Motor Trade Association

of South Australia

Options for Strengthening Misuse of Market Power Laws Submission 2016

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Submission Contact

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Background

The following comments are provided on behalf of Motor Trade Association of SA Inc., (an employer organisation representing the interests of its 1100 members), the MTA GTS Inc. a registered training organisation (and Group Training Scheme) which delivers post trade and apprentice training to mechanics including diesel training to both the industry and also places some 500 apprentices in over 200 host businesses.

As a representative state body MTA has various Divisions representing the full range of business within the motor industry except for the vehicle manufacture group.

In particular, membership comprises:-

- small component manufacture, assembly, and reconditioning
- commercial body building (heavy light and specialty commercial vehicles, assembly
- new and used vehicles of all kinds (farm machinery, industrial , light passenger, caravans and trailer able boats, leisure craft and motor cycle)
- automotive mechanical repair of all of the above sectors specialist repair and diagnosis, collision repair and towing, restoration of vehicles/coach work
- dismantling of vehicles.

Case for Change

The Automotive Industry

The MTA notes that 125 countries have adopted some form of 'effects' test.[1] The MTA considers that there is a strong case for the introduction of an 'effects' test in Section 46 of the *Competition and Consumer Act 2010* for the following purpose:

"A corporation that has a substantial degree of power in a market shall not engage in conduct that has the purpose, effect or likely effect of substantially lessening competition in that or any other market."

The automotive industry has witnessed several situations where there is the need for change to the CCA's design and operation.

Broadly speaking, the CCA most often fails to protect small businesses, which make up 94% of the automotive sector[2], where a third party purchases products and services on behalf of consumers.

The most illustrative examples of this are in the auto-franchise and auto-insurance markets.

In these examples, agreements between third party purchasers and automotive supply 'partners' require suppliers to enter into terms such as pricing, timeliness, exclusivity, quality and

[1] *Competition Policy*, Australian Automotive Dealer Association, 2014, http://aada.asn.au/competition-policy-2/.
[2] *Hansard*, Styles, Mr Peter John, Chairman, Motoring Advisory Council, Senate Economics References Committee: Future of Australia's automotive industry, 8 October 2015, p 23.

willingness to partner in exchange for an understanding that the third party will direct consumers to their partners.

The anti-competitive conduct occurs on several levels.

The agreement terms are determined, or in practice are set by, the purchasers due to their market power. These are often beyond the scope and capacity of the suppliers to meet unless they themselves incur financial losses.

These types of agreements effectively align purchases and suppliers vertically, to the exclusion of independent suppliers.

While ostensibly, this appears to be creating competition between the third party purchasers, in practice it is entrenching their substantial market power with loss leading pricing that they would otherwise be unable to absorb. These losses are then passed on to contracted suppliers.

As the purchasers control the flow of work to suppliers, they are left with little choice but to either accept these terms or face greatly reduced volumes due to exclusivity provisions, even in market where 'freedom of choice' is theoretically available.

These factors combine to stop innovation, reduce the number of competitors (both contracted and independent) in a given market either through lack of throughput or financial hardship and leave only the 'preferred networks' as the only practical choice. This further reduces the bargaining power of the small businesses when negotiating agreement with purchases.

Case studies for these examples are provided below.

Purpose v Effect

It is widely acknowledged that the current 'purpose' test sets a very high threshold to prove anti-competitive conduct. This view is supported by the Harper Review Findings.

One of the principle arguments against an 'effects' test is the question of whether it would reduce competitive behaviour such as price competition or product innovation. This submission will address that specific point separately by it is raised in this context to highlight the subjective nature of a firm's 'purpose'.

Is it to offer lower prices; and better products and services, which obviously are benefits to consumers, or rather, is it designed to take advantage of the firm's market power to exclude new market participants thereby entrenching the original firm's market dominance? How can 'purpose' be reliably and objectively proven?

The answer is 'purpose' cannot be reliably and objectively proven as a stand-alone factor.

Some will argue that the Australian Competition and Consumer Commission has had a high success rate with S46 cases, up to 73% by estimates, and therefore no change is necessary – the implication been that the Act is functioning well.[3]

Between the period 1974 and 2012, the competition regulator initiated S46 proceedings on 18 occasions, with successful outcomes in 11 cases. However, there are two features of these outcomes worth noting.

First is the remarkably few actions initiated over 38 years. On average there has been only one case initiated every 2.11 years.

Second, of the 11 'successful' cases, 8 of these have been won by consent.

These two aspects do not support the contention that the Act is functioning well. Rather they indicate that only the most blatant contraventions of the Act are subject to action and even then firms would prefer to make commercial agreements that substantially reduce their liability and reputational damage compared to a litigated outcome.

A carefully designed 'effects' test, which includes provisions for determining 'purpose', will provide a measurable and consistent framework to protect competition. Introduction of an 'effects' test would also align S46 with other key provisions of the CAA.

Take Advantage

The MTA considers that the current 'take advantage' test is inadequate in capturing firm's engaging in misuse of market powers conduct.

The 'take advantage' test allows firms with substantial market power to engage in particular business conduct if firms without market power can also commercially engage in that conduct.

Confusion over whether certain actions constitute pro or anti-competitive conduct, and the potential consequences of limiting competition through unintended consequences of an 'effects' test, have typically made government reluctant to implement such an 'effects' test.

The 'take advantage' test sought to remedy this but has in fact created a perverse outcome.

Courts have often accepted that certain actions such as price cutting by firms with substantial market power had the purpose of damaging a competitor. These conditions are typically interpreted as 'price competition'.

In some instances, firms use internally derived concepts of 'quality assurance' to effectively exclude competitors, which is further compounded by aggressive, loss leading price cutting. The lower pricing is then cited as evidence that the quality assurance is producing better outcomes for consumers.

[3] *ACCC v Ticketek: A non-event?* The Journal of Chartered Secretaries Australia Ltd, April 2012, Volume 63 No. 3, pp. 158-161.

The difficulty in proving anti-competitive behaviour has been proving that such a firm, with substantial market power and engaging in conduct that was damaging to competitors, did so ***because*** of its market power, with actions that would not otherwise be available to it if it did not have that market power.

The MTA considers removing the 'take advantage' test will improve the operation of the Act.

Current Operation of Section 46 of the Act

Competition is a process of rivalry between businesses seeking to outdo each other for their individual commercial gain. This process drives businesses to increase sales and service offerings by bringing new products to market, and find new ways to deliver lower prices and meet customer expectations to increase market share and return on capital invested. Competition and the threat of competition (contestability) promote efficient production which, over time, also drives innovation and investment in new technologies, and the development of new products and business models that meet consumers' needs.

The object of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading, and provision for consumer protection. It provides competition laws that apply across the economy to encourage and maintain the competitive processes in Australia's markets. In particular, Part IV of the CCA seeks to proscribe particular types of conduct which would be anti-competitive in the sense of harming competition in a market, or preventing or deterring the entry of new firms.

The misuse of market power provision (section 46) regulates unilateral anti-competitive conduct. Subsection 46(1) prohibits a corporation with a substantial degree of market power from misusing that power. Subsection 46(1AA) more specifically prohibits predatory pricing by a corporation with a substantial share of the market. In both sections, behaviour is prohibited where it has the purpose of eliminating or substantially damaging a competitor, preventing the entry of competitors or deterring or preventing competitive conduct.

Neither of these provisions prohibits a large market share or a high degree of market power on their own, or even a monopoly. Rather they are designed to protect the competitive process in markets.

This is described by the High Court in an oft cited passage:

The object of section 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to 'injure' each other in this way. This competition has never been a tort ... and these injuries are the inevitable consequence of the competition section 46 is designed to foster.

That is, firms are entitled, and indeed encouraged, to succeed through competition, even if they put competitors out of business and achieve a position of market dominance through their success. This 'Darwinian' process of aggressive rivalry is what drives efficient outcomes and benefits to consumers. The law should keep markets contestable so that innovative Australian businesses or new entrants from overseas have the opportunity to compete on their merits.

The role of section 46 is to distinguish vigorous competitive activity, which is desirable, from economically inefficient, monopolistic practices that may exclude rivals and harm the competitive process. To use a sporting analogy, section 46 should not seek to prevent a team from winning a grand final by training harder, having better skills or using better strategies, but it should prevent

teams from refusing to allow their opponents access to the field. A business with a substantial degree of power in a market is not allowed to use this power for the purpose of eliminating or substantially damaging a competitor or to prevent a business from entering into a market. This behaviour is referred to as 'misuse of market power'.

Misuse of Market Power Test

The possession of market power of itself is not unlawful. To determine whether there has been a misuse of market power, the courts will consider three questions:

1. Does the company have substantial market power?
2. Is it taking advantage of that power?
3. Is it using the power for an illegal purpose?

Substantial Market Power

Market power is the ability of a business to insulate itself from competition. The market may be considered by asking three questions:

1. Which products are sufficiently close substitutes (the relevant product market)?
2. Which other businesses are sufficiently nearby to compete effectively (the relevant geographic market)?
3. What is the functional level of the market (this relates to the stage(s) in the production/distribution process covered by a market)?

Within that market a business's market power may be determined by a combination of factors such as:

- How difficult it is for competitors to enter the market;
- The business's ability to behave with little regard to what its competitors, suppliers or customers do;
- The market share of the business;
- The financial strength of the business; and\or
- The ability of the business to consistently restrict competition.

Taking Advantage of Market Power

In determining whether, by engaging in conduct, a business has taken advantage of its substantial degree of power in a market, the court may have regard to the following factors:

1. Whether the conduct was materially facilitated by the business's substantial degree of power in the market;
2. Whether the business engaged in the conduct in reliance on its substantial degree of power in the market;
3. Whether it's likely that the business would have engaged in the conduct if it did not have a substantial degree of power in the market; and
4. Whether the conduct is otherwise related to the business's substantial degree of power in the market.

Illegal Purpose

It is not illegal to have market power or to use it. Conduct by a business with market power is only a contravention of the *Competition and Consumer Act 2010* (CCA) if it is carried out for an illegal purpose.

The CCA spells out illegal purposes as follows:

- Eliminating or substantially damaging a competitor
- Preventing the entry of a person into that or any other market
- Deterring or preventing a person from engaging in competitive conduct in any market.

The courts have established that the illegal purpose need not be the only purpose, nor even a dominant purpose, of the conduct in question. It is enough that it be one of the purposes, and a substantial one.

Section 46 Strengthening Elements

The Take Advantage Test

The MTA considers that the 'take advantage' test should be amended to remove reference to the 'special' position threshold in the CCA, whereby contravention of the CCA is deemed to have occurred if the action is possible *only* because of the firm's substantial market power.

The provisions for having 'substantial market power' and 'anti-competitive' conduct should be retained.

This would assist in calming concerns that an 'effects' test would preclude competitive behaviour, such as legitimate price competition or through various forms of quality assurance. The intention of this change should be to ensure that comparisons over available business models are between firms with *comparable* market power and not between firms with substantially different market power. By retaining the two considerations above, large firms would not be able to simply use their market power to 'starve out' smaller competitors with loss leading pricing.

The MTA considers these changes would have a beneficial effect on competition, particularly in regards to firms entrenching their market power through the use of 'seemingly' competitive mechanisms.

Defining the 'take advantage' test could be assisted by mandating factors for the courts to consider. This is addressed below.

Purpose, Effect or Likely Effect

The MTA considers that current provision should ensure that:

"A corporation that has a substantial degree of power in a market shall not engage in conduct that has the purpose, effect or likely effect of substantially lessening competition in that or any other market."

By relying solely on 'purpose', the CCA is placing a heavy emphasis on documentary evidence. This is obviously an easily circumvented loophole that makes detection and prosecution difficult.

The MTA does not consider the 'purpose' provision, of itself, to be adequate to meet the objectives of the Act nor of the Harper Review. However, the MTA does not rule out the possibility that other amendments may improve the operation of this provision as it currently stands.

For the CCA to be efficacious, its scope cannot be limited to just 'intent'. It must also look at the consequences of a firm's actions, particularly, but not exclusively, with regard to numbers of market participants, market participant churn, relative profitability, market share, retail pricing, and freedom of choice in the primary and any secondary markets.

Substantially Lessening Competition

S46 of the CCA specifies that prohibited conduct applies where the conduct has the purpose of 'eliminating or substantially damaging a competitor.' The courts have routinely decided to interpret this to reflect the competitive process rather than individual competitors.

Whilst many international jurisdictions are concerned with breaches affecting the competitive process rather than individual competitors, this is not the wording of Act.

The MTA considers that the Act should reflect current practice. The MTA also considers that there is substantial benefit in defining what constitutes 'substantial lessening' in the Act.

The MTA considers that there should be appropriately contextualised mandatory factors taken into consideration by the courts that prohibit 'anti-competitive' behaviour.

The Government poses a peculiar question on page 8 of its Options Paper, where it asks:

An alternative to applying a 'purpose, effect or likely effect' test could be to limit the test to 'purpose of substantial lessening competition'. What would be the advantages and disadvantages of such an approach?

Seemingly, the question is asking whether an alternative to an 'effects' test is to have a 'purpose' test for competitive behaviour. This is the *status quo,* but the Options Paper appears to be implying that somehow the two tests can perform the same function equally well. The MTA cannot see how the two tests are substitutable given that one looks at a firm's intent and motive while the other looks at market effects.

The MTA is of the view that an 'effects' test that considers whether behaviour 'substantially lessens competition' is the best option.

Mandatory Factors

The MTA considers that there is substantial merit in providing mandatory factors for courts to consider when interpreting S46 of the CCA, particularly if an 'effects' test were introduced.

Mandatory Factors will provide a clearer roadmap for developing businesses models, thus likely increasing compliance with Act, and also allow for more efficient litigation where it is required. This will result in a lower regulatory burden.

Each industry will have variations on what factors should be considered, and the MTA considers there should be developed through further consultation before they are legislated.

However, as a general principle, the MTA offers the following factors as a basis for discussion:

1. Does the conduct reduce the viability or number of competitors in its primary market, or in secondary markets?
2. What is the relative bargaining power of the parties?
3. Is the market structure static over time or is their sufficient churn of participants to suggest such conduct is not erecting barriers to entry?

4. What are the likely short, medium and long terms effects of conduct on consumer pricing and service?
5. What are the impacts of product innovation, differentiation and quality?

Authorisations

The MTA considers that where there is overwhelming evidence of a substantial public benefit, and there is no substantial impact on competition, time limited authorisations may be acceptable.

Other Issues

The questions asked in this section of the Options Paper appear to be asking whether there is an increased regulatory burden as a result of changes to S46. Obviously, there will be higher compliance costs for companies that will be potentially captured by a strengthened S46 that currently are not.

The MTA does not consider this cost to be a sufficient to justify not introducing an 'effects' test or the other measures discussed above given the economy wide benefits these would bring.

Preferred Option

Option F – Full Harper

The MTA considers that of the six options proposed by government, Option F represents the most beneficial to the automotive industry and the wider economy.

This option provides for a reliable and predictable legislative framework which overcomes the current concerns about the operation of S46, while ensuring genuine and desirable competition is not punished.

While Option F canvasses the complete removal of the 'take advantage' test, the MTA see merit in retaining a provision that increases scrutiny and transparency on firms with larger market shares.

The MTA does not consider the other proposed options offer either the scope or redress to adequately ensure that small businesses are not disadvantaged simply because of their market share.

The MTA agrees with the Harper Review recommendation.

Case Study

The automotive insurance market is dominated by two major players, IAG (33%) and Suncorp (37%), who hold approximately 70% of the market. The next 7 players barely hold 30% market share combined.

Insurers' process claims through their tele-claims call centres according to a carefully scripted process which directs claimants invariably to one of the insurers 'preferred partners'. Unless a well-informed consumer strongly insists on using their own repairer, the insurer will cajole the claimant to a repairer which has a commercial relationship with the Insurer.

To achieve this preferred status, and benefit from the flow of work, the repairer must submit to pricing and time requirements that are effectively set by the insurer and which are not based on the repairers cost and safety minimums.

This affects competition in two markets. By having these preferred partners, insurers are effectively shifting their loss leading pricing strategy off their books and onto the repairers in order to maintain market share in the automotive insurance market. There are also significant implications for the exclusive dealing, unconscionable conduct and third line forcing provisions of the Act.

At the same time, by having such a dominant market share, repairers have little choice to accept these losses else they do not receive the benefit of the workflow stemming from tele-claims, 70% of which is controlled by two insurers.

This harms not only independent repairers who are not in the network but in theory should have an equal access to the workflow under freedom of choice legislation, but also on repairers in the network who face increasing losses.

As the numbers of repairers decline, their negotiating power also declines, entrenching the pricing and customer service model of the insurers.

These actions are only possible because the two insurers have such a dominant market position.

The IBISWorld industry intelligence bulletin makes five damning observations in this regard:[1]

"Industry operators rely on insurance companies to provide them with most of their work, as consumers make claims to insurers to pay for vehicle repairs."

[1] *Motor Vehicle Body, Paint and Interior Repair in Australia, On a Collision Course: Vehicle Insurers are increasing their leverage over the industry*, IBIS World Industry Report S29412, David Whytcross, March 2015.

"While the code of conduct has eradicated some anticompetitive activity within the industry, car insurers have still managed to become increasingly powerful within the industry over the past five years. The majority of industry business goes to firms that have PSR agreements with car insurers, most of which are owned by Suncorp Group and Insurance Australia Group."

"However, insurance companies are also expected to continue entering the industry themselves. Insurers generally aim to have repairs completed at the lowest cost. Suncorp Group has entered the industry through its part ownership of Capital S.M.A.R.T Repairs and QPlus Production. Suncorp Group owns car insurance brands including AAMI, GIO, Apia, Shannons, Just Car, Insure My Ride and Bingle. Through these brands it can push consumers to use a preferred smash repairer that it actually owns. This trend is expected to continue over the next five years as insurers aim to gain greater control over the claims and quoting process."

"As car insurers are paying the repair costs, their market dominance has driven down prices and consequently industry revenue despite the high number of claims processed."

"The industry is expected to consolidate over the 10 years through 2019/20, with the number of industry enterprises declining due to acquisitions by larger players."

"Profit margins in the industry are restricted by the need to quote low prices and the bargaining power of insurance companies. The majority of business in the industry comes from insurance claims. Industry operators need to develop relationships with insurers to become preferred suppliers. However, due to the strong bargaining power of insurers, costs need to be minimised to make it a profitable enterprise for the insurer."

Currently, because the insurers claim the reason for these networks is to guarantee quality and safety, notwithstanding the fact that if the entire repair terms of authority are met the lifetime guarantee is meant to be honoured, it is difficult to prove a case of misuse of market power.

None the less the numbers of repairers in South Australia, and the profitability of those remaining, has significantly declined over time. Additionally, wages in the sector per employee have fallen by $2080 or 4.3% [2] With fewer competitors, profitability should be increasing. This is a stark example of where an 'effects' test would capture the anti-competitive behaviour. The below table illustrates the long term effects of the continued market dominance of the insurers in the automotive repair sector:[3]

[2] *Motor Vehicle Body, Paint and Interior Repair in Australia, On a Collision Course: Vehicle Insurers are increasing their leverage over the industry,* IBIS World Industry Report S29412, David Whytcross, March 2015.
[3] *Idem*

Year	Revenue	Establishments	Enterprises	Employment	Wages
	(%)	(%)	(%)	(%)	(%)
2011-12	-0.60	-2.30	-1.90	-4.90	-0.50
2012-13	-0.70	-0.60	-1.40	-1.10	-1.50
2013-14	-0.70	-1.20	-1.30	-1.50	-2.50
2014-15	-1.80	-0.60	-1.60	-0.20	-2.10
2015-16	-1.80	-1.20	-1.20	-0.50	-1.80
2016-17	1.00	0.20	-1.40	-0.10	0.80
2017-18	-1.20	-1.60	-1.30	-0.40	-0.20
2018-19	-0.20	-1.20	-0.80	-1.90	0.60
2019-20	0.40	0.20	0.40	0.70	1.10