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the state of COMPETITION

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It is joked that hospitals run more efficiently when they have no patients. In the competition arena, we're sometimes a little more serious about preferencing efficiency over real people, particularly consumers.

Consumers, however, play an integral role in creating and maintaining competitive markets – a competition policy that assumes consumers to be mute and passive can result in consumers who are just that. But this behaviour itself leads to ineffective competition. So as we gird our loins for Election 2013, it's worth remembering what we're trying to achieve.

The consumer is king! (Out of sight, out of mind)

After a long summer break, news of a forthcoming election can make for a thudding return to reality. In our domain, there's the constant concern that the *Competition and Consumer Act* (the CCA) might become a political football, used by one side or the other as a way of satisfying particular interest groups. This begs the question: what is the Act supposed to achieve? And – given that the Act's "new" name is now a few years old – should we look at the joining of competition and consumers as a uneasy marriage in which the parties rarely talk, or is it a deep and fruitful relationship?

Australia is not alone in combining consumer protection and competition law in a single instrument (and enforcement agency). The reason for this is simple: rampant competition without consumer protection is likely to lead to unfortunate and even dangerous consequences: consider the use of melamine in Chinese baby formula or horse meat in European lasagna. Conversely, there's little point in having well-informed consumers diligently shopping around unless multiple suppliers are actively vying for their custom. More than 20 years after its passing, the CCA (then known as the TPA) was given an objects clause which identified these factors: "The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection" (section 2).

While this theoretical underpinning is broadly accepted, there is a strong tendency to compartmentalise section 2 – Part IV, for example, may be considered to be for the promotion of competition, whereas the Australian Consumer Law (formerly Parts IVA and V) contains the provisions dealing with fair trading and consumer protection. This, however, can create a false dichotomy – one which is not in accordance with the historical context of the legislation, economic theory or political reality.

Why do we have competition law?

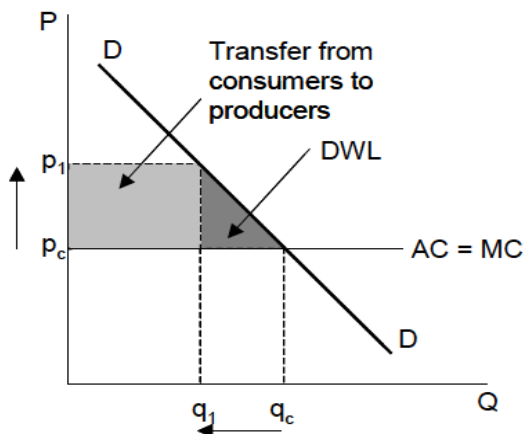
Efficiency vs transfers (aka: theory vs history)

There is a strong tendency to assume that competition law's highest goal is the promotion of efficiency. So when economists talk of reining in market power, they tend to do so in this context. What does it mean? The concept of efficiency includes technological developments ("dynamic" efficiency), reducing costs ("productive" efficiency) and ensuring that resources are allocated to those willing to pay a price that covers the costs of production ("allocative" efficiency). There tends to be a particular focus on

"The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection" (section 2)



And so are Julia, Tony & all their friends...



A simplified graph showing what happens when prices increase from the competitive level P_c to the monopoly price of P_1 . Quantity (Q) reduces, there is a transfer from consumers to producers and an overall loss to society known as the “deadweight loss”. For essential services, the deadweight loss is smaller again (relative to the transfer) as the demand curve (D) flattens out

the latter (and its corollary: reducing the “dead weight loss” that arises when resources aren’t allocated efficiently). Bork, a famous exponent of the Chicago school, states, “[t]he whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare”.

Caring about efficiency is quite different from caring whether consumers pay too much. According to many, competition law should be agnostic on the issue of “transfers” – these occur when consumers over-pay (relative to the costs of production) for goods or services. For some, a concern with transfers unduly elevates the welfare of consumers over that of others (eg suppliers and their shareholders). After all, when a consumer pays more to a producer than s/he “should”, there is no impact on the economy as a whole. Hence, it is argued, whether transfers exist is a distributional issue, and one which competition laws are ill-equipped to handle.

Nonetheless, Lande observes that “the redistributive effects of market power generally exceed the allocative inefficiency effects by a substantial amount” (as shown in the graph above). Indeed, he claims that “[u]nder market conditions most likely to be encountered”, the transfer is likely to be between two and forty times greater than the deadweight loss. So it is unsurprising that transfers tend to be the focus of political attention. Having analysed the Congressional debates which preceded the world’s first substantive antitrust legislation, the United States’ *Sherman Act*, Lande identifies transfers as the primary concern of the legislature; indeed, he notes that the concept of allocative efficiency “was, at best, on the verge of discovery” when the *Sherman Act* was passed.

Other concerns

There are other concerns which competition law can be used to address. For example, economists condemn the inefficiencies which arise due to businesses trying to obtain market power – this is generally known as rent seeking. Conversely, a more political assessment might point to the importance of small business as a reason to control market power. “Fairness” is also frequently cited. These sorts of “value-laden” assessments are much frowned upon by economists (although there is also a strong link between a vibrant small business sector and dynamic efficiency, as it tends to be the smaller players

who innovate). In any case, the protection of small business was frequently raised in the Congressional debates surrounding the *Sherman Act*, and it is still a notion with political traction here as demonstrated during virtually every election campaign in recent memory.

Determining the priority of concerns

These various concerns at times conflict; consequently, their resolution requires prioritisation. Krattenmaker et al argue that a broad conception of consumer welfare is the appropriate measure: “Under this interpretation, a practice restrains trade, monopolizes, is unfair, or tends to lessen competition if it harms consumers by reducing the value or welfare they would have obtained from the market-place absent the practice”. As such, the issue of transfers will be important. Efficiencies are also significant. Thus, in assessing whether say, a use of market power warrants regulatory intervention, the consumer welfare approach considers the efficiency gains that the conduct in question may generate as against its costs.

What is the object of regulating market power according to Australian law?

There is limited guidance as to how we should order our priorities in the Australian framework. The issue is particularly relevant here, as our legislation is very unusual in permitting otherwise anti-competitive practices if there is sufficient “public benefit” (this occurs via the authorisation and notification processes, which allow for exemptions from Part IV).

Similar to US legislative history, there’s little evidence to suggest that when the TPA was passed, it was designed to seek and destroy the deadweight loss. According to the second reading speech, the main focus was that highly charged issue of the early- to mid-1970s, inflation. The only other guidance is a general statement noting that the sorts of anti-competitive practices prohibited by Part IV:

cause prices to be maintained at artificially high levels. They enable particular enterprises or groups of enterprises to attain positions of economic dominance which are then susceptible to abuse; they interfere with the interplay of competitive forces which are the foundation of any market economy; they allow discriminatory action against small businesses, exploitation of consumers and feather-bedding of industries...

As such, consumers as well as small businesses appear to be the intended beneficiaries of the TPA (now CCA). Absent more specific direction from Parliament, it then falls to the Courts – and to a lesser degree, the Australian Competition Tribunal and the ACCC – to determine priorities as competing interests come into conflict.

The current rationale given by most economists... is that we regulate for reasons of allocative efficiency, or to reduce deadweight loss.... Most Australians would, of course, be surprised by this. They think we regulate to make sure that the owners of monopoly infrastructure do not take advantage of their position and ‘gouge’ consumers.

Rod Sims, chairman of the ACCC, speaking in the context of regulated industries in 2012

A close analysis of the approach of the Courts, the Tribunal and the ACCC to this question provides an interesting insight. The first observation is that each institution’s views have evolved – to varying degrees – over time. Further, there has been a clear shift from a consumer focus to an economic focus. Indeed, efficiency is clearly gaining primacy – particularly for

the Tribunal (eg the quote extracted below) – although that is less so for the Courts. That said, the ACCC is the only one of the three to grapple with developing an over-arching theme for the CCA/TPA: this may reflect the ACCC's broad role as against the other institutions (being the only one to actively work with each operative part of the Act). Thus, it is perhaps unsurprising that the ACCC is inclined to view certain issues within a broader policy context.

More specifically, the Courts and the ACCC do not consider that the object of the CCA/TPA should have different constructions depending on the Part in question, although the Tribunal does not necessarily agree. Indeed, the Tribunal appears to consider that the

Parts falling under its purview – the access provisions of Part IIIA and their telco-specific equivalent in Part XIC, as well as the authorisation/notification provisions in Part VII – require a specifically economic construction (in stark contrast to the High Court's recent decision in *Hamersley Iron*). While this is explicable in the case of the access regimes (as they have express objects clauses), it seems less obvious for Part VII.

It also appears to conflict with the Tribunal's statement in *Qantas* that Part VII has "broader social values" than those reflected in Part IV (to which Part VII creates exceptions). Given that the Courts most commonly consider policy issues in the context of Part IV, it is notable that the Courts themselves consider that broader notions of public interest (rather than purely economic welfare) apply to the operation of the CCA/TPA. Indeed, the Courts clearly do not endorse the view that Part IV has the solitary objective of promoting efficiency (specifically allocative efficiency) – on their view, the right policy mix lies somewhere between consumer welfare and efficiency (with the early years dominated by the former, but the latter more ascendant in recent times).

By contrast, efficiency increasingly appears to be virtually the *only* means by which the Tribunal measures public benefit. The Tribunal clearly rejects any distributional role for the CCA/TPA. That said, the Tribunal adopts an "efficiency plus" approach to assessing public benefit: there *are* some factors, falling outside immediate notions of efficiency, that the Tribunal is prepared to take into account (eg environmental impact). Even then, however, the Tribunal's preferred approach is to describe such factors in economic terms.

[I]f... for one reason or another, a [taxi] driver refuses to accept payment [by card] and as a result is punished, there is a detriment that should be brought to account. We do not mean that it is the punishment itself that is the relevant detriment. If the punishment is by fine, that is simply a wealth transfer...

The Australian Competition Tribunal is all about efficiency in Application by Michael Jools (2006)

The Tribunal's narrow approach to its role is reflected in its disinterest in the broad objective(s) of the CCA/TPA as a whole. It simply doesn't turn to section 2 for any substantive guidance to the Act's application. Similarly the Courts have generally declined to engage with the objects provision, with Kirby J being a persistent exception. Nonetheless, the majority of the High Court in *Baxter* marked a significant change in approach when it turned to section 2 to assist in resolving an important policy issue concerning the application of the Act. Generally, however, section 2 appears underutilised, particularly when the

Courts or Tribunal face policy issues such as the correct approach to predatory pricing.

This general approach of the Tribunal and the Courts contrasts with the ACCC, which has sought to articulate the purpose of the Act from its beginning. Even before section 2 was inserted (yes, when passed in 1974, the Act had a section 2 but it was later repealed... long story), the ACCC's predecessor consistently tried to describe what the Act was intended to achieve. Indeed, the ACCC's greater focus on consumers as compared with the Tribunal and – to a lesser extent – the Courts, suggests that its understanding of the "welfare of Australians" is quite consumer-oriented. This is exemplified not only by its enforcement priorities but also its approach to the public benefit test.

Anything that potentially damages consumers is a concern for us (Rod Sims, ACCC)

A detailed review of their respective activities shows that the Tribunal adopts a much narrower view of the CCA/TPA's purpose than do the other institutions. Doubtless, this reflects the Tribunal's limited role in respect of the Act; but, given the significance of the Tribunal for regulated industries, it implies that such industries are subject to a slightly different approach than industries whose only contact is with the ACCC or Courts. Given that regulated industries tend to be those providing essential services – which are often subject to Government policies concerning equity of access and pricing – the Tribunal's approach seems a little out of step. As the workload of the Tribunal appears only to increase, it will be interesting to see whether this difference in approach continues.

So where does consumer protection fit it?

As the cricket and tennis fade from our screens, the current affairs shows are back, along with their staple diet of scams: shonky car dealers, dodgy builders, high pressure sales tactics and fruit juice cures for cancer. Why are consumers vulnerable to such chicanery and does competition law have a role in reducing its impact?

Consumer detriment, a term used more in Europe than in Australia, has been defined by the United Kingdom's Office of Fair Trading as "the loss to consumers from making misinformed or uninformed choices". The OFT has also said the term encompasses "the difference between the outcome that consumers experience with the available information and the outcome they would experience with the further information they could usefully obtain and assimilate, perhaps by additional shopping around". Notably, these approaches focus upon *access* to information, with only a hint in the second quote that there might be some failure to properly *use* the available information (we'll discuss this in more detail below). Perhaps the term "consumer risk" – which is slightly broader – is more useful: this can be thought as occurring wherever consumer welfare would be higher but for specific conduct by suppliers.

Regardless of your preferred terminology, when consumers experience detriment or additional risk, the result is inefficiency. As Earl observes, "consumers pay more to meet their goals, or to obtain particular bundles of consumption characteristics, than they needed to do, or they fail to meet goals they could have achieved had they used their resources differently".

Historically, consumer issues were thought to arise because markets were not sufficiently competitive, eg there were few alternative suppliers for a particular product resulting in limited bargaining power for consumers. For this reason, a strong competition policy was seen as the means of protecting consumers. Even today, notwithstanding other protective legislation, the US antitrust provisions are seen as its cornerstone for consumer protection.

But experience shows that highly competitive markets may be precisely the sort of environment that stimulates attempts to mislead and deceive consumers. The competitive nature of the market provides the incentive for producers to cut costs and increase profits. Avoiding costs associated with particular product attributes – eg

environmentally responsible production, reduced food additives, ethical trading practices – but still charging a premium for those attributes boosts profits.

Such conduct, however, is only possible if there is a deficit of information. This may occur because the information necessary for informed decision-making is only available to the producer and not to the consumer (asymmetric information) – for example, eggs may be advertised as free-range but consumers can't verify this themselves. Alternatively, it may be because consumers are overwhelmed by the extent of information available and decide to “opt out” of the process.

But where is the consumer?

To date, our understanding of the consumer in all this is pretty limited. Although the consumer is held up as the (or at least one) objective of our laws, this consumer is considered to be economically rational and hence predictable – thus s/he is also silent and passive. This paradigm is finally starting to be re-considered (we'll write about behavioural economics soon). For present purposes, however, it's enough to note that where consumers do not actively participate in markets – eg by searching and comparing prices, quality and service – previously competitive markets will soon cease to be so.

Consider, for example, the move to full retail contestability in the electricity market – as part of the final transition to a competitive market, consumers who had previously been allocated a specific retailer were granted the right to choose between several. When first offered this choice, the overwhelming response of consumers was to do nothing.

Upon investigation, consumers were found to be interested by potential price savings but they lacked faith in the market to deliver such savings (or better service). In particular, they were strongly suspicious of retailers' profit motives in a privatised market structure. This lack of faith and corresponding suspicion can become self-fulfilling: if customers are largely unresponsive, then there is little point in suppliers competing vigorously. As observed (admittedly some time ago) in the United Kingdom's electricity market, “customer inertia has resulted in extensive monopoly pricing, raising doubts as to whether the domestic market could ever be considered functionally competitive”.

Sharam observes that “[r]emarkably, in developing policies to introduce competition to the household sector, neither the Kennett nor Bracks governments assessed Victorians' attitudes to competition” – once again, the consumer was assumed to be predictable and consequently rendered mute. Such an approach to consumers can lead to the creation of policies for “our own good” – current examples arguably include the imposition of smart meters in electricity, or the change from an opt-in process for the NBN to an opt-out.

There's a conundrum here: a competition policy that assumes consumers to be mute and passive can result in consumers who are just that – but such consumer behaviour itself leads to ineffective competition.

Why are consumers passive?

Consumers may fail to engage with a market for various reasons. For example, they may assume that the market is competitive and so there is no need to do their own research. Perhaps the time and money it takes to shop around is not worth it. Then again, it may just be too hard to compare products properly.

Vigorous competition can in fact lead to disengagement. Joshua Gans co-opts the Dilbert notion of “confusopoly”, whereby suppliers actively engage in strategies to make price comparisons more difficult. Consider the traumatic process of selecting a new mobile phone plan: can you really tell which offering delivers the best price and conditions for your needs? Or do your eyes start to cross as you try to compare the value of data options and “free” minutes, meanwhile interviewing your entire family to work out whether you're a chance to take advantage of free calls on a given network?

Gans cites the work of Ran Spiegler, which demonstrates how businesses can use “frames” (the manner in which they present their offerings) to soften competition. Gans summarises Spiegler's analysis as follows:

the frame one firm uses has to be able to counter their rival's incentive to jump to greater transparency and offer discounts. Put simply, if you are worried that a rival... may move to break up the confusion, you will want to respond by changing the frame to counter that strategy. Specifically, you will use strategies (more coupons, more deals and more time pressure) that make your prices hard to compare to a transparent but low price. Thus, while some economists... have argued that firms can profit from honest pricing, their competitors can take actions to mute that...

It's no coincidence that much of the ACCC's enforcement activity in recent years has been in this space: proceedings have been brought against several telcos (Optus, TPG, SMS Global, Global One), and there are also numerous undertakings on the register. As all first year lawyers know, however, these cases are not premised on mere confusion – the conduct must be likely to mislead or deceive. Accordingly, such cases are only the tip of the iceberg when it comes to conduct which damages the competitive process by confusing the public.

How do we get engaged consumers?

One approach currently on the political agenda is the idea of a consumer advocate, an independent body that acts as the voice of consumers. Last December, faced with community concerns about steep increases in regulated charges for energy networks, the Council of Australian Governments agreed to a package of reforms including the development of such a body for the energy sector.

The basic idea is to create an independent body that represents and advocates on behalf of consumers to Governments, regulators and industry. Successful consumer advocates also become a trusted source of information and advice for consumers, even helping to explain unpopular policies.



There's not enough coffee in this world to make mobile phone plans intelligible

Establishing a successful consumer advocate requires serious investment in building up a knowledge bank and skill sets equal to the lawyers and consultants who typically represent the “big end of town”. It also requires genuine independence and that means Governments and regulators ceding some “ownership” of the consumer interest to the consumer advocacy body. For example, what happens if the elected Government thinks it understands consumers (ie voters) better than their appointed advocate?

A consumer advocate also raises the interesting prospect of how Governments and regulators may feel about being taken to task by an fiercely independent body that is not prepared to allow consumer interests to be used for political ends.

Conclusions: political football vs Parliamentary sovereignty?

Those of us who practise in competition law (your authors included) can tend to be a little proprietary towards the Act – and we get particularly protective at this stage of the political cycle when “our” Act seems to be used to buy votes from the small business lobby/consumer groups/big business/bank bashers/[insert other interest groups here]. Yes, the CCA is often the means by which many and varied problems – actual and perceived – are sought to be resolved: in part, this is what makes our work so interesting. Our legislation lies at the heart of the Australian economy and is indeed the most important tool for its regulation. But before we get too resentful of the political process, perhaps we should recall that those sitting in Parliament are elected, while we are not. If voters look favourably upon the promotion of consumer welfare over economic efficiency, then who are we to disagree?

There's been plenty happening in the consumer sphere already this year

The High Court found that **Google** is not responsible for misreps made by advertisers using its AdWords service. As observed by the majority, “Google is not relevantly different from other intermediaries, such as newspaper publishers... or broadcasters... who publish, display or broadcast the advertisements of others. The fact that the provision of information via the internet will... necessarily involve a response to a request made by an internet user does not, without more, disturb the analogy between Google and other intermediaries”.

In the **Lux** case, the Federal Court found that pressure sales tactics used by door-to-door salespeople to convince elderly folk – some with dementia – to buy vacuum cleaners did not amount to unconscionable conduct. The judgment is pretty black and white in its approach to unconscionability but is largely unremarkable. That said, Jessup J's assessment of the term “equivalent” is reminiscent of early attempts to define markets (anyone for a Datsun?).

The ACCC wants to take the **TPG** decision to the High Court, after the Full Court allowed in part TPG's appeal relating to alleged misreps in its broadband advertising. If special leave is granted, the High Court will consider not only the nature of the representations but also – for the first time – penalties under the Australian Consumer Law.

Jewellery outlet **Zamel's** was pinged \$250,000 over the use of “was/now” pricing representations.

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Rachel and Alexandra are both Australian Legal Practitioners within the meaning of the Legal Profession Act 2004 (Vic), with liability limited by a scheme approved under Professional Standards Legislation.

Further reading

There are heaps of interesting articles on this issue (and we'll post some links on our [reading page](#) soon; feel free to [email](#) us in the meantime), but here's one recent working paper that's particularly intriguing: Maurice Stucke, *Should competition policy promote happiness?* Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2203533. Maurice is inviting comments and would welcome your feedback.

Next issue

We'll be looking at the various filing options with the ACCC, and consider why some have fallen out of favour.

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