HOUSING INDUSTRY ASSOCIATION

Submission to Treasury

in response to the

Options to strengthen the misuse of market power law

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ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the industry, HIA represents some 40,000 member businesses throughout Australia. The residential building industry includes land development, detached home construction, home renovations, low/medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diversity of residential builders, including the Housing 100 volume builders, small to medium builders and renovators, residential developers, trade contractors, major building product manufacturers and suppliers and consultants to the industry. HIA members construct over 85 per cent of the nation's new housing stock.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."*

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

The aggregate residential industry contribution to the Australian economy is over $150 billion per annum, with over one million employees in building and construction, tens of thousands of small businesses, and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional member committees before progressing to the Association's National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.
The Association operates offices in 23 centres around the nation providing a wide range of advocacy and business support, including services and products to members, technical and compliance advice, training services, contracts and stationary, industry awards for excellence, and member only discounts on goods and services.

1. EXECUTIVE SUMMARY

HIA welcomes the opportunity to respond to the Government's Discussion Paper 'Options to strengthen the misuse of market power law'.

This Discussion Paper is intended to encourage debate on certain proposals made during the recently completed Harper Competition Policy Review (Harper review). It sets out 6 options.

HIA supports the first option – the status quo. For the reasons elaborated in these submissions, changes in the form proposed by the Harper Review and in those modified options set out in the Discussion Paper are not necessary in the residential building industry and are not desirable for the broader economy.

Background

The relevant market power provisions are set out in Section 46 of the *Competition and Consumer Act* 2010 (CCA).

Under section 46, corporations that have a substantial degree of power in a market are prohibited from taking advantage of that power for the purpose of eliminating or substantially damaging a competitor, preventing entry into, or deterring/preventing competitive conduct in, a market.

The Harper review proposed a substantial change, and recommended a new Section 46 as follows:

…prohibit a corporation that has a substantial degree of power in a market from engaging in conduct if the proposed conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.

HIA acknowledges that there are significant differences of opinion concerning the effectiveness and scope of the current laws.

This debate however, is not new. As noted in the Discussion Paper, Section 46 has been subject to 11 independent parliamentary reviews since 1976. Yet prior to the Harper Review, only the 1984 Green paper recommended change in the form of an effects test.

HIA agrees with the Harper Panel's conclusion that the law should protect competition, not individual competitors. But their ultimate recommendations to introduce an effects test and remove the "take advantage" elements run contrary to the findings of the vast majority of previous reviews, including the well regarded reviewed conducted by Justice Dawson in 2003.

In fact, arguments concerning market power go to the core principles at the heart of Australia's market economy; namely that firms will compete aggressively to win the business of consumers and create a larger share of the market or preserve their market share from being eroded by rivals or new entrants.

Consumers benefit when firms, even those already large firms, strive for increased business by charging lower prices and/or building a better product/service, even if that has the consequence of taking business away from smaller rivals. Competition is not painless. A by-product of this aggressive competitive behaviour is not only lower prices for consumers but invariably that some smaller, weaker or less agile firms may fail and exit the market. In many cases this facilitates the entry of new competitors with new products and new competition strategies.

In HIA's submission, misuse of market power laws should be targeted at those firms with substantial market power misusing that power to stifle competition and innovation. And misuse implies wrongful rather than accidental or collateral lessening of competition.

Whilst HIA acknowledges that governments regularly intervene and regulate markets to pursue various public policy objectives, to look at the "effect" of market conduct rather than its "misuse" represents a fundamental change that is inconsistent with competitive, productive and efficient markets.

Introducing laws that "protects" one business at the expense of another is the antithesis of competition, is counterproductive and will aggravate the difficulties faced by business. If firms were to be required to cease competing in a market at the point where weaker competitors might possible fail, that market would become moribund and competition would cease to provide consumers with the benefits it should.

HIA refers to the following comments of Justice Kirby in support of market freedom whilst in the NSW Court of Appeal:

But the law of contract which underpins the economy, does not, even today, operate uniformly on a principle of fairness. It is the essence of entrepreneurship that parties will sometimes act with selfishness.

The law may legitimately insist on honesty of dealings. However I doubt that, statute or special cases apart, it does or should enforce a regime of fairness on the multitude of economic transactions governed by the law of contract. Well meaning, paternalistic interference by courts in the market place, unless authorised by statute or clear authority, transfers to the courts the economic decisions which our law, properly in my view, normally reserves to parties themselves.[1]

The basis of HIA's opposition to an effects test is set out in further detail below together with some general comments in relation to competition and market power in the residential building industry.

2. COMPETITION, MARKET POWER AND THE RESIDENTIAL BUILDING INDUSTRY

Builders and contractors in the residential building industry operate in a regulatory environment that includes extensive licensing controls and consumer protection measures, a planning and building approval system that is complex and unpredictable, workplace health and safety management requirements, a hostile industrial relations framework, taxation reporting requirements and many other rules and regulations that do not apply to other businesses in the economy.

These regulatory measures impose high costs and often impose artificial barriers to entry that impede competition.

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1 *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130.

Yet in spite of this, the industry remains extremely competitive. There is a large number of small to medium sized firms, operating in a marketplace which includes but is not dominated by a handful of major home builders.

Competition amongst builders and contractors does however differ from market to market and region to region.

Although, as a general rule, the market is not concentrated, issues relating to market power and firm size do still occur from time to time. Like all markets, the housing industry is imperfect.

There are natural and competitive advantages for larger firms who have established economies of scale in managing the planning, land acquisition, market and finance risks associated with large scale developments.

In this regard, there is a perception that the rise in recent decades of large multi-staged, "master-planned" residential developments has had the effect of excluding smaller firms lacking the scale or capital necessary to compete with larger developers who can buy up land well ahead of time.

In HIA's view, this practice is not a case of use (or misuse) of market power but is principally caused by government land-use regulations such as urban growth boundaries, restrictive zoning, planning controls and other policies and regulations that artificially restrict the supply of land and impose rules that create considerable barriers to market entry.

Solving the underlying land supply shortage, in part, caused by a drip feeding of developable residential land by state governments and anticompetitive planning controls would diversify the range of subdivisions available to the market, which would ultimately lower prices, improve competition and improve affordability. This would be far more beneficial to consumers than any possible changes to section 46.

HIA considers that the housing industry does not provide persuasive evidence of any need to change section 46.

3. THE ARGUMENTS AGAINST AN EFFECTS TEST AND THE HARPER RECOMMENDATIONS

HIA notes that whilst there is a perception that the current section 46 threshold is too high, over the past decade there have been relatively few misuse of market power cases brought to trial.

In HIA's view, whilst supporting the Panel's view that section 46 should be about protecting competition rather than individual competitors, there is a real risk that the introduction of an effects test into section 46 would have the effect of becoming a de facto prohibition on firms with substantial market power using their market power to improve quality and drive down prices, rather than only preventing them from misusing that power.

HIA's opposition to the Panel's recommendations are elaborated on below:

1. An effects test as proposed risks judicial and government intervention into matters of commercial judgement, risk taking and decision making

   The majority of firms operating in the residential construction industry are small businesses. These firms must operate in an environment that is not only highly susceptible to external economic shocks but is highly input costed, highly taxed and heavily regulated. The costs of complying with complex overlapping state, local and Commonwealth laws and regulations have a considerable impact on business operations, profitability and viability of these small businesses.

   HIA does not support further regulatory interference in the residential building industry.

   Many of the proponents for change to section 46 appear to be somewhat motivated by a paternalistic desire to protect small business and to guarantee them an economic niche.

   HIA opposed the recent amendments to the CCA that extended unfair contract laws to business to business transactions on the basis it is an unnecessary and unwelcome intrusion into commercial relationships beyond the laws that were already in place. Similarly, changes to the misuse of market power laws, driven primarily by an agenda to "level the playing field", risks eroding the "independent" status of small business.

   A large problem with using competition laws to shift the balance of power in arrangements between big and small parties is that it further encourages businesses to seek regulators (and then the courts) to intervene and arbitrate in the distribution of gains in bargaining arrangements on matters of fairness and equity, rather than efficiency.

   Increased regulatory intervention is likely to lead to less proactive and dynamic commercial activity from business- too easily wielded a regulation, such as that proposed by an effects test invites ACCC intrusion into almost any commercial arrangement.

   The existing unconscionable conduct provisions of the CCA already provide significant avenues for the ACCC. For instance, HIA notes that the ACCC has recently commenced proceedings against Woolworths for an alleged abuse of their market power in trying to force more than 820 suppliers to pay over $60 million in extra payments.[2]

2. The current laws whilst perhaps imperfect, are well understood and provide certainty

   There is over 30 years of case law on the current provision.

[2] See http://www.smh.com.au/business/woolworths-unconscionable-conduct-case-kicks-off-in-federal-court-20160130-gmhtoe.html#ixzz3zGXV0UNz

Section 46 as it is currently interpreted by the Courts is intended to protect competition rather than protect individual competitors or small business per se.

According to the American Bar Association inserting a separate effects test into Section 46 has the potential to raise significant uncertainty as to how such a test ought to be applied by the Australian courts. Although Section 46's apparent focus on "purpose" appears at odds with international norms, the Australian courts have developed and applied Section 46 using sound economic principles and a careful consideration of competitive effects and potential harm to consumers.[3]

Further, whilst the effects test currently enjoys some support amongst certain small business groups, it should be noted that a number of organisation in support of an effects test, appear to be driven by concerns specific to their sector. The impact, intended and unintended, of the contemplated changes are likely to be broader than those specific industries.

3. <u>An effects test on the other hand is impractical, uncommercial and impede the proper working of the market</u>

   An effects test will also essentially require a business to weigh up the (adverse) impact of their conduct on their competitors before making a commercial decision.

   However the 'effect' of conduct will depends often on internal factors relating to the other parties in the marketplace, of which the competitor will have very imperfect knowledge.

   HIA is concerned that it will be impracticable and often impossible for boards and managers of those businesses with a substantial degree of market power to know in advance what the price effect of their price reductions, new services, better quality offerings will have on rivals and hence be sure that their conduct does not break the law. It will set their legal advisers an impossible task, with erring on the side of abundant caution the only sensible option.

4. <u>An effects test is flawed as it is no longer directed to a misuse of power</u>

   The proposal to capture any conduct that has the purpose of substantially lessening competition – without requiring any consideration of misuse or taking advantage of market power -- is much broader than what was originally contemplated.

   HIA understands it goes beyond the equivalent laws in other countries.

   HIA does not support the removal of the "take advantage" element.

   It is the "take advantage" element in section 46 that is significant and distinguishes legitimate commercial conduct from conduct which is essentially anti-competitive and must be penalised.

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[3] Joint Comments of the American Bar Association Section of Antitrust Law and Section of International Law on The Australian Competition Policy Review Issues Paper.

By way of a hypothetical example, a national building product supplier may achieve efficiencies in its logistics and inventory management and seeks to pass on cost savings to its customers at lower prices, with such prices uniformly set across the country. Suppose these price reductions have the effect of driving one or more smaller but less efficient rivals out of a regional market. This behaviour could be said to have substantially lessened competition in that market.

4. CONCLUSION

HIA considers that the dangers of any change to section 46, in terms of the chilling effect it would have on competition, significantly outweigh any social benefits that might arise through an enhanced ability of small business to survive with a protected status in an otherwise competitive Australian marketplace. In particular, HIA does not consider that any change would assist the housing industry or the participants in that industry.