II. Competition and Economic Regulation

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Competition Law

A Case Study and its Implications

I want to acknowledge the outstanding contribution of Pradeep Mehta and CUTS to the cause of having well-functioning markets all round the world and especially in developing countries. No person has made a greater contribution than Pradeep to the promotion of competition law and its serious implementation in developing countries. While the contribution to India and South Asia and then Africa has been at the forefront, his influence has been universal.

His establishment and development of CUTS has been remarkable. It is a sizeable, world valued institution whose high quality output contributes globally to competition law and policy.

CUTS has a clear commitment to an economically sensible approach. The consumer movement has its heart in the right place but sometimes it presses for solutions involving too much intervention rather than for ones that make markets work better. CUTS has not made this mistake—and the same applies to its pro-trade approach—and this is despite its sensitivity to the special characteristics of developing countries.

In this short paper, I want to go back to basics by presenting a true case study. One of my purposes is to highlight some characteristics of competition law. Another is to draw attention to the links between its core elements.

Let me therefore begin with a true typical cartel story. For 20 years two major firms dominated the Australian freight express business, which transports parcels and packages from one city to another. They had a secret agreement that assigned customers (called pets) exclusively to one or the other. They agreed not to poach 'pets' from one another. If customers tried to switch suppliers, the competitor would quote a high price and that would usually be the end of the matter. Occasionally however, a customer would switch supplier but then receive very bad service: urgent overnight deliveries from Melbourne to Sydney would arrive several thousand miles away in Darwin a few days later or get lost. In the jargon of the companies they were trying to 'burn' customers to induce them to switch back. If burning failed, the firm would try to compensate its competitor by getting rid of one of its existing customers of like size by sharply rising prices or by reducing service quality. Occasionally financial compensation to the business that lost the customer was paid instead. All this was done to avoid competition and raise prices.

The Australian Competition and Consumer Commission (ACCC) successfully broke up the arrangement and with much fanfare had the firms fined about AUS$13 mn, a big amount in those days. Alas! there were no criminal sanctions then for cartels.

There were occasional attempts by new competitors to enter this profitable market. However, whenever this happened, at least one of the firms would quote prices well below that of the new entrant. They often quoted prices that were well below their costs: if the variable or marginal cost of overnight delivery between Melbourne and Sydney was AUS$50, then they would quote at AUS$30. This drove most competitors out of the market. Legal action to recover damages under the competition law was eventually taken by one of the surviving competitors.

After the cartel was broken up one of the players came to the Commission and claimed that there was only room for one firm in the market. Could they merge? If so they said, a great deal of duplication would be eliminated, cost savings would occur and the customer ultimately would benefit from lower prices. The combined firm would also have the scale to enter into overseas markets. However, from the ACCC's perspective, such a merger seemed anticompetitive, and would have been likely to cause higher prices. So the ACCC opposed the suggestion.

Yet, as serious competition broke out, the ACCC received some information from people within one of the firms which suggested that the advertised claims that packages were transported by air from one capital city to another, were incorrect. The ACCC tested this by sending some packages of its own which included altimeters. On collecting the packages, the altimeters showed that at no stage had the parcel been more than 300 metres above sea level indicating either that the planes tended to fly rather low or that there was misleading and deceptive conduct in breach of the consumer protection provisions of the Trade Practices Act. Action was taken via fines, publicity and court orders to stop the practice.

Let us draw some general conclusions.

Cartels—secret agreements between competitors not to compete, to raise prices, to restrict service—are a great temptation for business. The gains can be large. The global vitamins cartel ran for nearly a decade, raised prices by large amounts—75 per cent—and made billions around the world for the conspirators. Cartels are also hard to detect, increasing the incentive to operate them. However, they do great economic harm—to business customers and consumers—bring no offsetting economic or social benefits and are unethical. In most OECD countries it is unlawful for competitors to agree to share a market so that they do not compete against one another. It is also unlawful for them to agree on prices or to rig bids. Anticartel laws are a core component of competition law.

To cut prices in response to a new competitor is not generally unlawful. This is competition at work. However, to cut prices persistently below variable cost to eliminate a competitor is usually unlawful or ‘predatory’. Predatory behaviour breaches abuse of market power (or abuse of dominance) provisions of competition law. In Australia it is unlawful for a firm with a substantial degree of power in a market to take advantage of that power in order to eliminate competitors or deter them from competing where this harms competition. There is nothing wrong with being a monopoly under competition law—monopoly may be the result of a business being more efficient than its competitors. It is however, unlawful in most OECD countries to engage in acts of ‘monopolisation’ or 'abuse of dominance', that is to use market power illegitimately to prevent competition e.g.:

- by systematically pricing below variable cost to destroy small players or new entrants and thereby having competition as a whole in the market;
- by refusing to supply where the purpose or effect is to lessen competition;
- by engaging in a range of restrictive practices such as exclusive dealing (supplying a customer on condition that it does not purchase from a competitor) where this is anticompetitive;
- by engaging in resale price maintenance (requiring a retail purchaser not to sell below a specified minimum price) where this is anticompetitive.

Such anticompetitive behaviour by business harms competition, efficiency, business opportunity and innovation. Such behaviour ('monopolisation' in US jargon) has been unlawful in North America since the time of Rockefeller and is still so as Mr Gates has discovered and now firms like Google and Apple are discovering. It is however, a field in which difficult judgements are often required: when is pricing below cost, a sign of intense competition and when it is a sign of damaging anticompetitive behaviour? Up to a point, an abuse of dominance law has a powerful pro-competitive effect. Carried too far it can chill competition.

The merger proposal incident described above highlights the fact that some mergers can be anticompetitive and that this can often be their real motivation. When Australia introduced a competition law in 1965, it prohibited anticompetitive agreements but did nothing about mergers. This put an end to some price-fixing arrangements between competitors but they then nearly all merged, achieving the same effect as the former anticompetitive arrangements. This is one reason why merger provisions are needed in competition law—to prevent outlawed cartels from merging to become a monopoly.

Not all mergers are anticompetitive. Moreover, unlike most cartels, they can bring efficiency benefits. Indeed it is possible under

Australian law, if a merger is anticompetitive to have it 'authorised', if the applicants can demonstrate that the benefit to the public exceeds the harm. The job of the ACCC and its appeal body—the Australian Competition Tribunal—is to distinguish between those mergers between competitors that are of benefit to the public and those the claims for which are merely trumped up excuses for reducing competition in the Australian market. Over time, a well administered merger law has a major beneficial effect on the competitive structure of an economy.

Regarding the false claims about air transport, not only was this behaviour misleading and deceptive with respect to customers, it was also unfair for others in the industry, which were ethical. It was a form of unfair competition. It also did not enhance the industry's reputation. It also meant that competition did not work well: competition only works well if consumers are informed properly or at least not wrongly informed about the nature of the products or services being offered on the market. Laws about misleading and deceptive conduct, and consumer protection more generally, are best regarded as a part of competition law, and in about half of the OECD countries, including Australia, they are administered and enforced by competition regulators.

I will now bring this together with a very brief overview of the basic elements of competition law.

Competition law applies to businesses (usually including publicly owned ones) and is designed to break up cartels, anticompetitive mergers, the abuse of market power (or dominance) and in many countries to misleading and deceptive conduct. It takes the form of statutory prohibitions either of:

- general nature e.g., all arrangements between businesses that substantially lessen competition are prohibited by law, and
- specific nature e.g., price fixing arrangements between competitors are automatically prohibited, irrespective of whether they affect competition. The reason for automatic prohibition is that the arrangements are assumed nearly always to be harmful to the economy and rarely or ever offset by any benefits to the economy. Accordingly, it is considered

best to ban them automatically rather than consider the economic effects of each arrangement individually before banning them. Resale price maintenance is treated similarly in most countries.

Competition law is administered and applied by an independent regulator, which has powers to investigate behaviour it believes may be unlawful.

In North America and Australia such regulators play a prosecutorial role: they collect evidence, seek to prove their case in court and obtain court orders. In Europe, the regulator itself may have power to make orders, including fines (although appeals may usually be made to a court).

Competition law can only work effectively if there are credible, adequate sanctions. Courts can impose injunctions, fines, gaol sentences, damages and other orders.

The penalties under the Trade Practices Act take the form of fines and sometimes damages can be added on. But are fines sufficient in all situations? Recently Australia decided to join a number of other countries in having the possibility of jail sentences for collusion on prices, market sharing and bid rigging because fines alone were insufficient deterrent.

An interesting feature of competition law in North America and Australia—and to a much lesser extent in many countries, and continents, such as Europe—is that it is also possible for individuals including individual businesses to take action themselves. They can sue for damages and injunctions (but not fines) in a court. This is a very important and powerful backup to competition law that usually works well and is likely to be adopted on a much more substantial scale in Europe before long.

In summary, some features of competition law that emerge from this case are:

- Most often the direct beneficiaries of enforcement action under the Trade Practices Act are businesses (especially small businesses) rather than consumers. On balance most businesses gain from competition law.

- In some areas, there is a fine line between competitive and anticompetitive behaviour. An example is when a monopolist reduces prices in response to entry by a new competitor.
- In other areas, there may be a trade off between competition and efficiency e.g., some mergers may allow the achievement of scale economies at the expense of competition.
- The treatment of monopoly has some special features. As noted, monopoly itself is not unlawful. Monopoly may, after all, result from a firm being more efficient than any other competitor or potential competitor and thereby eliminating them.
- In Australia there is no power to break up monopolies. In the US the law goes a step further. There is power to break up a monopoly where it has actually acted anticompetitively in breach of competition law. There is however, no power to break up a monopoly without there having been some unlawful anticompetitive behaviour.
- In competition law, there is normally no prohibition on the prices which a monopoly charges even if they are considered excessive.
- The law applies to all or nearly all forms of business. However, the millions of small businesses are generally unaffected by the law and/or are exempt when there is some possibility that a technicality might catch them. Of greater importance however, is the fact that there is pressure from nearly every sector to gain exemptions from the law on the grounds that their circumstances are special.
- In Australia we have an interesting way of dealing with claims for exemption. If someone believes that the law should not apply to them they may apply in public to the independent regulator who holds a public hearing before deciding whether they should have so called ‘authorisation’ to continue to engage in anticompetitive behaviour. This is an alarming sounding exception to the competition law but in practice the regulator has been extremely strict and does not grant many authorisations. It is also a better way of

dealing with exemption applications than leaving them to politicians

- Anticompetitive behaviour can occur on a global scale but there is no global competition law or regulator. When a global cartel is detected, however, it is usually possible to obtain fines and damages at national levels: this is a reason why a domestic competition law is desirable. If the US, for example, uncovers a global cartel, a local regulator can often piggyback on its actions to obtain fines and damages where local harm has occurred providing there is a local law.
- A considerable administrative and legal apparatus is needed to apply competition law. It can take years to build up.
- The law may not have much relevance to some important state-owned utilities in areas such as telecommunications, public transport, energy and water. Very often these are monopolies protected by statute from entry by competitors. Being a monopoly there is no competition to collude with, to take over or to take monopolisation action against. But having a protected monopoly can be economically harmful. To deal with it requires more than the application of competition law. It requires a full assessment of the structure of an industry and all possible policy approaches including divestiture.
- Competition law regulates anticompetitive behaviour by businesses. It does not apply to, nor override the many actions of governments that limit competition.

Finally, this case study highlights the fact that, if the underlying structure of an industry is not competitive, there may be many manifestations of market power—cartels, monopolisation, restrictive practices, anticompetitive mergers and misleading and deceptive conduct. In an uncompetitive industry, it is necessary to focus on all forms of anticompetitive conduct that may occur.