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Comment on Draft Regulations relating to anti-competitive price signalling and information disclosure

RBB Economics, 22 March 2012

1 Introduction and summary of main points

On 23 December 2011, the Parliamentary Secretary to the Treasurer invited submissions in response to the draft *Competition and Consumer Amendment Regulations* (2012) (referred to as the Draft Regulations or DRs). The DRs relate to the prohibitions introduced into the *Competition and Consumer (CCA) Act*[1] in 2011 to target anti-competitive price signalling and information disclosure which were passed by the Senate on 24 November 2011 and will be contained in a new Division 1A in the *Competition and Consumer Act 2010*. Those laws contain two prohibitions:

- Section 44 ZZW is a *per se* prohibition against corporations making private disclosure of pricing information (including information relating to discounts, allowances, rebates, or credits) to competitors.

- Section 44 ZZY prohibits corporations from disclosing price information (including information relating to discounts, allowances, rebates, or credits) for the purpose of substantially lessening competition. The disclosures covered by this provision include price disclosures, but also capture disclosures relating to capacity information and any aspect of commercial strategy.

As the prohibitions were intended to apply only to the banking sector, one purpose of the DRs is to define the scope of Authorised Deposit-taking Institutions (ADIs) that are subject to the

[1] The anti-competitive price signalling and information disclosure provisions are contained in the *Competition and Consumer Amendment Act* (No. 1) 2011.

prohibitions in the Act. The DRs also outline the process to be followed by the Minister before extending the application of the prohibitions beyond the banking sector.

This commentary by RBB Economics focuses on the process proposed in the DRs to extend the prohibitions targeting anti-competitive price signalling and information disclosure to sectors other than banking. We do not comment on the definitions that have been proposed for ADIs.

We believe that the need for a process such as that set out in the DRs to extend the laws beyond the banking sector highlights the shortcomings of the existing price signalling and information disclosure laws and illustrates why those laws should be amended before being extended to other sectors.

The remainder of this submission is structured as follows:

- Section 2 argues that a *per se* prohibition is not a necessary part of the price signalling and information disclosure laws and that it clearly risks chilling desirable pro-competitive conduct.

- Section 3 then sets out why the *per se* prohibition cannot meet one of the objectives of the laws which is to provide certainty to businesses about the type of conduct that is considered to be "clearly anti-competitive". As the consultation process on the existing laws just for the banking sector illustrated, there are often valid reasons for competitors to exchange price information and a *per se* prohibition can only work if accompanied by a complex series exceptions and carve outs identified through a process such as that proposed in DR 49. This will lead to unproductive disputes (and uncertainty) about whether particular conduct is captured by the exceptions, rather than focussing on whether the exchange of price information reduces competition and leads to consumer detriment.

- Section 4 presents our recommendation that the competition test contained in the existing price signalling and information disclosure laws could be extended to all sectors without the need for the *per se* prohibition and without the process contained in DR 49. But in order to ensure that the competition test focuses on conduct that harms competition and gives rise to consumer detriment, we suggest that the test be recast as an "effects" test as this is a more effective way of distinguishing between pro- and anti-competitive price signalling and information disclosures. We would recommend that the ACCC issue guidelines that set out the analytical framework that would be used to show when price signalling and information disclosures can lead to a collusive outcome and that this framework draw heavily on the ACCC's approach to assessing co-ordinated effects in horizontal merger control.

2 A *per se* prohibition against price signalling risks chilling pro-competitive behaviour

The exchange of information in an economy contributes to economic efficiency. Information exchange allows firms to identify ways of reducing their costs, to learn about demand conditions and even to predict what actions their rivals are making. All of these can help firms to make the right decisions and help ensure that resources are allocated efficiently across the economy. These benefits can be illustrated through the example of fisherman in Southern India provided by Bennett and Collins.[2]

> *"The fishermen had to pick which port to land their fish at. However, if they all landed their fish at the same port, then the other ports would have no fish, and the port at which they landed their fish would have a glut of fish forcing the fishermen to throw the fish away. This situation was inefficient for the fishermen and for the consumers. However, when the fishermen gained the use of mobile phones they were able to phone ahead to the ports to see what the market price was and which fisherman had landed their fish where. Jensen found that the greater sharing of information benefited everyone. The fishermen's profits rose by 8% on average whilst consumer prices fell by 4%."*

Xavier Vives (2007) also noted that the welfare analysis of information sharing is complex and that the impact on consumer surplus and total surplus depends on the type of competition (strategic substitutes or complements) and uncertainty (private and common value, cost or demand) as well as on the number of firms. Vives concluded that information exchange cannot be taken as prima facie evidence of collusion, since firms may have unilateral incentives to share information and there are a range of situations where the exchange is welfare improving.[3]

The Revised Explanatory Memorandum (REM) acknowledges that information disclosure plays a vital role in any economy and is to be encouraged. It sets out the beneficial role it plays to customers and also the benefit of the signals that it provides to rivals which can encourage competitive activity. The REM then states that:[4]

> *"As a general rule, such communications are perfectly legitimate, pro-competitive and efficiency enhancing. However, in some cases, the provision and receipt of information between competitors clearly has the potential to diminish competition."*

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[2] Bennett and Collins, 'The Law and Economics of Information Sharing: the Good, the Bad and the Ugly', in European Competition journal, August 2010, 311, 318.

[3] Vives, X (2007) "Information Sharing: Economics and Antitrust" IESE Business School – University of Navarra, Occasional Paper no 07/11.

[4] See revised Explanatory Memorandum, para 1.7.

But rather than try to discuss when the receipt of information can be pro-competitive and when it can be anti-competitive, the REM then simply asserts that the private disclosure of price information between competitors "is only likely to occur in circumstances where one or other of the competitors is seeking to facilitate prices above competitive levels". Paragraph 2.70 of the REM on the *CCA Amendment Act* explained that the *per se* prohibition contained in section 44ZZW is based on the view that the private disclosure of pricing information among competitors is "clearly anti-competitive".[5] The justification for the *per se* prohibition was listed as follows:[6]

> *"Private disclosure of price information between competitors is only likely to occur in circumstances where one or other of the competitors is seeking to facilitate prices above the competitive level, and the disclosure gives rise to an increased probability of such an outcome occurring. This conduct is suitable for prohibition, even if the competitors are able to ascertain each other's prices from the market. That is, it is the circumstance of private disclosure that creates the high risk of collusion, and it is therefore considered appropriate that it be prohibited per se."*

The assertion that the private disclosure of price information between competitors is only likely to occur in circumstances where one or other of the competitors is seeking to facilitate prices above the competitive level enables Treasury to disregard the complexity noted by Vives above and to ignore the challenging task of assessing how the exchange of price information in each particular context helps to facilitate a collusive outcome and avoids the need to analyse such an exchange in its economic context.

Such an approach echoes that used to justify the *per se* prohibition against explicit cartels which is part of the legal framework governing cartel conduct in Australia and elsewhere. In Australia, the laws prohibiting cartels were overhauled in July 2009 when the *Cartel Conduct and Other Measures (CC&OM)* Act introduced a set of (*per se*) criminal cartel offences and parallel civil prohibitions into Division 1 of Part IV of the CCA.[7]

However, the two situations are simply not comparable in this way. There is widespread agreement that explicit cartels lack a pro-competitive justification and warrant a per se prohibition. It is undeniable that cartels are almost universally anti-competitive. If they are successful, they tend to raise prices and reduce output to anti-competitive levels. Customers in markets where cartels have been successful tend to pay higher prices and economic efficiency will have been reduced.

But in contrast, there is no widespread agreement that private disclosure of any pricing information among competitors lacks a pro-competitive justification and warrants a similar *per*

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5 See revised Explanatory Memorandum, para 2.70.

6 See revised Explanatory Memorandum, para 2.71.

7 Division 2 contained a civil per se prohibition on exclusionary provisions and a civil prohibition on provisions that have the purpose, effect or likely effect of substantially reducing competition.

se prohibition. Indeed competition authorities in other jurisdictions have accepted that not all pricing information has the same effect when exchanged among competitors. In its recent Decision to accept binding commitments to modify a data exchange tool used by Motor Insurers, for example; the OFT found that:

> *"the sharing of data which is more than six months old is* ***highly unlikely to facilitate a collusive outcome****. This is because a firm's ability to signal, monitor and react to deviation or market entry is significantly reduced. The OFT does not therefore consider that permitting the exchange of* ***six month old price information*** *on this basis is incompatible with EU law in the way argued by the respondent (emphasis added)."*[8]

Closer to home, the exchange of retail petrol prices twice a day on the MotorMouth website allows consumers to reduce the price they pay for fuel by accessing accurate and reliable information on fuel prices. MotorMouth argues that 87 per cent of its consumers have changed their petrol purchasing patterns as a consequence of using MotorMouth. MotorMouth is part of the Informed Sources group of companies (and we recognise that the ACCC has raised concerns with the use of the refiner-marketers of other products developed by Informed Sources). MotorMouth which contains largely the same information as that which has concerned the ACCC in another context is an example of how the exchange of prices (through a third party) can in some instances benefit consumers.

And as the Australian Bankers Associations argued in its response to the exposure draft dealing with the price signalling and information disclosure laws, there are numerous examples where the private disclosure of price information can be pro-competitive.[9] It gave the following examples:

- Communications between a **syndicate of lenders** in a commercial lending arrangement will inevitably involve pricing disclosures as part of the negotiations for the syndicated facility. Yet, without such pricing disclosures, syndicated lending would be unworkable, dramatically decreasing the availability of funds facilitating economic development in Australia.

- Two or more lenders to a **financial distressed business** seeking to arrange a workout for the business rather than relying on enforcement of their securities will need to discuss pricing arrangements in order to implement a workout plan. Without the ability to discuss prices, many workouts would not be possible, resulting in many loans being recalled, potentially leading to otherwise avoidable business insolvencies had banks not been prohibited from discussing pricing to effect a workout arrangement.

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[8] OFT 1395, December 2011. "*Decision to accept binding commitments to modify a data exchange tool used by Motor Insurers*". Para 5.60. One respondent to the OFT's consultation argued that a period of delay beyond six months was needed for the information exchange to be consistent with the principles of EU law.

[9] *ABA's submission in response to the exposure draft on Competition and Consumer Bill (No. 1) 2011*, pages 4-5.

This suggests that the current *per se* prohibition – which captures aggregate price data and historic price information and which could even prevent consumers from receiving pricing data from third party providers - is simply not capable of differentiating between anti-competitive conduct and pro-competitive conduct and as a result, clearly risks chilling pro-competitive conduct.

3 Can a *per se* prohibition provide certainty?

Despite arguing that the private disclosure of price information was "clearly anti-competitive", Treasury appears to have recognised that – as demonstrated in section 2 – a *per se* prohibition that was rigorously implemented would have the undesirable consequences of outlawing a number of welfare-enhancing exchanges of information, and as a result would present a serious risk of chilling pro-competitive conduct. As a result, Treasury has provided three ways of curbing the excesses of such a prohibition.

- First, it has allowed for any conduct that firms believe is pro-competitive to be authorised by the ACCC.

- Second, it has (at the eleventh hour) inserted into section 44ZZW of the existing laws an exemption for price disclosures between competitors that are "not in the ordinary course of business" (which we understand has been criticised by a number of legal experts for lacking a clear definition and creating uncertainty).

- Third, it has introduced a number of specific exceptions relating to the banking sector such as price disclosures made in relation to the provision of loans or credit, and disclosures made between credit providers and providers of credit services.

Treasury has argued that the effect of these provisions will be to provide certainty for businesses when trying to assess the impacts of the price signalling and information disclosure laws (compared to having a prohibition that relies solely on a competition test). However, it must be extremely unlikely that the specific baking sector exceptions identified by Treasury will capture definitively the full set of current and future scenarios in which information exchange is pro-competitive, and the "safety net" provided by the much more general language of the "not in the ordinary course of business" exception is so general that it is most unlikely to prove capable of discriminating between pro- and anti-competitive conduct.

If a simple rule aimed at prohibiting conduct that is "clearly anti-competitive" can be supported only by having a complex series of exceptions that are often unclear and which will need to be supplemented as new situations emerge, as well as every time the price signalling and information disclosure laws are extended to other sectors, the obvious conclusion is that the claimed certainty of the *per se* prohibition is an illusion.

This reinforces why having a *per se* rule in this area is inappropriate and why a process such as that proposed in DR 49 is considered to be necessary to give effect to the existing price signalling and information disclosure laws. That process states that:

> *"...the Minister must be satisfied that any consultation that is considered appropriate and that is reasonably practicable to undertake, has been undertaken. To be satisfied, the Minister may have regard to whether the consultation:*
>
> - *drew on the knowledge of the persons having expertise in fields relevant to the proposed regulation;*
> - *ensured that the persons likely to be affected by the proposed regulation had an opportunity to comment on its proposed content; and*
> - *if appropriate, involved an invitation of submissions to be made by a specified date, or consultation involving an invitation of participation in public hearings held concerning the proposed regulation."*

DR 49, therefore, is aimed at ensuring that the price signalling and information disclosure laws contain appropriate safeguards to prevent the *per se* prohibition (in particular) from deterring pro-competitive conduct when applied beyond the banking sector. It reflects the recognition by Treasury that despite the argument in the REM that "private disclosure of price information between competitors is only likely to occur in circumstances where one or other of the competitors is seeking to facilitate prices above the competitive level", the reality as illustrated by the ABA's examples, is that there will, in practice, be numerous examples of disclosures that are not anti-competitive.

The result of DR 49 will be a long list of exceptions developed by "experts" after an "appropriate period of consultation". But any list of exceptions is unlikely to be complete or sufficiently comprehensive to make it useful in legislation. Ultimately, this will lead to a series of unproductive debates about whether conduct falls in or out of specific exception and whether or not conduct is "in the ordinary course of business". Such a formalistic approach to price signalling is a distraction from the task of identifying anti-competitive conduct and preventing consumer detriment.

4 A sensible competition test can prohibit price signalling and information exchange in a more effective manner

In our view this commentary argues strongly against extending the *per se* prohibition beyond the banking sector (and indeed for the Government to consider withdrawing it from the banking sector). This would remove the requirement for DR 49. The impact of this would be to leave section 44 ZZX as the only provision available in the new Division 1A to the ACCC and to courts

to protect against anti-competitive price signalling and information disclosure,[10] which prohibits disclosures where the corporation has the purpose of substantially lessening competition.

The question is whether the removal of the *per se* prohibition weakens the ability of the competition authority and courts to target anti-competitive price signalling and information disclosure. In our view, it does not and we set out below a number of reasons why a well defined competition test – based around the effect of the conduct rather than the corporations' purpose – could help to identify and prevent anti-competitive price signalling and information disclosure much more effectively than a *per se* prohibition designed around a simple rule.

First, it avoids the need for the government to pick the sectors where it believes these laws are required. It also avoids the need for a complex, administrative process such as that proposed by DR 49 to identify exceptions to curb the excesses associated with a *per se* prohibition. In short, it can be rolled out simultaneously to all sectors in the economy and be applied consistently to all firms.

Second and more importantly, it places an obligation on courts and the ACCC to look at the nature of the information being disclosed and to formulate a view as to whether that disclosure can substantially lessen competition in a market. The competition test currently in section 44ZZY lists a number of matters that the court may have regard to when determining whether a corporation has made a disclosure for the purpose of substantially lessening competition in a market. These matters include:

- Whether the disclosure was a private disclosure to competitors in relation to that market;
- The degree of specificity of that information;
- Whether the information relates to past, current or future activities;
- How readily available the information is to the public; and
- Whether the disclosure is part of a pattern of similar disclosures by the corporation.

We have noted in section 2 that competition authorities in other jurisdictions have expressed doubts that the exchange of historic price information can facilitate a collusive outcome. Similarly, the degree of specificity of information may make also it difficult to facilitate a collusive outcome. Information about the total turnover and total volume may allow competitors to work out the average price, but that information may be close to meaningless if the firm sells many different products at different prices. The frequency of the information exchanges are also

[10] There are other provisions in Part IV that prohibit collusive behaviour, but these are subject to difficulty of establishing a "commitment" between parties to collude that the price signalling and information disclosure laws are trying to avoid.

important (and should be assessed in conjunction with the frequency of pricing decisions taken by the firm).

That is not to suggest that the exchange of information (including historical price information) can never give rise to a competition concern. But whether or not an information exchange has an anticompetitive *effect* depends not only on the nature of the information exchange but also on the characteristics of the industry in which the information exchange takes place. And an effects-based approach – rather than an approach that relies on a per se prohibition or on identifying the corporations' purpose – is the only effective tool to carry out this assessment.

4.1 What an effects- based approach looks like

The courts and the ACCC are familiar with applying competition tests so it is not a new exercise for them. This benefit was recognised by the legislature in the Revised Explanatory Memorandum:

> *"By incorporating a competition test, the SLC prohibition is consistent with the framework of the TPA as it is the basis of various Part IV prohibitions including section 45 (exclusionary provisions), section 47 (vertical restraints) and section 50 (mergers)."*

The experience of the ACCC in this area should enable it to provide guidance that draws on the analytical framework that it currently uses to asses approach to co-ordinated effects in horizontal merger control. That framework recognises that it is "impossible to be prescriptive about the conditions in which coordinated conduct is likely to arise or the types of mergers that would increase the likelihood of coordinated conduct"[11] which is, of course, precisely why the sorts of simple rules contained in the *per se* prohibition in this area cannot succeed.

The analytical framework for conducting the necessary effects-based test relies heavily on the economics of tacit collusion which acknowledges that tacit collusion may emerge when competitors, through repeated interactions, manage to elevate price above the competitive level (and possibly close to the monopoly level). That framework asks three questions:

- **Whether firms can reach an agreement.** This in turn depends on factors such as whether the industry is concentrated, whether the firms themselves are similar, whether all firms sell a single, homogenous good or each sells a slightly different product and whether demand is stable. Firms are more likely to be able to coordinate their actions in concentrated industries, in which there are fewer parties between which to agree a collusive outcome and to monitor deviations, than industries where there are many firms. Similar firms, in terms of size, costs and other variables, are more likely to have

[11] ACCC (2008), Merger Guidelines. para 6.6.

interests that align and thereby reach a mutually beneficial collusive outcome. Industries with a single homogenous good are more likely to facilitate collusion as it is easier to coordinate when all firms produce one identical good than when firms each produce slightly different goods in terms of quality, branding and other features important to consumers. Stable markets make it easier for firms to reach an agreement as they increase the length of time over which any price or output is likely to be appropriate.

- **Whether an agreement between firms is internally stable.** This depends on factors such as whether there are any “maverick” firms in the industry, whether demand is uncertain, whether firms can detect deviations and whether firms can punish deviations in a timely manner. A “maverick” firm is one that for whatever reason pursues different interests to those firms that attempt to collude. Such maverick firms can have a disruptive influence on any attempt to reach a collusive outcome in the industry. When demand is uncertain firms may struggle to distinguish deviations from price (or output) changes due to random demand shocks. The easier it is for firms to detect deviations, for example because of greater price transparency, the more able they will be punish deviations and thereby sustain collusion (although in this context firms will need to know that the price information they have is reliable). The more frequently firms interact, the more rapidly a firm can punish deviation and, as a result, the easier it is to sustain collusion.

- **Whether an agreement between firms is externally stable**. A collusive agreement between firms could be disrupted by entry of a new firm. When entry is easy, any excess profits could attract a new firm to enter which may destabilise any collusive agreements.

Under an effects-based framework, the courts and the ACCC can determine whether a particular information exchange is problematic against this established analytical framework and based on the facts of the case. Relatively simple exchanges, for instance, might be problematic in a simple sector where firms sell one homogenous product at a uniform price, but they would have to be considerably more detailed to facilitate collusion in a sector where firms sell a large number of different products and negotiate prices individually with each customer. Similarly, information exchanges may be more problematic in industries that are susceptible to collusion and when it allows firms to coordinate on prices or provides sufficient transparency to monitor deviations from a collusive outcome.

Such an effects-based framework allows the courts and ACCC to adopt a nuanced approach to tackling price disclosures and other information exchanges.

5 Conclusion

This submission argues that process set out in DR 49 exposes the main shortcomings of the current price signalling and information disclosure laws, and in particular, the *per se* prohibition

on the private exchange of pricing information. The main problem with these laws is that they proceed from the naive assumption that the private exchange of price information is "clearly anti-competitive" and rely on a simple rule that prohibits the private disclosure of information. Such an approach risks chilling pro-competitive conduct and requires numerous exceptions which it hopes will be identified from the process set out in DR 49 (as well as a reliance on the authorisation process). This will be costly, create its own uncertainty, and will mean that the laws are rolled out across sectors in a piecemeal manner that could delay or constrain the successful prosecution of anti-competitive conduct.

We recommend that the *per se* prohibition be abandoned. The impact of this is that DR 49 would not be required. Instead, Treasury could rely on a competition test that prohibits all price signalling and information disclosure that has the *effect* (rather than the purpose) of substantially lessening competition in the economy. This approach appears more complex than the simple rule contained in the existing per se prohibition, but we have seen that the apparent simplicity of the per se approach quickly dissolves once the need for complex exceptions is taken into account. An effects-based approach also asks the right question and allows Treasury to roll out enforcement against anti-competitive conduct simultaneously across the economy as a whole. Finally, we believe that the approach recommended in this commentary offers better protection against the unintended consequences of the existing prohibition than relying on a consultation process aimed at identifying and listing all of the possible exceptions into the legislation.