



AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Guidelines on misuse of market power

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Purpose of these Guidelines

Section 46 of the *Competition and Consumer Act 2010 (CCA)* has been revised. Section 46 now prohibits a firm with a substantial degree of market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition in a market.

The ACCC is responsible for investigating and enforcing the competition provisions of the CCA, including s. 46. This includes the power to bring court proceedings seeking to prove that the CCA has been contravened.

Businesses may also be subject to action by private parties for contraventions of s. 46.

These Guidelines set out how the ACCC currently proposes to interpret s. 46 and describe the general approach the ACCC will take in investigating alleged contraventions of s. 46.

Australian courts are ultimately responsible for:

- interpreting the CCA
- determining if s. 46 has been contravened
- determining what, if any, penalty or other orders should be imposed.

Decisions of the courts may be inconsistent with the ACCC's approach referred to in these Guidelines. If so, those decisions will be incorporated in revisions of these Guidelines as appropriate.

These Guidelines set out the ACCC's understanding of the law and are prepared for the general guidance of legal practitioners and business advisors. They are not a substitute for legal advice.

1. Why the ACCC takes action under section 46

- 1.1. Markets function well where firms strive to develop and offer products that are more attractive to customers than the products offered by their rivals. A firm with substantial market power may be able to damage this competitive process by preventing or deterring rivals, or potential rivals, from competing on their merits. That is, a firm with substantial market power may maintain or advance its position by restricting or undermining its rivals' ability to compete, rather than by offering a more attractive product. Sometimes this is referred to as 'exclusionary conduct'. Such conduct undermines the effective operation of markets and the economy.
- 1.2. Preventing firms with a substantial degree of market power from engaging in conduct that has the purpose or effect of substantially lessening competition is now a central limb of Australia's competition laws. Where it considers s. 46 has been contravened, the ACCC will take action to protect the competitive process and address consumer harm.
- 1.3. Section 46 does not prohibit a firm from obtaining a substantial degree of market power. Nor does it prohibit a firm with a substantial degree of market power from 'out-competing' its rivals by using superior skills and efficiency to win customers at the expense of firms that are less skillful or less efficient. This conduct is part of the competitive process, which drives firms to improve their performance and develop and offer products that are more attractive to customers, and should not be deterred. As stated by the High Court in *Queensland Wire Industries v Broken Hill Pty Ltd* (1989):

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...these injuries are the inevitable consequence of the competition section 46 is designed to foster.¹

2. Section 46 – key concepts

- 2.1. Subsection 46(1) of the CCA provides that a:

corporation that has a substantial degree of power in a market must not engage in conduct that has the purpose, or has or is likely to have the effect, of substantially lessening competition in

- a) that market; or
- b) any other market in which that corporation, or a body corporate that is related to that corporation:
 - i) supplies goods or services, or is likely to supply goods or services; or

¹Mason CJ and Wilson J in *Queensland Wire Industries v Broken Hill Pty Ltd* (1989) 167 CLR 177 at p. 191 ('QWI').

- ii) supplies goods or services, or is likely to supply goods or services, indirectly through one or more other persons; or
- c) any other market in which that corporation, or a body corporate that is related to that corporation:
 - i) acquires goods or services, or is likely to acquire goods or services; or
 - ii) acquires goods or services, or is likely to acquire goods or services, indirectly through one or more other persons.

2.2. The key concepts in s. 46 are:

- a) 'market'
- b) 'substantial degree of power in a market'
- c) purpose, effect or likely effect
- d) 'substantially lessening competition'.

Market

2.3. A market is the product and geographic dimension in which the competitive process takes place. It is defined in s. 4E of the CCA to mean 'a market in Australia', and includes goods or services that are substitutable for, or otherwise competitive with, the goods or services under analysis.

2.4. The ACCC's starting point for assessing market definition is to identify:

- a) the good or service supplied or acquired by the relevant firm and its close substitutes (product market); and
- b) the geographic region in which the relevant firm supplies (or acquires) the good or service and close geographic substitutes (geographic market).

2.5. The ACCC also considers the functional dimension of the market (the different levels in the supply chain such as the production, wholesale or retail functional level) and the timeframe over which substitution possibilities should be assessed.

2.6. Market definition is purposive. In *ACCC v Flight Centre* [2016], the High Court observed that:

Identifying a market and defining its dimensions is 'a focusing process', requiring selection of 'what emerges as the clearest picture of the relevant competitive process in the light of commercial reality and the purposes of the law'.²

2.7. This means that a market is not defined in isolation. The definition of a relevant market will be considered in the context of the particular conduct under

² [2016] HCA 49 at [69], quoting *Singapore Airlines Ltd v Taprobane Tours WA Pty Ltd* (1991) 33 FCR 158 at 178.

investigation. It is well recognised that market definition is not an exact science and that it is not possible or necessary to identify precise boundaries.³

Product market

- 2.8. To determine the product market, the ACCC considers the good or service under analysis and then identifies substitute products — typically those products to which consumers would switch if the price of the good or service under analysis increased.
- 2.9. In addition to this substitution by customers (demand-side substitution), a firm can also be constrained by the potential behaviour of firms supplying other products (supply-side substitution). If the price of a good or service increased, the ability of suppliers to switch quickly and without significant investment to supply the product or a substitutable product will be relevant.

Example 1: Product market

Firm A is a supplier of a popular brand of ice cream. Firm A decides to increase the price of its product by 10 per cent above the competitive level, resulting in a significant number of Firm A's customers switching to a brand of frozen yoghurt produced by Firm B. In this scenario, both Firm A's ice cream and Firm B's frozen yoghurt would be included in the relevant product market.

Geographic market

- 2.10. To determine the geographic market, it is first necessary to identify the area in which the good or service under analysis is supplied or could readily be supplied. The ACCC then considers the geographic areas where consumers would be able or willing to find substitutes for the goods or services in question.
- 2.11. A number of factors will determine the extent of the relevant geographic market, including the portability of the relevant good, costs to customers of obtaining supply from alternative regions, and any regulatory or other practical constraints on suppliers selling to alternative regions.
- 2.12. Although s. 4E refers to a 'market in Australia', the geographic market may contain goods or services from overseas. Section 4 of the CCA makes it clear that competition includes competition from imported goods or from services rendered by persons not resident or not carrying on business in Australia.

³ For example, see: Gordon J in *Air New Zealand Ltd v ACCC; PT Garuda Indonesia Ltd v ACCC* [2017] HCA 21 at [57]–[66]; Deane J in *Queensland Wire* at [196]; Allsop J in *ACCC v Liquorland* (2006) [2006] FCA 826 at [428]–[430]; Dowsett J in *ACCC v ANZ* (2015) 324 ALR 392 at [135].

Example 2: Geographic market

Firm A operates the only pet supply store in the regional town of Kiama. It decides to increase the price of pet food by 5 per cent, resulting in a substantial number of customers switching to a pet supply store in a neighbouring town. In this scenario, the relevant geographic market in which Firm A competes would include at least Kiama and its neighbouring town.

Substantial market power

2.13. A firm may only contravene s. 46 if it has a substantial degree of market power.

2.14. Market power comes from a lack of effective competitive constraint. A firm with market power is able to act with a degree of freedom from competitors, potential competitors, suppliers and customers. The most observable manifestation of market power is the ability of a firm to profitably sustain prices above competitive levels. Substantial market power may also enable a firm to raise barriers to entry, profitably reduce the quality of goods or services or slow innovation.⁴

2.15. There are a range of factors that can influence the degree of competitive constraint faced by a firm which are likely to be relevant to the ACCC's assessment. These factors can include those outlined by the Trade Practices Tribunal in *Re Queensland Co-Op Milling Association Limited and Defiance Holdings Limited*:

- a) the number and size distribution of independent sellers, especially the degree of market concentration
- b) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market
- c) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion
- d) the character of 'vertical relationships' with customers and with suppliers and the extent of vertical integration
- e) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.⁵

2.16. The ACCC does not impose a market share threshold in determining whether a firm has a substantial degree of market power. While market share can be an important factor, more than one corporation may have a substantial degree of power in a market.⁶ Further, a firm may have market power even though it does not substantially control the market or have absolute freedom from the constraint of

⁴ See discussion on market power in Kaysen and Turner, *Antitrust Policy* (1959), p. 75 in QWI at [200].

⁵ (1976) 8 ALR 481 at 515–516.

⁶ Section 46(7) of the CCA.

competitors.⁷ Similarly, financial strength does not by itself determine whether a firm has market power.

2.17. The ACCC will assess each case on its merits according to the specific nature of the good or service, the industry and the particular competitive impact likely to result in each case.

Purpose, effect or likely effect

2.18. Even with a substantial degree of market power, a firm will only contravene s. 46 if its conduct has the purpose, effect or likely effect of substantially lessening competition in a relevant market.

2.19. '**Purpose**' refers to a firm's intention to achieve a particular result. It can be established by direct evidence or by inference. The purpose specified in s. 46 need not be a firm's only purpose, but it needs to be a substantial purpose.

2.20. '**Effect**' refers to the direct consequence of a firm's conduct. This is determined objectively by examining the actual impact on the competitive process within the relevant market. Although not determinative, evidence of consumer or competitive detriment will be relevant to the ACCC's consideration of whether to pursue a matter.

2.21. '**Likely effect**' refers to the likely consequences of a firm's conduct, including its potential impact on the competitive process. 'Likely' means that there is a real chance or a possibility that is not remote.

2.22. When assessing a firm's conduct, the ACCC considers the nature and extent of that conduct, including the firm's commercial rationale. For example, whether the conduct is likely to be profitable for the firm because it improves its customer offer or because it restricts rival firms from improving their customer offers. A firm's commercial rationale may be relevant to understanding the conduct in question and assessing its purpose and/or effect on competition. However, it will not amount to a defence. Conduct engaged in by a firm with substantial market power may still have the effect or likely effect of substantially lessening competition even where the firm did not have the purpose of substantially lessening competition.

2.23. When assessing effect or likely effect on competition, the ACCC may undertake a 'with or without test'. This compares the likely state of competition 'with' the conduct, to the likely state of competition 'without' the conduct, to determine whether any lessening of competition would be the effect or likely effect of the firm's conduct.

Substantially lessening competition

2.24. There is no legislative definition of 'substantially lessen competition'; however, the test is longstanding within Australia's competition laws. In essence, conduct

⁷ Section 46(5) of the CCA.

substantially lessens competition when it interferes with the competitive process in a meaningful way by deterring, hindering or preventing competition. This can be done by raising barriers to competition or to entry into a market.

2.25. '**Lessening competition**' means that the process of rivalry is diminished or lessened, or the competitive process is compromised or impacted. 'Lessening competition' extends to 'preventing or hindering competition' (s. 4G of the CCA).

2.26. '**Substantially**' means meaningful or relevant to the competitive process. It is a relative concept and does not require an impact on the whole market.

2.27. In *Rural Press v ACCC* (2003), the majority of the High Court relevantly assessed 'substantially' by asking:

...whether the effect of the arrangement was substantial in the sense of being meaningful or relevant to the competitive process, and whether the purpose of the arrangement was to achieve an effect of that kind.⁸

2.28. In *Universal Music v ACCC* (2003), the Full Court observed:

... The lessening of competition must be adjudged to be of such seriousness as to adversely affect competition in the market place, particularly with consumers in mind. It must be 'meaningful or relevant to the competitive process.'⁹

3. Types of conduct that may involve a contravention of s. 46

3.1. It is not possible to identify with precision particular types of conduct that will necessarily contravene s. 46. Whether or not conduct contravenes s. 46 will always depend on the circumstances.

3.2. Despite this, competition agencies and courts have regarded some types of conduct as having greater potential to contravene s. 46. These include:

- a) refusal to deal
- b) restricting access to an essential input
- c) predatory pricing
- d) loyalty rebates
- e) margin/price squeezing
- f) tying and bundling.

⁸ (2003) 216 CLR 53 at [41].

⁹ (2003) 131 FCR 529 at [242] quoting *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000] FCA 38 at para 114.

Refusal to deal

- 3.3. Businesses are generally entitled to choose whether or not they will supply or deal with another firm, including a competitor. Even if a firm has a substantial degree of market power, there is usually no obligation for it to deal with other firms.
- 3.4. However, in limited circumstances, a refusal to deal by a firm with a substantial degree of market power may amount to a contravention of s. 46. For instance, where a firm that has a substantial degree of market power in the supply of a key input:
- a) refuses to supply that input to its competitors in a downstream market and the purpose, effect or likely effect of the conduct is to prevent or hinder those competitors from being able to compete in the downstream market, or
 - b) states a willingness to supply a key input to its competitors in a downstream market, but only on terms at which no competitor would reasonably be willing to buy the input (for example, by charging an excessively high price), and if the purpose, effect or likely effect of the conduct is to prevent or hinder those competitors from being able to compete in the downstream market.

Example 3: Refusal to deal

A firm owns the only cement works in a regional town. The next closest cement works is a considerable distance away. The cost of transporting cement to the town from the next closest cement works is significant. The firm also owns all the ready-mix concrete plants servicing the regional town. It is not possible to transport ready-mix concrete to the town from the next closest ready-mix plant. Cement is an essential input into ready-mix concrete.

A new entrant plans to set up a ready-mix concrete plant in the regional town. The new entrant has a strong track record of operating successful ready-mix concrete operations in other towns. The new entrant approaches the firm to acquire supplies of cement. The firm refuses to supply the new entrant with cement. One of its reasons for doing so is to protect the employment of its workers in its ready-mix concrete plants. The new entrant does not proceed with its plans to establish a ready-mix plant in the town.

Assessment

The firm has a substantial degree of market power in the supply of cement in the regional town. It is the only supplier of cement in the town and the nearest potential competitor would incur very high transport costs in transporting cement to the town.

While one of the firm's motivations is to protect the employment of its workers, it is seeking to achieve this by preventing the rival firm from entering the market for the supply of ready-mix concrete and competing away business. Further, a purpose of substantially lessening competition only needs to be a substantial purpose for the conduct and does not need to be the only purpose.

The effect of the firm's refusal to supply is to prevent the new entrant entering the market for the supply of ready-mix concrete and competing with the firm on its merits.

The conduct has the purpose and effect of substantially lessening competition.

The ACCC is of the view that the conduct is likely to breach s. 46.

Restricting access to an essential input

- 3.5. In some circumstances, a firm with a substantial degree of market power may prevent or restrict a competitor's access to an essential input. Where this conduct has the purpose, effect or likely effect of substantially lessening competition, it may breach s. 46.
- 3.6. **'Essential inputs'** are non-substitutable resources which are indispensable for the provision of goods and services. Restricting access to an essential input has the potential to prevent competitors from competing with a firm on their merits.

Example 4: Restricting access to an essential input

A large fuel retailer operates six out of eight retail fuel sites in a major but remote town. By volume, it supplies 85 per cent of the town's fuel. All fuel retailers in the remote town rely on acquiring fuel from two seaside storage facilities, owned by two competing fuel wholesalers. There are considerable barriers to establishing new fuel retailing businesses or wholesale storage facilities.

Travelling distances and associated costs mean it is not feasible for retailers to switch to other sources of road based fuel supply, or for the wholesalers to profitably sell outside the remote town. Given the shipping, storage and other running costs, each fuel wholesaler must supply some of their fuel to the large fuel retailer to remain viable.

The large fuel retailer separately approaches each fuel wholesaler stating it will only acquire fuel from that wholesaler if it receives better trading terms than the other fuel retailers, including a 5 per cent lower price than the lowest price offered to the large fuel retailer's competitors on a daily basis and first preference to fuel in the case of shortages. While each wholesaler may lose some revenue if it agrees to these terms, it stands to lose more if the large fuel retailer ceases acquiring fuel from it.

The wholesalers independently decide to agree to the terms.

Assessment

It is likely that the large fuel retailer has a substantial degree of market power in the market for the acquisition of fuel in the remote town.

The large fuel retailer's threats to not acquire fuel from wholesalers who also supply its competitors mean that the retailer's competitors will be unable to acquire fuel on competitive terms, making their businesses untenable in the medium term. New entrants would face the same insurmountable barrier. The large fuel retailer's conduct is likely to have the purpose and effect of substantially lessening competition in the retail fuel market in the remote town.

The ACCC is of the view that the conduct is likely to breach s. 46.

Predatory pricing

- 3.7. Businesses compete by providing more compelling offers to consumers than their competitors. This often involves businesses undercutting prices offered by rivals. In almost all circumstances low pricing is beneficial for consumers and is part of the competitive process. However, in rare circumstances, very low pricing by a firm with a substantial degree of market power may be predatory.

- 3.8. Predatory pricing occurs when a firm substantially reduces its prices below its own cost of supply for a sustained period:
- a) causing competitors to exit the market,
 - b) disciplining or damaging competitors for competing aggressively, or
 - c) discouraging potential competitors from entering the market.
- 3.9. Predatory pricing might result in a firm losing money in the short to medium term. However, if the practice leads to a reduction in competition or the potential for competition, the firm may be in a position to charge higher prices and maintain or increase its market share in the longer term.
- 3.10. Predatory pricing by a firm with a substantial degree of market power can harm an individual competitor; however, the test is whether the conduct has the purpose, effect or likely effect of substantially lessening competition in a market.

Example 5: Predatory Pricing

A firm publishes the only newspaper in a major regional town. The firm provides the newspaper for free and has built up a substantial readership through its focus on local news and events. The firm attracts substantial revenues from local businesses who advertise in the newspaper and earns substantial profits. Most local businesses consider it essential to advertise in the newspaper.

A new entrant commences publishing a competing regional newspaper and offers advertising rates comparable to those offered by the firm. The new entrant starts to win some advertising sales from the firm.

The firm reduces its advertising rates for all of its customers to less than 50 per cent of the rates offered by the new entrant. At the new advertising rates, the firm does not cover its costs of printing and distributing its newspaper. The firm's board documents indicate it is willing to incur these losses to reinstate its position as the sole regional newspaper and the profits that position generates.

The new entrant is unable to attract sufficient advertisers and closes its newspaper. After the closure, the firm raises its advertising rates to their original level.

Assessment

It is likely that the firm has a substantial degree of market power. Being the only regional newspaper has enabled the firm to build a substantial readership. Advertising in the newspaper is the most effective way for local businesses to reach local residents, and there are no close substitutes available.

The firm's reduction in advertising rates was substantial. The reduced rates were substantially below those offered by the new entrant and were not sufficient to cover the costs of printing and distributing the newspaper. The reduced advertising rates were not a short-term offer, lasting until the rival newspaper closed. The financial losses made by the firm during this period were substantial.

The firm had the purpose of forcing the rival newspaper to close and prevent it from

competing on its merits. In reducing its prices, the conduct had the purpose, effect or likely effect of substantially lessening competition.

The ACCC is of the view that the conduct is likely to breach s. 46.

Loyalty rebates

- 3.11. Businesses are generally free to set their own sales promotions, including rebates. Rebates usually do not harm competition. In many cases, including where the firm offering a rebate has substantial market power, rebates are an example of the benefits of the competitive process, incentivising retailers to promote the supplier's products and reducing the overall price customers pay for goods and services.
- 3.12. However, in limited circumstances a firm with a substantial degree of market power offering rebates can substantially lessen competition. This is most likely to occur where a rebate is conditional on a retailer meeting certain targets. For instance, where a firm offers its retail customers volume rebates which are conditional on the retailer purchasing a large proportion of its requirements from the firm (loyalty rebates). Such conditions can have the effect of preventing retailers from purchasing from competing suppliers.
- 3.13. Unconditional rebates, which simply reduce the price of an item with no additional conditions placed on the retailer, will likely only raise concerns if the reduced price amounts to predatory pricing.

Example 6: Loyalty rebates

Firm A is a supplier of patented transmissions used in heavy-duty vehicles. Heavy-duty vehicle manufacturers prefer to use Firm A's patented transmission systems in the majority (approximately 80 per cent) of heavy-duty vehicles.

However, there are some heavy-duty vehicles where Firm A's transmissions do not have key advantages over competing systems, and manufacturers generally fit transmissions from either Firm A or its competitors, depending largely on price. Demand for Firm A's transmissions has generally been stable relative to demand for its competitors' transmissions. There has also been low to no growth in heavy-duty vehicle manufacturing. Firm A's sales growth has stalled.

To address this, Firm A offers heavy duty vehicle manufacturers a new supply agreement. The agreement contains an offer to pay those manufacturers a conditional 10 per cent rebate on the price of every heavy-duty vehicle transmission they purchase from Firm A. The customer will only qualify for the 10 per cent rebate if the customer purchases at least 15 per cent more transmissions from Firm A than they did the previous financial year. The rebate structure ensures Firm A's customers must buy substantially more transmissions from Firm A for vehicles which could use competitors' transmissions, if they want to receive a 10 per cent rebate on every heavy-duty vehicle transmission purchased that year.

Assessment

It is likely that Firm A has a substantial degree of market power in the market for heavy-duty truck transmissions. It has significant market share in Australia and there are no close

substitutes available to its patented system which is preferred in most heavy-duty vehicles.

The likely effect of the rebate is to deter or prevent competing heavy-duty vehicle transmission suppliers from being able to compete effectively on their merits to sell heavy duty vehicle transmissions. The structure of the conditional rebate creates an incentive for heavy-duty vehicle manufacturers to increase their purchases from Firm A by 15 per cent, as the rebate will then be applied to every transmission sold.

Firm A's rivals are unlikely to be able to effectively respond by offering an equivalent or higher discount, as the heavy duty vehicle manufacturers stand to lose the 10 per cent rebate offered by Firm A on the 80 per cent of transmissions they already purchase from that firm if they do not meet the additional 15 per cent target.

The conduct is likely to have the effect of substantially lessening competition in the supply of heavy-duty truck transmissions. The ACCC is of the view that the conduct is likely to contravene s. 46.

Margin/price squeeze

- 3.14. Businesses are generally entitled to charge different prices to different buyers for the supply of goods or services along the supply chain.
- 3.15. However, a firm with a substantial degree of market power in the supply of a key input can disadvantage its competitors in downstream markets by reducing the margin available to these competitors. It could do this, for example, by charging its competitors an input price that makes it uncommercial for them to offer a competitive price in the downstream market.¹⁰
- 3.16. As competitors in the downstream market require the input and have limited alternative sources of supply, a margin or price squeeze has the potential to prevent equally efficient competitors in the downstream market from competing with the firm on their merits.

Example 7: Margin/price squeeze

Firm X holds 90 per cent of the world's known deposits of a rare earth mineral (the REM) which becomes a key input in the development of touchscreens. While exploration is underway in a number of potential new REM sites and new touchscreen technologies are being developed, it is not known how many years it will be before either becomes available.

Firms A, B and C are the major producers of touchscreens for use on smartphones, tablets and other devices. They account for 70 per cent of the world's demand for the REM.

Firm X establishes a subsidiary to begin competing with Firms A, B and C in the manufacture and supply of touchscreens.

¹⁰ For example, a price that is similar to the price the corporation charges in the downstream market.

Shortly afterwards, Firm X substantially increases the price at which it sells the REM. Even with access to the remaining sources of the REM (which also increase their prices in response to X's price increase), Firms A, B and C all require access to the REM from Firm X to make their touchscreens.

Firm X offers a number of two-year contracts to provide touchscreens to major mobile phone and tablet producers where the price offered per screen is only just above what it will now cost Firms A, B and C to buy the REM required to produce each touchscreen.

Assessment

It is likely that Firm X has a substantial degree of market power in the supply of REM. It has 90 per cent of the world's supply of the REM and new entry in the foreseeable future is unlikely.

Firm X offers touchscreens at a price above what it would cost its competitors to buy the REM required to produce each touchscreen. However, if Firm X had to pay the same price for the REM as it charged Firms A, B and C, it would make a loss on each touchscreen sold when taking into account its other production and distribution costs.

The conduct is likely to have the effect of substantially lessening competition in the supply of touchscreens. The ACCC is of the view that the conduct is likely to breach s. 46.

Tying and bundling

- 3.17. Businesses are generally entitled to supply goods or services as part of a tied or bundled arrangement.
- 3.18. **'Tying'** occurs when a supplier sells one good or service on the condition that the purchaser buys another good or service from the supplier. For example, a printer supplier may sell a printer on condition that the customer also acquires ongoing servicing from the supplier.
- 3.19. **'Bundling'** occurs when a supplier only offers two products as a package or for a lower price if the two products are purchased as a package. For example, a mobile phone operator may offer bundles of handsets and mobile phone services plans where the price of the handset and plan is cheaper if consumers buy them together than if they buy each one separately.
- 3.20. Tying and bundling are common commercial arrangements which usually do not harm competition and in many scenarios promote competition by offering consumers more compelling offers. However, in limited circumstances, tying or bundling by a firm with a substantial degree of market power may amount to a contravention of s. 46. This can occur when a firm with substantial market power in one market uses a tie or bundle to extend or 'leverage' this market power into another market.

Example 8: Tying and bundling

A firm has the patent over the active ingredient in the only drug that can treat a common

heart condition (Drug A). The patent for Drug A lasts for another five years. The firm has the patent for another drug that treats a different and comparatively rare heart condition (Drug B). The patent for Drug B is about to end. Manufacturers of generic drugs are making plans to manufacture a generic version of Drug B.

The firm decides to alter its selling practices to only sell Drug A and Drug B as a package. The firm writes to all pharmacies stating that it will only sell Drug A to a pharmacy if the pharmacy agrees to purchase all of its requirements of Drug B from the firm. Pharmacies normally acquire drugs from a range of manufacturers. Absent the tie, there are no benefits to pharmacies in acquiring Drug A and Drug B from the same manufacturer.

Assessment

It is likely that the firm has a substantial degree of market power in the supply of Drug A. It is the monopoly supplier of Drug A (for the duration of the patent) and there are no comparable drugs.

If a pharmacy cannot dispense Drug A, it is likely to lose a significant number of customers. As a result, it is likely that almost all pharmacies will purchase both Drug A and Drug B exclusively from the firm. This will prevent or hinder manufacturers of generic drugs from competing to supply Drug B to the majority of pharmacies.

The conduct is likely to have the effect of substantially lessening competition in the supply of Drug B. The ACCC is of the view that the conduct is likely to breach s. 46.

4. Types of conduct that are not likely to contravene s. 46

- 4.1. The ACCC investigates s. 46 allegations with the aim of distinguishing between vigorous competitive activity which is desirable, and economically inefficient monopolistic practices that may exclude rivals and harm the competitive process.
- 4.2. Whether conduct breaches s. 46 will depend on all the circumstances. Conduct that enhances efficiency, innovation, and product quality or price competitiveness is unlikely to substantially lessen competition.
- 4.3. The ACCC considers that the following conduct would not generally raise concerns:
 - a) innovation, regardless of how 'big' the firm is
 - b) efficient conduct designed to drive down costs
 - c) responding to price competition with matching or more competitive (above cost) price offers
 - d) responding efficiently to other forms of competition in the market such as product offerings and terms of supply.
- 4.4. The aim of s. 46 is to preserve the integrity of markets so that businesses have the incentive to enter or operate more efficiently, price competitively and offer better products to their customers. Businesses that compete by undertaking a successful promotional campaign, undertaking research and development which results in

better products or more efficient processes, or passing savings through to consumers will be enhancing competition, not lessening it.

Example 9: Research and development

A firm with 80 per cent of the market has developed a substantially improved version of an existing technological product. This new product supersedes the first generation products currently on the market. The vast majority of consumers prefer the new product causing many suppliers of the first generation product to close.

Assessment

Investment by the firm to innovate and improve its product to make it more attractive to consumers is part of the competitive process. The exit of other suppliers is the result of the firm engaging in competitive activity, not the result of the firm engaging in conduct which deters its rivals from competing on their merits. The ACCC is of the view that the firm's conduct **would not** have the purpose or the effect of substantially lessening competition.

Example 10: Price war

Three firms each with 25 per cent of a market compete with a significant fringe of smaller suppliers. Periodically, one of the firms significantly discounts the prices of its product to win more customers. These price reductions are quickly matched by the other firms causing a price war. While the three firms remain profitable during the price war, some smaller suppliers do not and decide to close.

Assessment

Each firm faces significant competitive constraint from the other firms and smaller suppliers. The firm leading the price discounting has the purpose of winning customers from its rivals. The price matching by the other firms is a competitive response. This is competition on the merits and the conduct **would not** breach s. 46.

Example 11: Investing in new production technology to increase efficiency

A firm manufactures an iconic brand of lawn mowers. The popularity of the brand means that it currently supplies 70 per cent of lawn mowers sold in Australia. It is rumoured that a large established international manufacturer of lawn mowers is planning to commence selling its lawn mowers in Australia. The firm invests in new production technology to lower its costs and improve the reliability of its lawn mowers. As a result of its lower production costs, the firm reduces the prices of its lawn mowers. The firm advertises the price reductions and improved reliability of its lawn mowers extensively. The international manufacturer of lawn mowers decides not to sell its lawn mowers in Australia.

Assessment

Investing in new production technology to improve the reliability of its lawn mowers and to enable it to reduce its prices is a competitive response by the firm to the threat of new entry. The firm's conduct is not exclusionary. That is, it did not prevent or deter the

potential new entrant from competing with the firm on its merits. The decision by the international manufacturer not to enter the market is because the firm improved its offer to consumers. The conduct **would not** have the purpose, effect or likely effect of substantially lessening competition.

Example 12: Rewarding behaviour

Firm A identifies a new way of treating timber to prevent termite infestation and markets its new patented product extensively under the brand Tproof Timber. Tproof Timber becomes very popular for residential construction in regional, bushland and rural areas. While the research and development costs were high, the new treatment is very inexpensive to apply. However, Firm A charges a very substantial premium on the product, keeping the price near but below steel beams and almost double the price of other treated timbers.

Assessment

Even though Firm A is making a considerable margin on each Tproof Timber product sold, the ACCC is of the view that the conduct **would not** breach s. 46.

Even if Firm A did have substantial market power, which would depend on the Tproof Timber's substitutability with other building products among other factors, its ability to charge higher prices is Firm A's reward for its innovation. Rather than deterring competition on its merits, Firm A's higher profits should incentivize other timber producers to seek to develop better termite resistant products that compete directly with Firm A's offering.

5. Authorisation

- 5.1. Authorisation provides protection against legal action for future conduct that might breach the competition provisions of the CCA, including s. 46. Parties can apply to the ACCC for authorisation where they believe that there is some risk that the conduct they propose to engage in would or may breach s. 46 and they require the certainty provided by an authorisation to undertake the activity.
- 5.2. In general, the ACCC may grant authorisation if it is satisfied that the proposed conduct is either unlikely to substantially lessen competition or likely to result in a net public benefit.
- 5.3. Authorisation is a formal and public process. The application and supporting submission will be available on the ACCC's public register and provided to interested parties for their comment or response. All public responses are made available on the public register. The ACCC's draft and final determination including the reasons for the decision are also publicly available.
- 5.4. The ACCC cannot retrospectively grant authorisation for conduct that has already occurred. Parties are encouraged to contact the ACCC if they have any concerns about future or ongoing conduct.
- 5.5. Further detailed information on the authorisation process is available in the ACCC's authorisation guidelines at www.accc.gov.au

6. The ACCC's approach to investigating alleged contraventions of s. 46

- 6.1. In assessing allegations of contraventions of s. 46, the ACCC will consider:
- a) the nature and extent of competitive constraints on the firm engaging in the conduct
 - b) the nature and extent of the conduct
 - c) competitors or areas of competition to understand the impact of the conduct
 - d) likely market outcomes, including what would likely happen if the conduct did not occur, and
 - e) whether and the extent to which the competitive process is being restricted, deterred or prevented in any relevant market
- 6.2. In deciding whether to take enforcement action, the ACCC focuses on the extent to which matters will, or have the potential to, harm the competitive process especially where this is likely to cause widespread consumer detriment. The ACCC cannot pursue all the complaints it receives and will direct its resources to matters that provide the greatest overall benefit for competition and consumers.
- 6.3. To assist with this determination, the ACCC publishes an annual Compliance and Enforcement Policy which sets out the priorities for the following year. A copy of the Policy can be found at www.accc.gov.au.

7. Sanctions

- 7.1. If a court determines that a person has contravened, attempted to contravene or has been involved in a contravention of s. 46 (as set out in s. 76 of the CCA), the court may impose orders including but not limited to:
- a) requiring that person to pay a civil pecuniary penalty
 - b) requiring that person to pay damages
 - c) preventing that person from engaging in certain conduct
 - d) declaring that person has contravened the CCA
 - e) in the case of individuals, disqualifying a person from managing a corporation.
- 7.2. The maximum penalty payable by a body corporate for each act or omission (as set out in ss. 76(1A)(b) of the CCA) is the greatest of:
- i) \$10,000,000;
 - ii) if the Court can determine the value of the benefit that the body corporate, and any body corporate related to the body corporate, have obtained directly or indirectly and that is reasonably attributable to the act or omission—3 times the value of that benefit;
 - iii) if the Court cannot determine the value of that benefit—10% of the annual turnover of the body corporate during the period (the turnover

period) of 12 months ending at the end of the month in which the act or omission occurred.

- 7.3. The maximum penalty for any other person, including an individual, is \$500,000 for each act or omission (ss. 76(1B)(b) of the CCA).