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**HEARING ON OLIGOPOLY MARKETS**

-- Note by Australia --

**16-18 June 2015**

*This document reproduces a written contribution from Australia submitted for Item 5 of the 123rd meeting of the OECD Competition Committee on 16-18 June 2015.*

*More documents related to this discussion can be found at [www.oecd.org/daf/competition/oligopoly-markets.htm](http://www.oecd.org/daf/competition/oligopoly-markets.htm).*

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## AUSTRALIA

### 1. Evidentiary issues and challenges in establishing an oligopoly theory of harm in competition cases - Introduction

1. Oligopolistic market structures, in which a small number of firms recognise their mutual interdependence<sup>1</sup>, are commonplace in Australia.

2. Through their repeated interactions and mutual awareness of each other's strategies and responses over time, oligopolistic firms can achieve market outcomes that mimic or approach those of explicit collusion without explicit agreement, or even direct communication, between competitors.

3. Like explicit collusion, tacit collusion through oligopolistic interdependence can be detrimental to consumer welfare to the extent that it displaces a more competitive arrangement and results in higher prices, lower levels of service, lower quality goods, less variety of goods and services and/or reduced incentives to innovate.

4. Oligopolistic firms' ability and incentive to tacitly collude can be enhanced by conduct that alters the structure of the market, changes incentives and/or increases the transparency of individual firm's actions, to make it easier to overcome obstacles to coordination<sup>2</sup>. This can be achieved by, for example:

- reducing the number of firms competing in the market;
- increasing barriers to entry or expansion of existing or potential competitors;
- increasing the degree of symmetry of firms in the market in terms of costs, products or pricing;
- reducing the number or strength of fringe competitors or mavericks; and/or
- signalling prices or pricing intentions or output/capacity intentions or engaging in other facilitating/concerted practices.

5. Conduct that facilitates tacit collusion may be prohibited, generally<sup>3</sup> if it meets the legal threshold of substantially lessening competition.<sup>4</sup>

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<sup>1</sup> That is, each firm anticipates that its actions will impact market outcomes and trigger reactions from rivals and take these responses into account when forming their own price, output, capacity and other commercial decisions.

<sup>2</sup> In order to engage in (explicit or tacit) collusion, firms must reach an understanding of the nature of the collusive arrangement and how it is to be implemented, including how the gains from collusion are to be shared and how 'cheating' is to be detected and punished.

<sup>3</sup> Private disclosure of pricing information by banks is prohibited per se.

<sup>4</sup> The High Court, in *Rural Press v ACCC* (2003) 216 CLR 53 at [41], interpreted 'substantial' to require that the impact is 'meaningful' or 'relevant' to the competitive process. This confirmed the approach taken by French J in *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41-743. French J continued this approach in *AGL v ACCC* (No 3) [2003] FCA 1525 at [351], handed down shortly after *re Rural Press*. There remains, however, some uncertainty as to how meaningful or relevant the effect on competition must be in order to be regarded as substantial. The

6. In recent years the Australian Competition and Consumer Commission (ACCC) has investigated a variety of conduct which potentially increased the likelihood that oligopolistic firms would find it profitable to coordinate rather than compete. These include:

- mergers that reduce the number of firms in the market and/or raise barriers to entry and expansion;
- facilitating practices in oligopoly, including information exchanges, price/capacity signalling and most favoured nation clauses; and
- applications for authorisation<sup>5</sup> involving airline alliances that significantly reduce the number of airlines operating on a route or set of routes.

7. In our (albeit limited) experience, translating an oligopoly ‘coordinated effects’ theory of harm into evidence that will be acceptable to a court is challenging.

## 2. **Demonstrating that structural changes in oligopoly markets are likely to alter firm behaviour**

8. One practical difficulty we face in oligopoly merger cases is convincing the Court that changes in the structure of oligopoly markets are likely to affect firm behaviour in ways that are harmful to consumers.

9. It should be relatively straightforward to convince a court that a merger to monopoly is likely to cause consumer harm. However, convincing a court that there is likely to be a connection between increased market concentration and firm behaviour outside the extreme case of monopoly can be more challenging. With models of oligopoly predicting firm behaviour and market outcomes ranging from those expected in competitive markets (e.g. Bertrand) to those expected under explicit collusion, there are no easy rules of thumb for a court to follow.

10. In markets where there are two or three firms of significant size, there may be a presumption that, absent explicit collusion, firms generally have strong incentives to compete vigorously post-merger in the absence of compelling evidence to the contrary.

11. For example, in a recent merger case involving the proposed acquisition of Macquarie Generation, the largest independent electricity generator in New South Wales (NSW)<sup>6</sup>, by AGL Energy, one of the three largest vertically integrated ‘gentailers’<sup>7</sup> in NSW, the ACCC argued before the Australian Competition Tribunal (Tribunal)<sup>8</sup> that the proposed acquisition was likely to raise barriers to entry and expansion for other electricity retailers in NSW and therefore reduce competition compared to the situation if the proposed acquisition did not proceed.

12. The ACCC presented evidence suggesting that the structure of the NSW retail electricity market post acquisition would be dominated by three large vertically integrated gentailers. Evidence showed that post-acquisition the three largest gentailers would have approximately 70 per cent of electricity generation capacity, 80 per cent of electricity generation output and more than 85 per cent of retail electricity load in NSW.

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Court applies a with/without test to assess whether the conduct has or is likely to result in a substantial lessening of competition. This involves a comparison of the state of competition in the market with and without the challenged conduct.

<sup>5</sup> The ACCC has the power to authorise airline alliances (and other conduct likely to breach the competition provisions of the *Competition and Consumer Act*) where they confer net public benefits.

<sup>6</sup> New South Wales is Australia’s most populated state. Sydney is its capital city.

<sup>7</sup> A gentailer is a vertically integrated energy generator and retailer.

<sup>8</sup> Australian Competition Tribunal, Application for Authorisation of Acquisition of Macquarie Generation by AGL Energy Limited [2014] ACompT1 at 369.

13. The key question for the Tribunal was the likely effect of the proposed acquisition on the ability of non-vertically integrated retailers, who were expected to provide a significant source of competitive tension in the market going forwards, to source sufficient hedge cover to remain a competitive constraint in the NSW retail electricity market. This came down to arguments about the incentive for vertically integrated gentailers post-acquisition to offer hedge cover to meet the requirements of non-vertically integrated retailers seeking to enter or expand in the NSW retail electricity market. The Tribunal formed the view that the gentailers would have the incentive to compete in the supply of hedge contracts:

*There is nothing inherently wrong with a market in which three large firms compete vigorously for market share where there are incentives to steal customers away from rivals. It is behaviour that matters, not structure per se. It appears to the Tribunal that it has been invited to assume that the “Big 3” will not constitute a competitive market principally on the basis of their combined market share immediately post-acquisition on an assumption that competition between them would become muted over time. In the opinion of the Tribunal, oligopolies should not be prejudged.<sup>9</sup>*

14. The ACCC encountered difficulties in assembling qualitative or quantitative evidence to convince the Tribunal that the change in market structure was likely to affect the incentive for the vertically integrated gentailers to offer sufficient hedge cover to competing retailers. The Tribunal noted that the ACCC provided no empirical support for its contention that three large gentailers were likely to result in a less competitive market.<sup>10</sup> In hindsight, economic modelling of competition in the market may have provided some guidance on the potential for competitive harm. However, it is not clear that the Tribunal would have placed much weight on the predictions from economic models alone. The ACCC found it difficult to find empirical evidence to support the theory of harm as no other state in the National Electricity Market has a structure similar to the structure resulting from the acquisition. As discussed further in Section 4 below, in the absence of such a benchmark, it was difficult to convince the Tribunal that the acquisition was likely to cause competitive harm.

### **3. Demonstrating that conduct can facilitate tacit collusion without a ‘commitment’ by at least one of the parties**

15. Facilitating practices are generally prohibited<sup>11</sup> under Australia competition law only to the extent that they constitute a “contract, arrangement or understanding (CAU)” that has the purpose, effect or likely effect of substantially lessening competition.<sup>12</sup> Although prohibitions on anti-competitive information disclosure (which currently only apply in the banking sector) were introduced in Australia in 2011, these have not been tested<sup>13</sup>. The requirement to establish a CAU has increased the difficulty of bringing tacit collusion cases in Australia. A CAU has been interpreted as requiring communication, a meeting of minds, and a commitment by at least one party.

16. The law permits an inference of CAU from circumstantial evidence<sup>14</sup>, including behaviour by the parties consistent with the existence of an agreement. However, in practice, Australian Courts

<sup>9</sup> Australian Competition Tribunal, Application for Authorisation of Acquisition of Macquarie Generation by AGL Energy Limited [2014] ACompT1 at 369.

<sup>10</sup> Ibid also at 371

<sup>11</sup> As noted previously, there is a per se prohibition on private anti-competitive information disclosure by banks.

<sup>12</sup> Section 45 of the Competition and Consumer Act 2010 (CCA).

<sup>13</sup> The recent Competition Policy Review recommended the anti-competitive information disclosure provisions be replaced with an economy wide concerted practice prohibition. The Government is considering this and other recommendations of the Review.

<sup>14</sup> In a cartel case, ACCC v Air New Zealand Ltd [2014] FCA 1157, Perram J made the following observations concerning establishing an anticompetitive arrangement or understanding by circumstantial evidence: “In cases where direct evidence is not available, proof of a collusive

to date have been reluctant to infer agreement without direct evidence of commitment by at least one of the parties.

17. For example, in *TPC v Email Ltd & Ors* (1980) ATPR 40-172 the only two suppliers of electricity meters (Email and Warburton Franki) issued identical prices lists, submitted identical tenders, adopted the same price variation clause, sent to each other their respective (identical) price lists, forwarded to each other new price lists immediately they changed prices or introduced any new meter or component, and tendered in accordance with their respective price lists. However, Lockhart J found no evidence of commitment, either to exchange the price lists or to charge particular prices, and hence no CAU.

*By sending its price lists to Warburton Franki, Email helped Warburton Franki follow the Email prices if it chose to do so; but there was no obligation that it should do so; and this ensured pricing stability. By Warburton Franki receiving the Email prices quickly, the price leadership situation could operate quickly. Email was confident that Warburton Franki would follow its prices based on previous experience. The receipt by Email of Warburton Franki's price list was of little significance to Email.*<sup>15</sup>

*In my opinion the conduct of the parties does not support a conclusion that there was an arrangement or understanding in the sense contended for by the Commission. I am satisfied that the practice of Email in issuing its price lists and sending them to Warburton Franki was done unilaterally for sound commercial reasons.*<sup>16</sup>

18. Two more recent price fixing cases (in 2005 and 2007) involved competing petrol retailers communicating about price via telephone calls.<sup>17</sup> Following similar reasoning to Lockhart J in the Email case, the Courts ultimately required evidence of a 'commitment' on the part of one or more parties either to share information or fix prices in order to find a CAU.<sup>18</sup> The Courts were not willing to infer a CAU without evidence of commitment.

19. In August 2014 the ACCC instituted proceedings in a facilitating practice case involving petrol retailers. The ACCC is alleging that the information sharing arrangements between Informed Sources (Australia) Pty Ltd and five petrol retailers, through a service provided by Informed Sources, allows those retailers to communicate with each other about their prices, and that these arrangements had the effect or likely effect of substantially lessening competition in markets for the sale of petrol in Melbourne.

20. Subscribers to the Informed Sources service provide pricing data to Informed Sources at frequent, regular intervals and in return receive from it collated data from the other subscribers, and various reports containing pricing information across particular regions. The exchange of this information allows retailers to monitor and respond to each other's prices and observe and analyse the pricing behaviours and strategies of their competitors. The ACCC alleges that the arrangements are likely to increase retail petrol price coordination and cooperation and decrease competitive rivalry. A hearing has been set for February 2016 in the Federal Court of Australia.

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understanding must be circumstantial. There is nothing inherently weak about cases based on circumstantial evidence. In truth, the strength of any particular circumstantial case will be a function of the number of elements of which it consists and the corresponding unlikelihood of those elements happening for reasons other than as a result of the posited collusive behaviour."

<sup>15</sup> *TPC v Email Ltd & Ors* (1980) ATPR 40-172 at 42,371

<sup>16</sup> *Ibid* at 42,379

<sup>17</sup> *APCO Service Stations v ACCC* (2005) 159 FCR 452 and *ACCC v Leahy Petroleum Pty Ltd and Ors* (2007), ATPR 42-162.

<sup>18</sup> On appeal from a positive finding in the first case, one party was found not to have entered a CAU because the conduct never involved a commitment by Apco to fix prices. The second case then followed the reasoning of the Full Court on appeal in the first case and no CAU was found.

#### **4. Demonstrating that firm behaviour and market outcomes are likely to be substantially different without the challenged conduct**

21. Another practical difficulty we may face is in demonstrating that firm behaviour and market outcomes ‘with’ the challenged merger or conduct are, or are likely to be, materially different from those that would prevail ‘without’ it – enough that the Court can be satisfied that it results, or is likely to result, in a substantial lessening of competition.<sup>19</sup>

22. Presenting evidence that the challenged conduct is likely to change firm’s incentives may not be enough for the Court to be satisfied that an anticompetitive effect is likely. However, it can be difficult to do much more than this in situations where:

- firms’ behaviour ‘with the conduct’ cannot be readily observed at the time the matter is before the Court because the conduct is prospective (e.g. mergers and new airline alliances); and/or
- there is not an observable ‘benchmark’ market to shed light on likely firm behaviour and market outcomes without the challenged conduct. It can be especially difficult to convince the Court of an anticompetitive effect when the ‘market without the conduct’ is hypothetical and in dispute between the parties.

23. In both situations expert economist testimony can play a key role in persuading the Court that the conduct substantially lessens competition. However, it may be difficult for the Court to reconcile fundamental differences in the opinions of opposing expert economists.

24. Where oligopolistic firms’ behaviour ‘with the conduct’ is observable (e.g. in a facilitating practice case), the conventional approach is to present a combination of expert economist testimony and, where possible, market evidence<sup>20</sup> to establish that oligopolistic firms’ behaviour with the challenged conduct mimics or approaches the behaviours expected with explicit collusion (e.g. signalling of how firms should behave followed by punishment for non-compliance) and differs materially from what is likely to be observed in the market without the challenged conduct.

25. In the Email decision cited above, the Court was not convinced that firm behaviour and market outcomes would have been substantially different without the challenged price signalling conduct. For example, Lockhart J noted:

*Email issued a price list some four weeks before the tender closed; but I have no doubt that this was merely in furtherance of its price leadership and was no way intended as some form of signal to Warburton Franki.<sup>21</sup> The receipt of price lists by Wharburton Franki was a matter of little moment to Email, and Warburton Franki could readily have found out those prices from sources other than Email.<sup>22</sup> It was not the exchange of price information that led to parallel prices. This was produced by market forces, competition and the necessity for Warbuton Franki to follow Email.<sup>23</sup>*

#### **5. Conclusion**

26. While there is not a large case history in Australia, the ACCC has encountered difficulties translating an oligopoly theory of competitive harm into admissible evidence that convinces a court that the legal threshold of an ‘effect or likely effect of substantial lessening of competition’ under Australian competition law has been met.

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<sup>19</sup> Under section 45 (CAUs that substantially lessen competition) or under section 50 (mergers or acquisitions that would result in a substantial lessening of competition) of the CCA.

<sup>20</sup> It often is difficult to convince parties who benefit from the challenged conduct, or have regular dealings with firms that benefit from the conduct, to act as witnesses for the ACCC.

<sup>21</sup> TPC v *Email Ltd & Ors* (1980) ATPR 40-172 at 42,374

<sup>22</sup> Ibid at 42,379

<sup>23</sup> Ibid at 42,380