub? And will alternative delivery systems remain effective competitors to B2B hubs?

There will be B2B players who claim that the regulators do not understand the technology. They will argue they are not about selling dearer and buying cheaper but encouraging industries to become more efficient by enabling computers to process routine transactions rather than wasting people hours. This may well be the case but regulators must be alert to any breaches of the *Trade Practices Act*.

The Commission is having ongoing talks with a number of B2B operators to ensure that it fully understand the nature and scope of each project and can advise whether particular proposals are likely to raise concerns about competition.

The Commission is not just a regulatory agency; it has an education role it takes seriously and e-commerce is no exception. Consumers and businesses are being educated about the Internet through the Commission's Internet commerce and competition project which aims to protect consumers and promote fair trading while encouraging participation in e-commerce.

This month a web site was launched by the International Marketing Supervisory Network to enable consumers to report scams from around the globe. The site, Econsumer.gov, signals a new level of accountability for e-tailers when dealing with overseas customers. The Commission will have direct access to complaints from overseas customers about Australian on-line business. Increased efforts will be made to share consumer complaints across international borders.

CONCLUSION

I was asked me to speak on "how the Commission is changing the shape of competition in Australia". This must be put in the context that the Commission is not a law-maker but administers the *Trade Practices Act*. However, progress in

making Australia a more competitive nation depends heavily on how assiduously the Commission pursues its duties under the Act. As mentioned earlier, Court action has resulted in landmark decisions, especially with the Federal Court recognising that predatory pricing can constitute a misuse of market power and is therefore unlawful under s.46 of the *Trade Practices Act.*

Court decisions are a warning to those tempted to use muscle to crush rivals. The Commission is not so much changing the face of competition as working to ensure that competition and fair trading are enhanced features of the Australian economy.