ASEAN-AUSTRALIA-NEW ZEALAND FREE TRADE AREA (AANZFTA)
ECONOMIC COOPERATION WORK PROGRAMME (ECWP)

Australian Competition & Consumer Commission

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Abuse of Dominance

Australian Competition & Consumer Commission

Sam Strudwick-Day
Australia

Topics in this presentation

- Overview of Market Dominance
- Barriers to Entry
- Market Dominance in Australia
- Some example cases
- In Depth Case Study

Market Dominance

- What is dominance?
  - No exact definition set by the law
  - Generally conduct by a single company
  - Economists: ***"Ability to raise prices beyond the competitive level, profitably"***
  - Wider definition: *"Ability to engage in anti-competitive profitable conduct due to the absence of sufficient **competitive constraints**"*

Market Dominance

When is conduct an abuse of Dominance

- On the one hand, firms should not be discouraged from competing aggressively and on their merits

- However, when does "competing aggressively" become an "abuse of dominance"?

- This is a very complex question!

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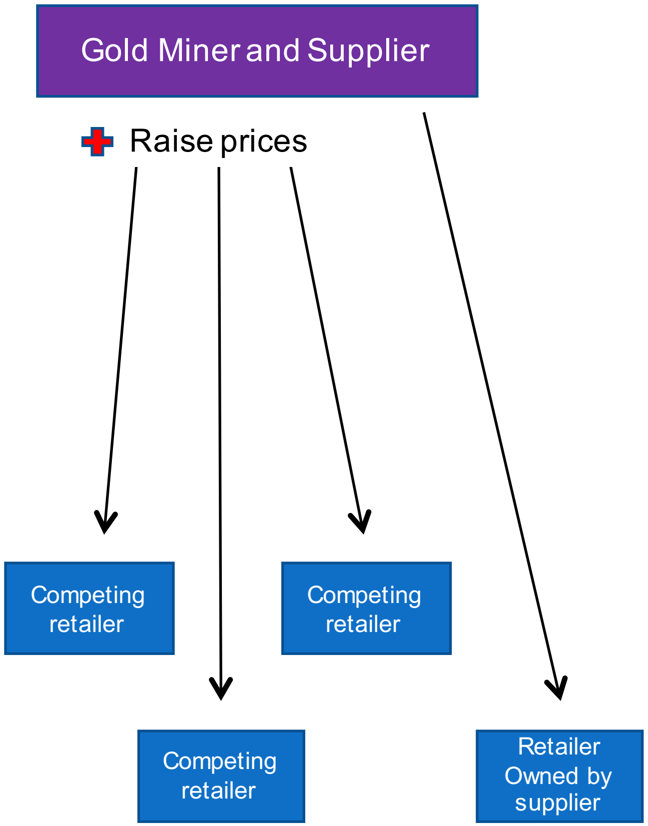
Market Dominance

Example

- A firm is a monopoly **miner and supplier of gold**.
- This firm buys a retail jewellery store, one of 4 competing retailers
- The miner/supplier raises the price of gold to the competing retailers (but not to its own store) so the competing retailers are not able to be as competitive as the retailer owned by the supplier.



What is Dominance?

- The degree of dominance a firm has depends on a number of factors

  - **Market share** is just one consideration

  - **Other features** of the market are important, such as barriers to entry, competitors, suppliers, customers, product substitution, and sustainability.

Barriers to Entry

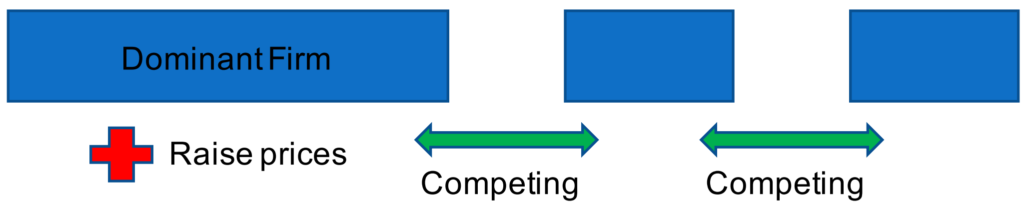
Barriers to Entry

- How easy/difficult is it for a firm to enter a new market?

- **Barriers to Entry** can take a number of forms, including:
  - Financial
    - Example: Very large sunk cost/set up investment required to enter
  - Regulatory
    - Example: Government regulations restrict entry
  - Structural
    - Example: Strategic locations unavailable to new entrants

Barriers to Entry

- If a dominant player in a market raises prices:

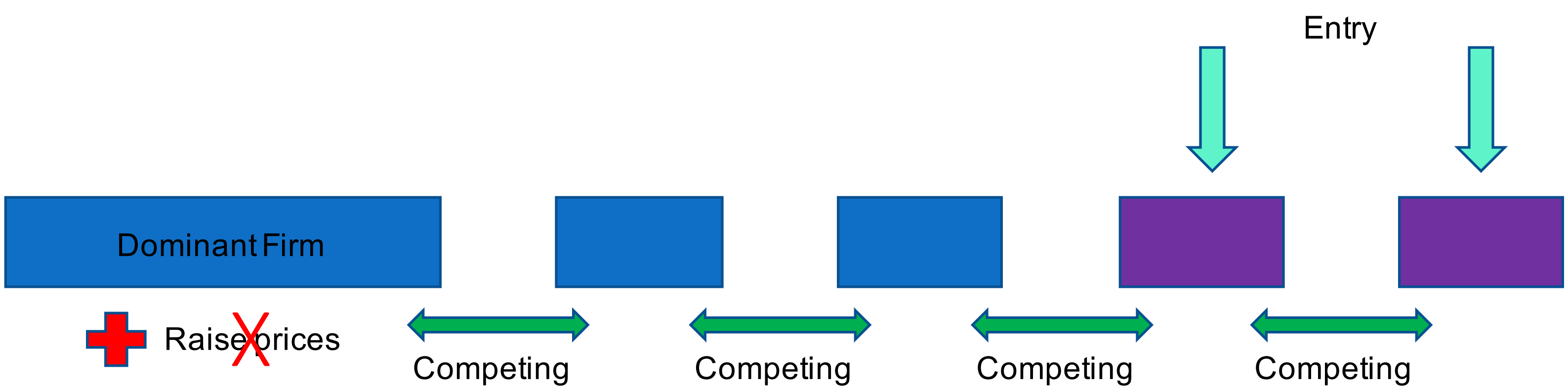


- Then the dominant player (and others who follow) will start to obtain monopoly profits.

- What happens next?

Barriers to Entry

- If there are **low barriers to entry**, new players will enter the market to try to capture these monopoly profits



- Sometimes the threat of entry is enough of a constraint to prevent a firm from having market power

Other constraints

- **“Must have”** product
  - A firm produces a product with a loyal following, eg. Apple
  - Patented medicines that are essential to hospitals

- **Countervailing power**
  - This is the ability of customers to credibly threaten to bypass the merged entity (vertically integrate, import, sponsor new entry)

Important to note

- Some companies obtain market dominance through competitive conduct – not abuse
  - Innovation leads to a popular product
  - This gives a company a huge market share or following as a result
- Market dominance should not be confused with financial power – they are different!
- Where is the conduct occurring? The business does not necessarily have to have market power in the same market as the conduct – it can be a related market

Conduct - Foreclosure

- Where a firm has the ability to use its market dominance to foreclose economic activity to a competitor.

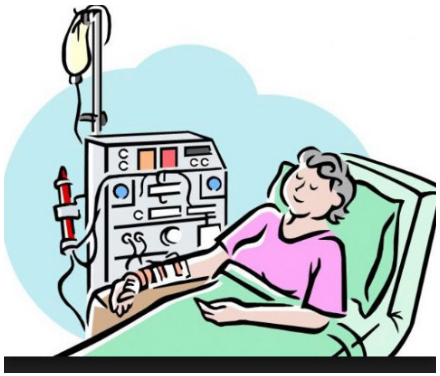
- This can be done in a number of ways:
  - The most common way is through exclusive dealing
  - This can be a vertically integrated firm refusing to deal with a downstream competitor
  - Using exclusive contracts to foreclose supply/demand to a competitor
  - The use of bundling or tying of products

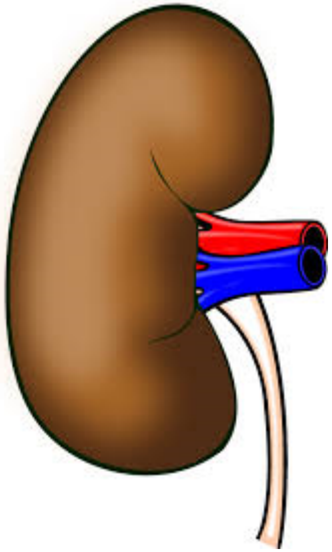
Baxter Healthcare

Facts of the case

- Baxter manufactured and supplied hospitals
  - General Sterile fluids

  - Special Dialysis fluids for kidneys

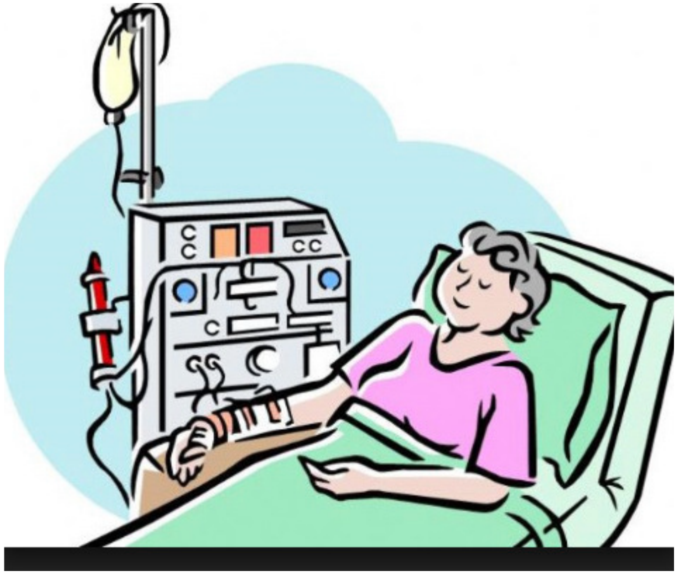




Baxter Healthcare

Facts of the case

Baxter had a **Monopoly** in General sterile fluids



Baxter faced **Competition** in Kidney fluids

Baxter Healthcare

Facts of the case

Hospitals issued tenders for the supply of **Sterile fluids & Kidney fluids**

Baxter bundled the supply of Sterile fluids and Kidney fluids **together**

The price for Kidney fluids was **cheaper** if bought with Sterile fluids

More expensive to buy Sterile fluids on their own

Baxter Healthcare

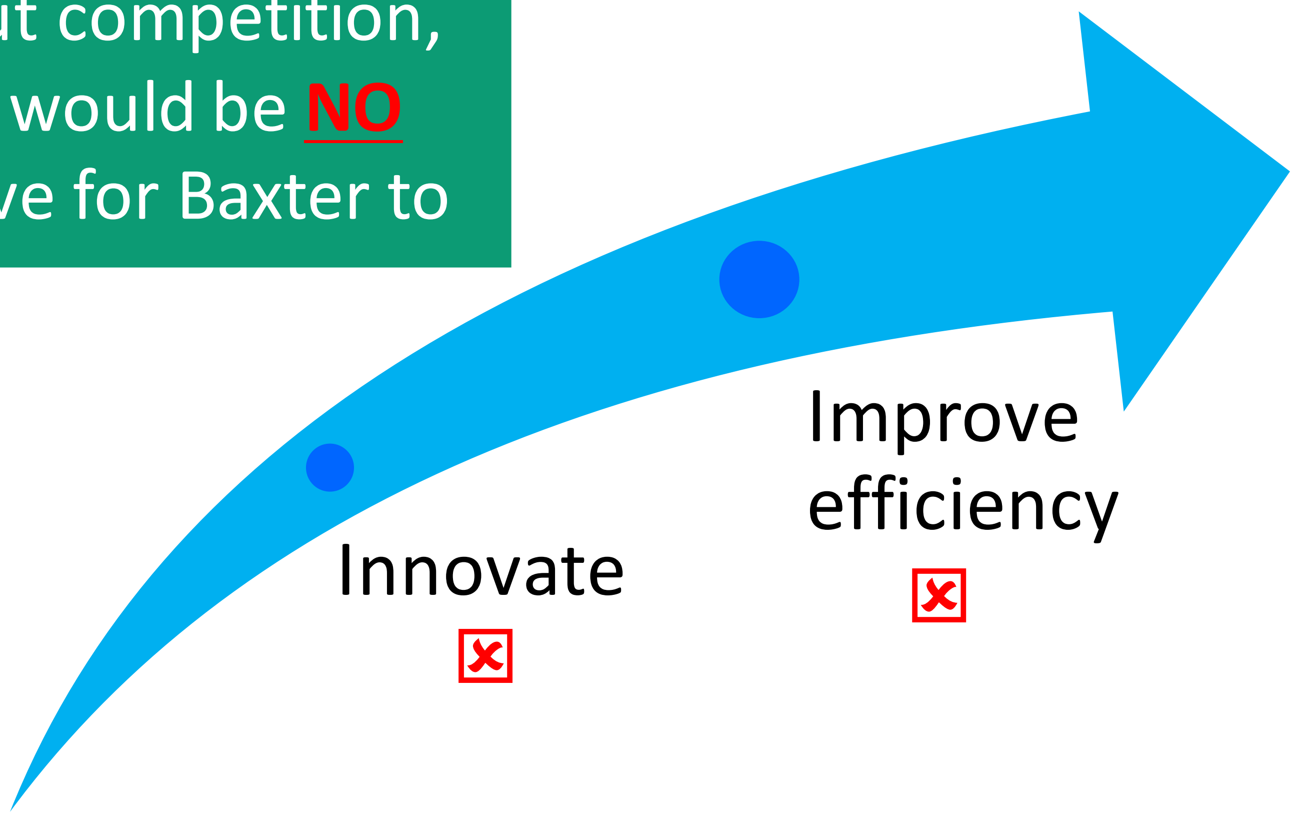
Why was the conduct bad?

- Hospitals paid lower prices in the short term
- Once competitors were driven out of the market
- Baxter could **increase prices** and recover losses in the long term

Baxter Healthcare

Why was the conduct bad?

Without competition, there would be **NO** incentive for Baxter to



Baxter Healthcare

ACCC's investigation

- The investigation started from a complaint by a doctor who could not get access to a competitor's kidney fluids

- ACCC interviewed
  - Health professionals (doctors and nurses)
  - Kidney fluid manufacturers
  - Hospital executives
  - Accounting experts
  - Economic expert

Baxter Healthcare

Outcome of investigation

- Baxter was fined $4.9 million for abuse of market power and exclusive dealing that substantially lessened competition

Baxter Healthcare

Lessons Learned

- Healthcare products are a very important part of the Australian economy
  - It must stay competitive

- Competition regulators must consider the long term implications of conduct, not just the short term
  - It was not enough to say that hospitals were getting cheap services when it was clear it would not last!!

Conduct – Predatory Pricing

- Predatory pricing, or selling below cost is where a firm sells its product into the market at an economic loss
- Why would a firm would do this??
  - Are loss leaders in a supermarket examples of predatory pricing?
- There are a number of important elements here:
  - How much product is sold?
  - How long the predatory pricing continues?
  - But most importantly, *what is below cost*?

Conduct – Predatory Pricing

- **What is below cost?** How do we define cost?
  - Marginal cost
  - Long run average cost
  - Total cost
  - Should advertising costs be included
  - Who's cost? Which company should be the benchmark?

- **The conduct can't be temporary.**
  There may be a need to show that the predatory pricing is of a sufficient length of time. Otherwise a really good holiday sale could be considered predatory pricing

Conduct – Predatory Pricing

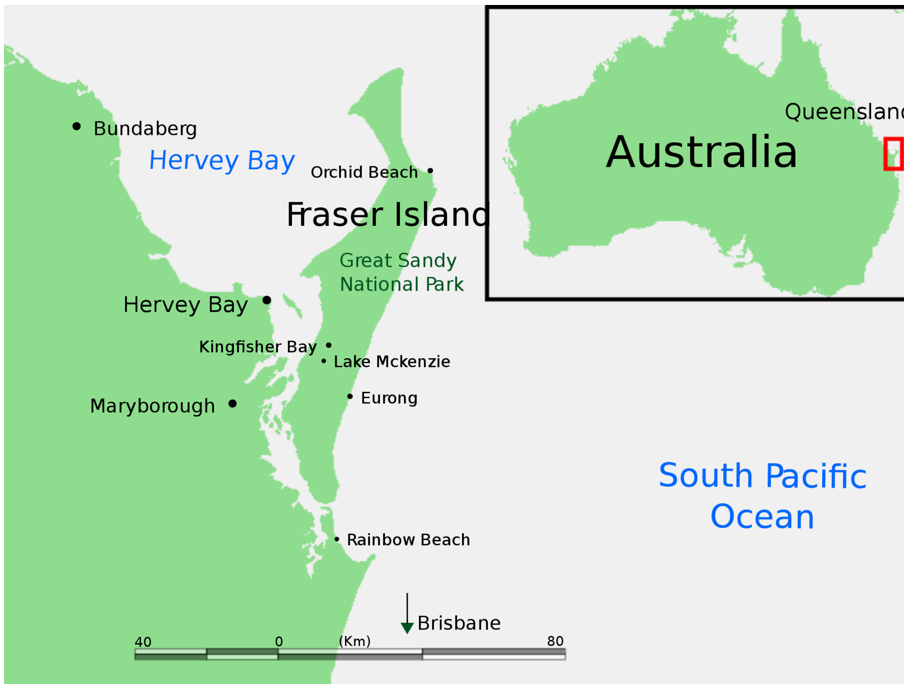
- Remember, just because a company comes to you and says that they can't compete in the market because they would have to sell below cost, it doesn't mean that predatory pricing has occurred.

- One company might be more efficient than they other.

- This is competition after all!

Ferry Services

Case Study



Ferry Services

Facts of the case

- The only way to reach Fraser Island from the Australian mainland was (and still is) by ferry
- A ferry service was provided by Mr Melksham
  - He also owned 1 of the 3 resorts on Fraser Island

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Ferry Services

Facts of the case

- A competitor began to offer ferry services to Fraser Island, and at a lower price
- Mr Melksham immediately dropped his price to lower than the new entrant's
- A price war between Mr Melksham and the new entrant began
- Prices dropped to such low levels that Mr Melksham **was making a loss on the service**

Ferry Services

Why was the conduct bad for businesses, consumers, and the economy?

- Even though customers paid low prices in the short term, once competitors were driven out of the market, Mr Melksham could increase prices and recoup his earlier losses in the long term

- If no competitors enter the market, this removes the incentives for Mr Melkham to provide better ferry services and increase efficiency

Ferry Services

How did the ACCC conduct its investigation?

- The investigation was triggered by widespread media reporting, especially of Mr Melksham's threat to drop prices to zero to destroy the new competitor

- ACCC interviewed a number of people
  - The new competitor
  - People who had previous dealings with Mr Melksham
  - Media representatives who had spoken to Mr Melksham

Ferry Services

Outcome of the investigation

- Mr Melksham was fined AUD$1 million for abuse of market power
- Competitive ferry services are now available at Fraser Island

Mr Melksham was never able to recover his losses

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Ferry Services

Lessons learned

- Important for businesses to have competition law compliance programs in place
- Tourism is very important for this part of Australia – it must remain competitive

- Regulators must consider the long term implications of conduct, not just the short term
  - It was not enough to say that consumers were getting cheap services when it was clear that would not last

Cement Australia

Cement Australia

- Cement Australia is a leading producer of cement in Australia, representing more than 50% of the cement supplied on the east coast of Australia.

- Allegations against companies in the Cement Australia group, alleging misuse of market dominance through its acquisition of

CEMENT AUSTRALIA

Cement Australia

- **Flyash** is a by-product of coal fired power stations. Once the waste from the power station is collected, flyash can be sold off and used in cement, rather than disposed of

Coal is used to generate electricity

Flyash is recycled from the waste

Flyash is then used in cement products

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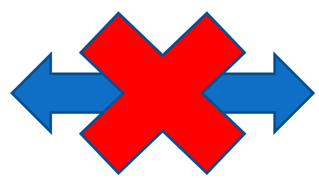
Cement Australia

- The ACCC alleged that Cement Australia took advantage of its power in the market for concrete-grade flyash in South-East Queensland by contracting to acquire flyash from the Millmerran power station ***in volumes substantially in excess*** of those required for Cement Australia's own use and/or re-supply

Cement Australia

- The ACCC alleged that this conduct had the **purpose** of preventing the entry of any competing acquirer, and of deterring or preventing any person from engaging in competitive conduct in the respective markets for flyash
- In other words, foreclosing supply to competing cement suppliers



Competitors

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Cement Australia

The ACCC's investigation

- The ACCC's investigation started with the identification of relevant markets.
  1. The market for the acquisition of flyash from power stations (upstream)
  2. The market for cement products made from flyash (downstream)
- The ACCC then identified any "victims" in the two markets. Smaller players were interviewed and became witnesses for the ACCC. They were interviewed to determine:
  - How they were affected
  - How the markets operated
- A focus of the ACCC's investigation was showing where the harm was. Could the ACCC prove its *theory of harm*?

Cement Australia

The ACCC's investigation

- Investigators took road trips to power stations. It was important for the investigators to see the facilities to clear up conflicting evidence about how relevant equipment was used and how the facilities were run
- It was also important for investigators to speak to people on the ground, who also eventually gave evidence in the trial.
- An important aspect of the case was dealing with government owned enterprises (the power stations)
- The ACCC argued the case under both the dominance provision (section 46) and under the provision that prohibits contracts which substantially lesson competition (section 45)

In Depth Case Study

Fuel discount vouchers

- In 2012 and 2013, the ACCC investigated the changing landscape of the retail fuel market, spurred on by an increase in subsidised fuel discount vouchers, or "Shopper Dockets".

Shopper Dockets

Current players

- The retail fuel industry in Australia is made up of a number of players. Two of which – Coles and Woolworths – are duopoly players in Australia's highly concentrated supermarket industry and are recent new entrants into the fuel retailing market. Both players co-branded with an existing fuel retailer - Woolworths with Caltex, Coles with Shell.
- The remaining players in the market are a mix of independent fuel retailers and established branded fuel retailers such as BP, Caltex (those outlets not connected with Woolworths) and 7-Eleven.

Shopper Dockets

The complaint

- Since entering the market, Coles and Woolworths have offered a fuel discount – spend $30 at a Coles/Woolworth supermarket and get 4 cents per litre (cpl) off the price of fuel (at the corresponding fuel outlet).
- In 2011/2012, Coles and Woolworths started offering deeper cross subsidies/fuel discounts. Some fuel offers were as large as $100 supermarket spend for a 40cpl discount.

Shopper Dockets

The complaint

- Independent fuel retailers complained to the ACCC that the fuel discounts offered by Coles and Woolworths were unfairly being subsidised by the retailer's respective dominant supermarket business.

- Further, the complaints alleged that any competing retailer would not be able to match the discounted prices offered by Coles and Woolworths, and if they did, they would have to do so by selling below cost.

Shopper Dockets

The thought process

- As our previous slides indicate, we first asked the question:

Why are Coles and Woolworths doing this?

- Is this just competitive conduct?
- Is this conduct designed to hurt other fuel retailers?
- Does it make economic sense to cross subsidise fuel with groceries?

Shopper Dockets

The Investigation

- Interviews with retailers willing to speak to the ACCC
- Initial assessment of the conduct
  - Relevant markets
  - Need to establish market power/dominance
- Compulsory notices to Woolworths and Coles for data

Shopper Dockets

Initial analysis

- Initially the ACCC looked at local markets and the effect on competition

Show excel spreadsheet

Shopper Dockets

Further analysis

- After consideration, the ACCC expanded it's analysis to look at a metropolitan market

Show word document

Shopper Dockets

Case Resolution

- The ACCC's analysis didn't get to be tested in court, as the investigation against both Coles and Woolworths was settled out of court.

Final Thoughts

- What does the law say?
- What elements will I be asked to prove?
- What is the economic rationale for a company to engage in the conduct?
- How will I plan out my investigation?
- Find your starting point and go from there

Questions?