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Promises to meet the competition seem to be pro-competitive, but sometimes have a sting in the tail. In this issue of The State of Competition, Alexandra Merrett and Rhonda Smith examine the economic implications of MTC offers, before considering what – if anything – the law can do to prevent some less than desirable consequences.

"Lowest prices are just the beginning!" Can promising to beat the competition really be anti-competitive?

At first blush, a promise to "meet the competition" (**MTC**) looks like competition in action. Indeed, sometimes merging parties might undertake to the Australian Competition & Consumer Commission to meet the competition to ease the way for their transaction. An MTC offer ensures that the customer is entitled to the best price available in the market, not just the best price offered by a particular supplier, even if the customer makes no ongoing commitment. So how can the customer lose?

A promise to meet the competition is generally in the form of a unilateral offer, to all actual and potential customers. Sometimes the offer is only to match a competitor's price; often it is to beat it and sometimes it applies over a period of time. For example, a recent price guarantee in the supermarket industry promises that, when you use a certain credit card, if a product's price changes by X amount over Y time, you'll be refunded the difference. Promising "lowest prices everyday" is a little more vague, but is still a form of meeting the competition.

Often an offer to meet the competition forms part of a firm's entry strategy into a new market. It acts to assure potential customers – you'll pay no more than you currently do - giving them confidence in acquiring from the entrant. An established firm might also use this approach when re-positioning itself, for example an exclusive (and expensive) supplier wanting to broaden its customer base.

But the customers win, right?

> **The benefits for customers seem obvious: you'll save money, without having to expend much effort looking for the best deal**

The benefits for customers seem obvious: you'll save money, without having to expend much effort ("search costs") looking for the best deal. There seems to be an implied condition that the supplier's prices aren't higher than its competitors and won't increase above them. So

the customer is sure to get a good deal otherwise the supplier incurs a penalty. But the value of the offer depends upon the customer's vigilance – ultimately, the customer has to conduct the necessary market research to ensure that the MTC offer is "enforced". So it's doubtful whether customers do in fact have reduced search costs or whether those costs simply shift time periods from before the purchase until after.

Another apparent benefit of offers to meet the competition is the incentive they create for suppliers to minimise their costs, to be as efficient as possible. Otherwise buyers will be free to acquire from lower priced suppliers or may be entitled to some form of compensation if a cheaper supplier exists.

But MTC offers actually have the potential to increase the market price. Take, for example, a major retail chain that engages in extensive advertising proclaiming that it will not be beaten on price and that, should customers find a better price, the chain will beat it by a given percentage. Consider smaller competitors in that market. They know they can't compete on price – any attempt to lower prices to attract customers will be beaten by the chain. If they were to lower their prices, there would be no increase in sales and profits would in fact fall. Price competition therefore becomes irrational and the likely effect of the chain's advertising campaign will be to harmonise prices across all suppliers in the market.

It might even be possible for a major player, acting as the market's price leader, to raise prices above the competitive level. This strategy will be profitable if at least a proportion of its customer base faces high search costs or is relatively uninformed about alternative prices. This might be due to a false sense of security that such an offer wouldn't be made unless the firm offering it is price competitive. Indeed, so long as at least some customers are uninformed about price, it will be a profit enhancing strategy to offer to meet the competition whatever price is chosen.

As for the rest of the market, when the price leader offers a price guarantee (even if its prices are high), it is pointless for small competitors to try to undercut it. In fact, typically, they will charge the same supra-competitive price. Consequently, an MTC offer can mimic the outcome of collusive activity: it enables a "collusive" price to be determined unilaterally (initially by the price leader, and subsequently by each remaining competitor) and it also provides a mechanism for unilateral changes to that price. Hence, there is no agreement between competitors. Further, it effectively removes the incentive to "cheat" on the collusive price thereby eliminating the need for monitoring and punishment.

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So, although firms may still engage in non-price competition (eg through innovation), an offer to meet the competition can "soften" competition as a result of its unfavourable impact on price competition.

Conditions necessary for competition concerns

Of course, not all offers to meet the competition are bad for competition or consumers. To impact on the rest of the market, the firm offering to MTC must at least have a substantial market share (but not necessarily substantial market power) in order for competitors to adapt their pricing behaviour. On the other hand, a new entrant trying to attract customers by providing some assurance it is price competitive via an offer to MTC would be unlikely to have the anti-competitive effects described above. But in a market with only a few players, a firm offering to MTC may be large enough to influence the others, especially if they recognise the benefit of treating that firm as a market leader.

Can undertakings to meet the competition fix competition problems?

Occasionally, a company might offer to meet the competition to allay the concerns of competition authorities (for example, in a merger context). As we noted earlier, a commitment to meet the competition appears to protect buyers as it links the supplier's price to an alternative supplier's.

But let's consider a market in which there are just two suppliers of cement used for producing ready-mix concrete. They wish to merge and, to overcome any perceived competition problems, undertake to the regulator to include an MTC clause in all customer contracts. Consequently if imports are cheaper than the local product, the merged entity will have to match the imported price or its customers are released from their supply contracts. This appears to confer some countervailing power on customers by providing them with an "out" from their contractual commitments if a better offer comes along.

But imported cement incurs higher costs than its local equivalent – it is bulky and hence expensive to transport; it's also prone to water damage and so must be insured. Consequently, if the merged entity can price at import parity post-merger, rather than at a price determined by domestic

competition, it may achieve a significant margin above the competitive price. Finally, knowledge of the undertaking to MTC is likely to reduce the incentive for importers to undercut the local supplier, as they'll know that the latter can afford to match any discounts. In other words, the offer to MTC merely entrenches (or even enhances) the merged entity's ability to engage in limit pricing.

Here, not only does the offer to MTC fail to confer any significant countervailing power, it does not even confer any meaningful increase in bargaining power. An undertaking to offer to MTC will therefore be an ineffective remedy for the perceived competition problems associated with that merger. An MTC offer where made by the market leader means the market is only as competitive as the next most significant player makes it. At best, therefore, such promises may be competitively neutral. However, if the agreement is to "meet or release" (ie the price is matched, or the customer can go elsewhere), the position is worse as the supplier can set prices above the competitive level and, if challenged, will not lose customers so long as it is prepared to match competing prices.

An MTC offer by the market leader means the market is only as competitive as the next player makes it

Mind the gap (between law and economics)

Of course, just because something lessens competition doesn't mean that the law will automatically stop it. (Sorry if we've dashed your illusions!) Offers to meet the competition are likely to attract the attention of Australian law in one of three ways: potentially as a misuse of market power (section 46 of the *Competition and Consumer Act* (**CCA**)); as an arrangement having the purpose or (likely) effect of substantially lessening competition (section 45); or in a merger context (section 50).

Because section 46 requires the pre-existence of market power, it is less well suited to capturing competition problems resulting from an offer to MTC than, say, the US *Sherman Act*. So, if a firm doesn't start with market power but acquires it due to its anti-competitive conduct, section 46 is ineffective. If the relevant company does have market power from the beginning, it may still be very difficult to show that the MTC offer amounted to a use of that power. But *ACCC v Safeway*, it should be remembered, involved somewhat similar conduct and there the Full Court ultimately decided there was a contravention of section 46.

Past experience gives little reason for optimism that the law is able to address the problem

As for demonstrating an anticompetitive arrangement, we've outlined above why offers to meet the competition can facilitate tacit collusion without ever giving rise to an arrangement that would trigger the cartel provisions set out in Division 1 of Part IV of the CCA. In true hub and spoke fashion, the relevant arrangements are between suppliers and customers, not between competitors.

But the general prohibition in section 45 against arrangements resulting in a substantial lessening of competition (**SLC**) may prompt some interest. Under Australian law, it is possible to aggregate the competition effects of multiple arrangements. For section 45 to be triggered, the parties do not need to be competitors and the aggregation power, although never tested, seems broad enough to capture

multiple arrangement even where there are different parties involved.

That said, an offer to meet the competition (even when formalised in a supply contract) is unlikely to amount to an SLC in and of itself. But it may by an important evidentiary component of a broader SLC case, particularly where the offer bolsters exclusive relationships. MTC offers can form part of a broader range of conduct – for instance, there may also be a "most favoured customer" clause in operation (as can occur in the supermarket industry), or there may be a variation of meeting the competition in the form of a "last bidding right" clause (as has occurred in football broadcasting). Understanding this broader context will be vital for discerning the true impact on competition.

Ultimately, the most likely scenario in which an offer to meet the competition will attract legal consideration is a merger. As we've shown, MTC practices in an industry may support tacit collusion. The ACCC's recent interest in "co-ordinated effects analysis" is a means of taking these practices into account, even where they are largely informal.

So the practical implications may be two-fold. First, where such practices already exist, they may suggest that tacit collusion is a possible problem, meaning that a given merger is more likely to SLC. Secondly, parties to a merger might offer an undertaking containing a commitment to meet the competition to smooth the way for their transaction. As shown above, such an undertaking in fact offers little or no protection from adverse competition effects. Indeed, a promise to MTC may effectively increase barriers to entry and thereby exacerbate any perceived harm from the transaction.

Wrapping up

In our view, offers to meet the competition by firms with a substantial market share should be presumptively anti-competitive, especially when they take the form of "last bidding rights" or a "meet or release" clause. However, MTC offers when made by small firms or new entrants may provide a means of reducing the risk for customers of leaving a known supplier, thereby lowering barriers to entry in the relevant market.

To the extent that such arrangements do raise competition concerns, past experience gives little reason for optimism that the law can address the problem. Prohibitions on unilateral conduct are particularly problematic because pre-existing market power is not required for these practices to be anti-competitive. Furthermore, particularly when combined with other arrangements, MTC offers may facilitate anti-competitive outcomes that might otherwise not be achievable. Consequently, competition regulators must be vigilant in their assessment of MTC offers.

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Further reading

If you'd like to know more about this topic (or would like some real examples of the issues we've discussed), you might find the following publications interesting:

• Rhonda L Smith and Alexandra Merrett, "Playing favourites: the competition effects of preferred customer arrangements" (2011) 7 *European Competition Journal* 179

• Aaron S Edlin, "Do guaranteed-low-price policies guarantee high prices, and can antitrust rise to the challenge" (1997) III *Harvard Law Review* 528

• Australian Competition and Consumer Commission, *Public Competition Assessment: Boral Limited's proposed acquisition of Adelaide Brighton Limited* (12 May 2004). Available at: http://www.accc.gov.au/content/index.phtml/itemId/866138