

## PREDATORY PRICING AND DAWSON – PROTECTING THE COMPETITIVE PROCESS, NOT COMPETITORS!

LYNDEN GRIGGS\*

### I INTRODUCTION

The question is relatively simple to state: under what circumstances, and to what extent, can a corporation with substantial market power engage in vigorous price-cutting? The importance of this question is that, as noted by the Dawson Review,<sup>1</sup> misuse of market power can be particularly detrimental to competition. The answer masks a far deeper complexity, to which the Review only makes ancillary reference. This reference was made in the context of the Dawson Committee's discussion of s 46 of the *Trade Practices Act 1974* (Cth). In noting that the section was aimed at anti-competitive monopolistic practices, and not at protecting business against aggressive competition, they comment:

Pricing is predatory where a corporation sells at unsustainably low prices in an attempt to drive competitors from the market. However, predatory pricing may be difficult to distinguish from legitimate pro-competitive conduct, such as vigorous discounting. Vigorous competition is desirable because it is likely to deliver economically efficient outcomes.<sup>2</sup>

The difficulty of establishing predatory pricing is demonstrated by, to the writer's knowledge, only one successful case of this nature ever being litigated in Australia.<sup>3</sup> This lack of success demonstrates the inherent conflict of competition law: the same conduct may well be permissible under some circumstances (eg, predatory pricing where there is no market power), but unlawful where the corporation has a substantial degree of market power.

In the absence of guidance from the Committee the question I will therefore consider is what legal principles can be discerned to assist in determining when the corporation is rationally pursuing its own best interests (perhaps through increased market share, and ability to earn a competitive return at some later

---

\* Senior Lecturer, Faculty of Law, University of Tasmania.

1 Committee of Inquiry for the Review of the *Trade Practices Act*, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act* (2003) (the 'Dawson Review') 29.

2 Ibid 80.

3 See *Victoria Egg Marketing Board v Parkwood Eggs Pty Ltd* (1978) ATPR ¶40-081. Compare *TPC v CSBP & Farmers Ltd* (1980) ¶ATPR 40-151 and *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1992) ATPR ¶41-167.

stage), as against seeking to damage the competitive process through the elimination of a competitor, in order to misuse its market power. After all, neither s 46, nor any other provision of the legislation prohibits having market share, or making monopoly profits – the prohibition is directed purposively. Because of these deep-seated difficulties, it is rare that price-cutting will be seen to be harmful – a point articulated by McHugh J in *Boral Besser Masonry (now Boral Masonry Ltd) v Australian Competition and Consumer Commission*<sup>4</sup> ('Boral'):

[A firm with a substantial degree of market power] has no general duty to help its competitors, whether by holding a price umbrella over their heads or by otherwise pulling competitive punches.<sup>5</sup>

Having said this, however, it is the use of that power within a market, leveraged for a proscribed purpose, that invokes the operation of the legislation. What will be difficult, particularly following the recommendation of the Dawson Committee that no change be made to s 46, is in affirmatively proving when a corporation has illegitimately used its market power in a manner that causally connects with an established proscribed purpose. Is the competition in the market place unlawful? Or is it simply brutal? The Committee leaves this analysis to the developing jurisprudence.

## II THE DAWSON REVIEW AND S 46

The principal submission made by the Australian Competition and Consumer Commission ('ACCC') was that s 46 should be amended to include an effects test. The section, if the proposal had been accepted, would have read (with changes italicised):

A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose, *or with the effect or likely effect*, of:

- (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
- (b) preventing the entry of a person into that or any other market; or
- (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

The Committee rejected this suggestion. The main argument advanced for the introduction of an effects test was the alleged difficulty of establishing a

---

4 (2003) 195 ALR 609.

5 Ibid 665. The Full Federal Court has recently handed down its decision in *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd* [2003] FCAFC 149 (Unreported, Heerey, Sackville and Emmett JJ, 30 June 2003). In a 2:1 decision, the majority held that Safeway Stores had taken advantage of its market power by imposing or attempting to impose a term of trade on bread manufacturers that they would not supply cheap bread to independent retailers who were undercutting the Safeway price. According to the majority there was no rational business justification for what they were doing.

proscribed purpose was not borne out by a number of cases.<sup>6</sup> Furthermore, the introduction of an effects test would, as drafted, capture pro-competitive as well as anti-competitive behaviour. The Committee states:

For example, a large firm which established a new outlet in a specific market would not necessarily be behaving in an anti-competitive manner but rather to increase competition in the market. However, it is likely that the effect would be to damage incumbent firms. An effects test would apply and capture behaviour with an adverse impact on competitors, but not necessarily on competition. The introduction of an effects test would be likely to extend the application of section 46 to legitimate business conduct and discourage competition.<sup>7</sup>

Overseas jurisdictions were also of no assistance. The European Union uses the higher threshold of market dominance; an attempt to monopolise in the United States requires intent; and the Canadian effects-based test has been interpreted to require purpose. Further, few cases are instituted in these jurisdictions.<sup>8</sup> The Committee recognised that the introduction of an effects test would not bring Australia into line with other jurisdictions; more likely, it would isolate.

Other submissions made to the Committee in terms of amending s 46 were similarly rejected. A 'lessening of competition' test was proposed, but the response was blunt. To introduce this would only exacerbate the problems inherent in the effects test (ie, that efficiency-enhancing conduct would be captured). Similarly, a suggestion that the onus of proof be reversed was rejected as unfair, particularly given the severity of the penalties and the requirement for any defendant corporation to prove a negative (ie, that the corporation did not act with a proscribed purpose).<sup>9</sup>

The rejection of any amendment to s 46, and the limited discussion of predatory pricing leads to the inevitable questions raised at the outset:

- (1) What circumstances will lead to a breach of s 46 because of predatory pricing?; and
- (2) To what extent will vigorous competition by price-cutting be acceptable and when will the boundaries be breached?

---

6 See *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd (Star Picket Fence Case)* (1989) 167 CLR 177 ('*Queensland Wire v BHP*'); *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd t/as Auto Fashions Australia* (2001) 178 CLR 253; *Boral* (2003) 195 ALR 609; *Australian Competition and Consumer Commission v Universal Music Australia Pty Ltd* (2001) 115 FCR 442; *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd (No 2)* (2001) 119 FCR 1; *Rural Press Ltd v Australian Competition and Consumer Commission* (2002) 118 FCR 236.

7 Dawson Review, above n 1, 80.

8 *Ibid.*

9 *Ibid.*, 85.

### III *BORAL*

The decision in *Boral* provides the foundation for future analysis of these questions. It also leaves some lingering problems.

The essence of the claim was that Boral Besser Masonry ('BBM') was selling concrete masonry products below avoidable costs over the period of 1994–96. Internal memoranda also demonstrated that BBM had a wish that the price war would lead to one or more of its competitors leaving the market – although the supposed 'target' of this conduct not only survived, but also prospered.<sup>10</sup>

The High Court, in rejecting the Full Federal Court's deliberations,<sup>11</sup> noted that whilst the United States jurisprudence on predatory pricing would assist in the analysis, caution had to be exercised due to the legislative differences. Similarly, it was recognised that competition law did not provide protection against unfair competition. Statutory protection would only be provided where the corporation with a substantial degree of power in the market engaged in conduct that had a deleterious effect on the competitive process. The fact that vigorous competition may lead to the removal or elimination of a competitor was simply the reward the market place offers for the more efficient competitor.

The High Court then went on to articulate the paradigm that may be useful in determining when a predatory pricing claim is established. The six member majority of the High Court (in three separate judgments) recognised that recoupment of losses was a central factor, although they differed in the emphasis that this should be given. The joint judgment of Gleeson CJ and Callinan J recognised the factual importance of the possibility of recoupment in determining when predatory pricing exists.<sup>12</sup> Similarly, the joint judgment of Gaudron, Gummow and Hayne JJ indicated that predatory pricing necessitated pricing below avoidable cost together with a reasonable prospect of recovering the losses.<sup>13</sup> Justice McHugh's reasoning was of a similar vein – though, arguably, his Honour was the most strident in recognising the necessity of recoupment.<sup>14</sup> In dissent, Kirby J also recognised the importance of recoupment.<sup>15</sup> The High Court thus constructed a two-stage framework:

- (1) Was there pricing below avoidable cost?; and
- (2) Would the inevitable losses incurred during predation be recoverable?

But this formula does not answer all questions. Whilst not articulated in these terms, it is arguable that, should these two stages be met, the company under challenge may still be able to defend its conduct by establishing that there was a legitimate business justification for what they had done.<sup>16</sup> In essence, the company would argue that there was no taking advantage of a substantial degree

---

10 See the comments of the trial judge *Australian Competition and Consumer Commission v Boral Ltd* (1999) 166 ALR 410, 444 (Heerey J).

11 *Australian Competition and Consumer Commission v Boral Ltd* (2001) 106 FCR 328.

12 *Boral* (2003) 195 ALR 609.

13 *Ibid* 640–1.

14 *Ibid* 667–8.

15 *Ibid* 701.

16 *Ibid* 618, 626 (Gleeson CJ and Callinan J), 644 (Gaudron, Gummow and Hayne JJ), 665–6 (McHugh J).

of market power; the price-cutting was simply a commercial judgment made in response to particular industry or business concerns, or was the effect of simply one competitor in the market place seeking to injure or harm another competitor, (a constituent element of the competitive process). Such a formula mollifies the neutrality of ‘taking advantage’ so critical in *Queensland Wire v BHP*.<sup>17</sup> Following *Boral*, a causal connection between the market power and the proscribed purpose is insufficient to found liability. In addition, there must be no legitimate business justification or reason for that conduct. These elements form the essential ingredients within the framework established by Gleeson CJ and Callinan J in *Boral*. They ask: ‘does the corporation have substantial power in the market. If so, does the conduct involve a taking advantage of that power?’<sup>18</sup> In cases of predatory pricing, pricing below avoidable cost and opportunity for recoupment will evidence substantial power. A taking advantage of that power is demonstrated by the lack of any rational commercial business justification for what has occurred.

Other matters left unresolved by *Boral* include the possibility of recoupment occurring not by raising prices post predation, but by maintaining prices between those in an oligopoly, where a truly competitive market would see the price falling to a new level (possibly brought about by increased efficiencies through technical development). In addition, the status of recoupment as either an integral ingredient in the establishment of predatory pricing, or simply something of factual importance is still to be resolved – this being of critical importance when an application is made to summarily dismiss a s 46 claim because of lack of potential recoupment. One suspects that evidentiary difficulties in proving the potential for recoupment will also present themselves.

In a media release following the decision of the High Court in *Boral*, the ACCC made the following comments:

The judgment raises concerns as to the ability of the misuse of market power provision of the *Trade Practices Act* to protect viable small businesses and efficient new entrants from anti-competitive targeting by larger and better resourced competitors, thereby undermining the benefits of competition.<sup>19</sup>

Inherent in this comment is a suggestion that s 46 should be used to protect competitors, rather than the competitive process. In some respects, a literal reading of the legislation supports this interpretation. After all, it does refer to the taking advantage of market power for the elimination of a competitor, or for the preventing of entry of a person into the market, or for the deterrence of a person from engaging in competitive conduct. Similarly, when amendments were made to s 46 in 1986, the second reading speech noted that:

---

17 (1989) 167 CLR 177.

18 *Boral* (2003) 195 ALR 609, 634, 659 (McHugh J).

19 Australian Competition and Consumer Commission, ‘High Court decision highlights difficulties in establishing misuse of market power’ (Press Release, 7 February 2003) <<http://www.accc.gov.au/media/mediar.htm>> at 7 July 2003.

A competitive economy requires an appropriate mix of efficient businesses, both large and small. Whilst large enterprises may frequently have advantages of economies of scale, there are many occasions when large size does not of itself mean greater efficiency. However, a large enterprise may be able to exercise enormous market power, either as a buyer or seller, to the detriment of its competitors and the competitive process. Accordingly, an effective provision controlling misuse of market power is most important to ensure that small businesses are given a measure of protection from predatory actions of powerful competitors.<sup>20</sup>

However, the value judgments inherent in this approach have been ignored. Protection is of the competitive process, not of competitors. No judgment is to be made that big business is necessarily bad, and small business correspondingly good. Each is judged according to the criterion of economic efficiency. If the competitive process leads to a monopoly, then that will occur because of the quality of the product, method of distribution and the forces of consumer demand. Intrusive judicial and political interference seeking to redress perceived injustices between those with size, power and influence and those without, may well form part of welfare law, but has no role in regulating competition in the marketplace. In conclusion, successful predatory pricing actions will continue to be an elusive holy grail for private litigants or the regulator. One only hopes that the regulator will not be so dispirited by the latest losses to discontinue funding cases seeking to test the boundaries of the law.

---

20 For the second reading speech see J Duns and M Davidson, *Competition Law Cases and Materials* (2002) [4.1].