the state of COMPETITION

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In the 1976 decision, Re QCMA, the Competition Tribunal articulated the concept of the market. It spoke of a "field of rivalry" that sets limits on the ability to "give less and charge more". Section 4E of the* Competition and Consumer Act *defines the market to include products that are "substitutable for or otherwise competitive with" each other. Want to test if two products are in the same market? Some might say, "just find an economist and do a 'SSNIP' test". But, when a market is changing profoundly, it's not so easy.

Substitutes & football: a primer in market definition

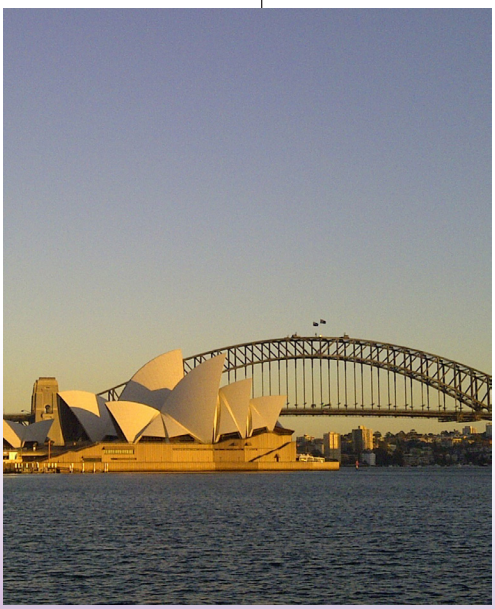
From St Kilda to Kings Cross is thirteen hours on a bus observed Paul Kelly in a song that has become embedded in our cultural psyche. (That's the musician, not the AFL Brownlow Medallist and former Sydney Swans captain.) Fortunately for fans of the other Paul Kelly, the trip is a lot shorter by plane.

And so it was that, over the last weekend in September, droves of Melbourne Storm fans headed north for the NRL grand final while Sydney Swans fans travelled south for the AFL decider. Demand for air travel between Melbourne and Sydney that weekend was so great that both Qantas and Virgin scheduled extra flights.

Meanwhile, in television land, large numbers of fans in the NRL heartland tuned in to watch the AFL and even more switched on their sets in the home of AFL to watch the rugby league.

So with the AFL cup enjoying views of Sydney harbour and the NRL trophy now a mere Cooper Cronk drop kick away from the MCG, are we seeing evidence of competing or complementary products? To put it another way, are Aussie rules and rugby league now in the same market, as suggested by Justice Burchett back in the 1996 *Superleague* case?

"I'd give you all of Sydney Harbour (all that land, all that water), for that one sweet promenade"



Rusted on: according to the song, Paul Kelly's never going to consider Sydney Harbour a substitute for St Kilda.

Superleague

Superleague was a rugby league competition established by News Limited in the mid 1990s following an unsuccessful attempt to acquire pay TV rights for the established competition. It ran for one season in 1997 alongside the Australian Rugby League (**ARL**) before the two were merged to form the present day NRL.

The litigation arose because the ARL had sought to lock in clubs to the existing competition. News Limited challenged these loyalty commitments on a number of grounds under competition law.

The challenge was initially unsuccessful because News Limited did not establish the rugby league specific markets it had pleaded. On appeal to the Full Court, News Limited succeeded in having the loyalty commitments declared void as "exclusionary provisions" (defined in section 4D of the *Competition and Consumer Act*), a finding that did not depend on establishing narrow rugby league markets.

The *C7* case

The *C7* litigation a decade later involved the claim by the Seven Network that, in the early 2000s, Foxtel/Fox Sports had acquired the pay TV rights to both AFL and NRL matches to put Seven's pay TV sports channel C7 out of business.

In a complicated case that failed at trial and on appeal, Seven asserted a number of pay TV focused markets, including separate markets for *AFL pay TV rights* and *NRL pay TV rights*.

The trial judge took the view that, at the time of the conduct, the respective products supplied by Fox Sports (an NRL sports channel) and C7 (an AFL sports channel) were not substitutes in demand or supply due to audience differentiation and loyalty to the individual codes. So these products were not in the same market and on this point the economic experts in the case agreed.

The Full Court accepted that both AFL and NRL have large numbers of loyal followers, many of whom would never consider defection from one code to the other. "However we do not accept that such loyalty necessarily justified the assumption that Fox Sports and C7 would not have sought to 'convert' existing subscribers who had such loyalties, attract existing subscribers who had no current loyalties or attract new subscribers. These are areas in which one would expect fierce competition."

The Full Court noted that this rivalry between pay TV sports channels "would have reflected the rivalry between the sports themselves."

Substitutability and loyalty

Defining markets is essentially about identifying the most immediate constraints on the decision-making of a firm (or a group of firms). This results when buyers and/or sellers (whether actual or potential) are able to respond to an increase in price because substitution possibilities exist.

But what does substitutability mean in situations of 'rusted on' consumer preferences? The point was illustrated by the Full Court in the 1990 *Arnotts* case:

> *The fact is that tea and coffee are distinct beverages, for each of which there is a distinct demand. To adopt the test applied in QCMA, a rise in the price of tea would probably cause few consumers to abandon tea for coffee.*

The argument put forward by News Limited in the *Superleague* case was that a major professional sport is a market in itself. This was based on the concept of loyal core supporters, in particular the notion that there were a large number of rugby league fans for whom no other sport was an acceptable substitute, making rugby league a unique channel to reach this demographic for marketing and TV programming.

The case was put that these fans may have some level of interest in other sports, "but their sport is rugby league". And at that time, particularly in New South Wales and Queensland, that proposition would no doubt have been widely accepted as reasonable by the average punter on the Bondi tram (so to speak).

So why back in 1996 did Burchett J reject the argument that separate rugby league markets existed, whether for supporters, sponsors or media rights? Does part of the answer lie in stories of kids like Kieran Jack (Sydney Swans premiership player and son of rugby league legend Garry Jack) who was then in primary school playing both codes and yet to decide his future professional path?

> If you had asked Garry [Jack, rugby league legend] in 1989 if he thought he would one day be at the MCG watching his son play in an AFL grand final, his response would have been emphatic.
>
> "You're dreaming. That's what I would have said, you're dreaming," Garry said.
>
> ***- Sydney Morning Herald***

Burchett J went back to first principles and countered the tea v coffee debate with a cola wars analogy of his own:

> *No doubt, there is a core group of persons for whom the taste of coca-cola is supreme, and for whom pepsi-cola is a poor alternative. They would not easily be lost to their favourite taste. Yet if the significant body of customers who buy what appears the best value at the time would be lost by a marketing decision, that would be a real constraint on the commercial behaviour of Coca-Cola, no matter how confident the company might be about its core customers. In the appropriate economic sense, pepsi-cola is plainly substitutable for coca-cola.*

The key is the size of the marginal group, something that may well be hard to measure.

Applying this to rugby league, Burchett J conceded that a core crowd might be hard to dislodge but "if a significant body of spectators attracted by an enjoyable game at an appropriate price were at risk of being lost to rugby league, that would be a real constraint on any attempt to lower standards or raise prices, irrespective of how firm the loyalty of the core crowd might remain".

Burchett J was satisfied that the commercial evidence before him showed a real sensitivity to any reduction in the quality of games that might lead to a "melting away" of crowds and, in the long run, even the erosion of core crowds.

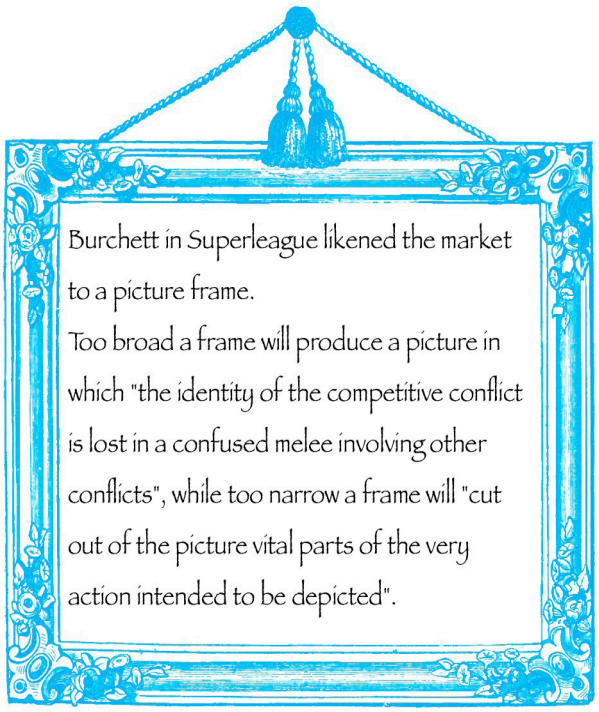
The language used by Burchett J also foreshadowed an important point that emerged in a 2004 US merger case involving Oracle and PeopleSoft. In that case, evidence from customers was rejected on the basis that their opinions spoke to preferences all else being equal, rather than substitutability premised on the supplier of their preferred product giving less or charging more.

The SSNIP test addresses effects but not the way competition occurs

Typically the relevant price increase used by economists for testing market definition is a small but significant, non transitory increase in price above the competitive level (a **SSNIP**).

For nearly all products, there will be a response if the price increase is large enough or the time period allowed is sufficiently long. On the other hand, if insufficient time is allowed, responses will be muted and markets may be defined unduly narrowly. So what is the right length of time to test the responsiveness of customers and suppliers to a SSNIP?

As the Tribunal remarked in one of its early decisions (*Tooth & Toohey's,* 1979):



> *...competition may proceed not just through the substitution of one product for another in use (substitution in demand) but also through the substitution of one source of supply for another in production or distribution (substitution in supply). The market should comprehend the maximum range of business activities and the widest geographic area within which, if given a sufficient economic incentive, buyers can switch to a substantial extent from one source of supply to another and sellers can switch to a substantial extent from one production plan to another.*

The Tribunal looked to the policy objectives of the legislation, and famously concluded that "it serves no useful purpose to focus attention on a short run transitory situation...We consider we should be basically concerned with substitution possibilities in the longer run".

So what is the long run?

In the short run certain factors cannot be increased or decreased as the level of demand alters. Firms can only expand output in the short run by more fully utilising existing capacity and by acquiring more variable factors such as labour and raw materials. However, in the long run, fixed factors become variable and firms can adjust factor inputs to changing market conditions and they may enter or leave the market.

But the calendar time necessary for long run responses (and indeed short run responses) can vary greatly between industries or even within an industry: it depends on technology.

It was put to Burchett J that rugby league had been slow to respond to some of the demographic challenges it faced in its heartland. He had to consider "whether that is because rugby league is controlled by a monopoly in a narrow market, or whether, despite the long run competitive forces in a wider market, there are factors which account, in the short run, for a relatively slow pace of change".

Burchett J recognised that the game's governing body was motivated not just by the pursuit of profit, but also by considerations of preserving and enhancing the traditions of the game. In a delightful passage, he reminded us that "the Good Samaritan delayed his business, and expended some of his funds, to serve a higher duty" and made the point that where moral considerations impinge on the forces at work in the market then they must be taken into account if the defined market is to accord with reality.

Adopting a wide-angled lens changed the perspective:

> *A mere decade into the great changes that have occurred in rugby league, it may be quite wrong to see the conduct of its administration as evidence of freedom from the kind of 'long run dynamic constraints' the existence of which would indicate it was indeed operating within a wide market.*

Burchett J emphasized that long term constraints can form part of the present reality. So while young Kieran Jack was playing Aussie rules on Saturday and rugby league on Sunday, Burchett J was observing that: "Plainly, the future of the game requires the maintenance of a minimum pool from which to draw players, and it would be unrealistic to look at rugby league's position vis-a-vis other sports only in the short term."

On the other hand, in *C7,* Sackville J took the view that "If the AFL and NRL… appeal to different audiences (the position Seven itself adopts) it would seem to follow that an AFL sports channel supplier would be unlikely to constrain a SSNIP by an NRL sports channel supplier".

The Full Court did not quite see it that way. It saw both Fox Sports and C7 as being sports channel suppliers rather than suppliers of either AFL or NRL content. The Full Court acknowledged that to be successful a sports channel supplier needed a 'marquee' sport such as AFL or NRL, but noted that, "In the longer term each had the potential capacity to displace the other as supplier of the latter's Marquee Sport".

The Full Court accepted that many subscribers may choose a particular pay TV platform because it carried their sport of choice. It accepted that, like changing religion, switching football codes might not be common but said it can't be assumed this would never happen.

The substitutability issues thrown up in the *Superleague* and *C7* cases are interesting because the SSNIP test could not be applied in a quantitative manner. Rather, a qualitative approach was required. Indeed, Sackville J in *C7* seemed doubtful as to whether it is ever possible to apply the SSNIP test on the basis of purely quantitative data, as the starting point for a SSNIP requires a calculation of the elusive competitive price for the product in question.

The Full Court in *C7* went further, cautioning how the SSNIP test is used given the richness of the concept of competition and the fact that it may take many forms: "competitive conduct may not have an immediate and obvious effect upon those matters. Particularly in a relatively new industry, competitors may be looking for longer term, rather than shorter term, advantages."

"The SSNIP test addresses the effects of competition, but it does not define the way in which it occurs" (the Full Court in *C7*)

As usual there's a nugget of gold in the Swanson Report

Back in 1976, the Swanson Committee discussed testing competitive effects according to effect on competition between particular competitors versus testing competitive effects by reference to the concept of the market. There is a subtle, but important, difference between the two that can easily be lost.

For those with a few hours to spare, pick up some statements of claim and see how often the alleged lessening of competition is described as a lessening of (price) competition between existing competitors, without explaining why this equates to a lessening of competition in the market. Although the naked eye might sometimes be satisfied, under the scrutiny of the video referee, near enough may not be good enough. So it's not surprising if such cases fail in court.

The Swanson Committee believed no attempt to define exhaustively what the term "market" means could produce a formula capable of certainty, particularly in the context of our competition law regime:

> *Importantly also, the Committee has regard to the fact that persons involved with particular cases wish the matters in dispute to be judged on the particular facts, as they may present them, and not by artificial rules designed to achieve what we would suggest is illusory certainty.*

Market definition as a tool for what?

The comment by the Swanson Committee is a reminder that the regime in Part IV of our Act is not necessarily about seeking some universal truth as to the correct market. Rather, the courts are trying to decide particular matters in dispute and the right market definition will be the one that is most appropriate to that task.

Sometimes this has been referred to as the difference between defining an economic market and defining an antitrust market.

Burchett J in *Superleague* raised an interesting point. What if something is seen as anti-competitive in a narrow economic market but pro-competitive in a wider market? This is not the same as defining away a problem (eg defining a hot beverages market that includes coffee simply in order to mask a dominance in tea).

The point is that, if a wider perspective reveals there are competitive forces at play beyond the narrow economic market, these cannot just be ignored.

> *[T]he paradox of a practice or arrangement being both anti-competitive and pro-competitive at the same time may fairly lead to a reconsideration of the market within which the practice or arrangement ought properly to be seen as operating...*

Burchett J found great force in the view that the effect of the loyalty arrangements was to increase competition in an entertainment or sporting entertainment market and, on that basis, "If the relevant entertainment or sporting market is defined too narrowly this will give the false appearance that competition is being restricted when in fact it is being enhanced".

Draining the hot tub – throwing the economist out with the bath water?

Market definition used to be seen as the domain of the expert economists quantifying the effect of a SSNIP and battling it out with each other in the 'hot tub' (see further reading). But economic evidence seems to be a bit on the nose at the moment. Perhaps the issue is more about how economists have been used, rather than their usefulness.

In the *C7* case, Sackville J commented that, "One consequence of the limitations of the SSNIP test (in the absence of quantitative data) is that in certain respects the economic evidence may not be as helpful as its volume (and the time spent on it in cross-examination) might suggest".

Market participants may be oblivious to the invisible hand that guides their actions. That's where qualititave economic analysis can help.

Sackville J identified two reasons why qualitative economic evidence is "apt to be less cogent". First, it involves the exercise of subjective judgement that, without specific industry experience, may come close to speculation. Second, it requires assumptions to be made (as the facts have not yet been established by the court) which can become "extraordinarily elaborate".

But the invisible hand at work in markets is not called invisible for nothing. Market participants may have no choice but to react to forces which they don't fully understand and cannot articulate. The evidence of market participants is also likely to be evidence of incumbency that may not reveal what innovators might do and how things might be done differently.

This is where an economist can provide a useful perspective to assist the court, particularly if market boundaries are evolving or are in transition.

Market definition is based on shifts along the demand (or supply) curve in response to price changes, rather than increases or decreases in demand (or supply) resulting from a change in some other determinant. The longer the period allowed for responses, the greater the risk that determinants of demand (or supply) other than price will also change, causing the demand (or supply) curve to shift and so confusing the issue.

This troubled Justice Finkelstein in the 2001 Full Court decision in the *Boral* case involving the pricing of concrete masonry products. Tilt-up and pre-cast concrete were new

products introduced in the 1980s. Producers of concrete masonry products responded by dropping prices to protect sales. Did that indicate substitutability or a market adjustment (downward shift of the demand curve) that was largely complete by the time of the conduct?

Economics is a social science

In the 2006 *Liquorland* decision, Justice Allsop identified his primary task as being to decide whether the markets pleaded were "a rational and appropriate analytical tool" with which to assess the matter before him. That decision involved assessing, as a whole, evidence comprised of "a diffuse body of facts and assertions, often personal and anecdotal".

In performing that task, Allsop J saw the economist as bringing a helpful perspective that gives "form or construct to the facts" rather than "the ascertainment of an identifiable truth in which task the Court is to be helped by the views of the expert in a specialised field".

> *Because it is a social science, and because it is a way of approaching matters and a way of thinking about matters, there is a role, for the economist to assist the court by expressing, in his or her own words, what the human underlying facts reveal to him or her as an economist and what it reflects to him or her about underlying economic theory and its application.*

And that is nailing the ball perfectly between the goal posts!

As for our initial question asking whether Aussie rules and rugby league are competitors or complements? Maybe in another mere decade we'll know the answer for sure.

Courtesy of the C7 transcript (with thanks to Julie Clarke), here's an insight into the tortures of that trial:

Noel Hutley for News: "The worse thing that can happen in this case is that the timetable breaks down."

His Honour (Sackville J): "The worst thing that can happen is that the judge breaks down."

Hutley: "Your Honour looks in glowing good health. We check every morning."

His Honour: "On January 1, 2006, Mr Hutley, when the temperature was 45 degrees, I climbed up on a ladder in order to clear the garage of our holiday home from leaves."

Hutley: "You should have told us, your Honour, we would have done it."

About the authors

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Rachel is an 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

• A good summary of the *Superleague* case can be found at: http://www.australiancompetitionlaw.org/cases/superleague.html

• There's also a summary of *C7* (unless you're keen to read the 1000+ pages yourself... and that's just first instance): http://www.australiancompetitionlaw.org/cases/c7.html

• If you'd like to see a hot tub in action, here's a "remake" of the evidence given in *Boral*: http://clen.law.unimelb.edu.au/index.cfm?objectid=BF008DE3-5056-B405-51FD73A645F8DB96&flushcache=1&showdraft=

• And, if you're feeling nostaglic, check out the video clip of *From St Kilda to Kings Cross*: http://www.youtube.com/watch?v=AV1FW_FCjx8&list=UUV4GjyogdR9_0Gqfhf6eNKw&index=59&feature=plcp

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