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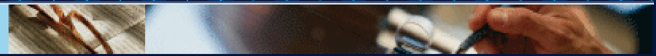

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Submission to the Senate Standing Committee on Economics

Enquiry into the Provisions of the Trade Practices Legislation Amendment Bill (No. 1) 2007 and the Trade Practices Amendment (Predatory Pricing) Bill 2007

July 2007

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A Executive Summary

1. It is a truism to state that if something is not broken, don't fix it. That truism is particularly applicable to section 46 of the *Trade Practices Act 1974* (Cth) (**TPA)**.

2. In this submission we provide reasons for our view that:

   - section 46 as it currently stands provides appropriate and adequate protection against illegitimate, anti-competitive of predatory pricing;
   - section 46 should not be amended to provide for a specific prohibition on predatory pricing, in the manner provided by either of the Bills which are the subject of this inquiry;
   - the proposed amendments which are said to seek to protect one class of competitors over another, in this case, small business, are unlikely to be effective and are more likely to distort the competitive process, result in confusion and increased uncertainty for all market participants, with the result being artificially high prices, to the detriment of consumers – something which is contrary to the objects of the TPA and competition law generally;
   - the amendments to the TPA contained in the Trade Practices Amendment (Predatory Pricing) Bill 2007, which are sector specific, are of particular concern and should be rejected as inherently dangerous and ill considered; and
   - many of the amendments to section 46 proposed in the Government's Trade Practices Legislation Amendment Bill (No. 1) 2007, whilst not objectionable, are simply a re-statement of the current law and add little, if anything to the state of jurisprudence on the issue.

3. The authors of this submission recognise that, in certain circumstances and in certain ways (such as the unconscionable conduct provisions), it may be appropriate to offer special protection to small business. It is our submission that amendment of section 46 in the manner proposed by the two Bills is not the appropriate vehicle for such protection and will not achieve the ends sought. Whilst we are not advocating the introduction of price regulation, price regulation for specified industries or sectors would, at least, offer the possibility of protecting small business without the uncertainties surrounding the proposed amendments to section 46. Whether such regulation is appropriate from a competition perspective is another matter.

B Introduction

4. For some time now there has been pressure on the Government to amend the TPA to make it easier for small business to address perceived misuse of power by larger businesses. The two Bills currently before the Senate, and which are the subject of this inquiry, are expressions of attempts to improve the effectiveness of the TPA in protecting small businesses from such conduct. Specifically, both Bills seek to address the issue of "predatory pricing", although the Trade Practices Legislation Amendment Bill (No. 1) 2007 goes further to amend section 46 more generally and to amend other sections of the TPA.

5. This submission addresses only the amendments proposed to section 46 of the TPA by both Bills. It covers the following matters:

- the current state of the law with respect to section 46 – is there any need for change?
- the concept and role of predatory pricing in competition law and how the Bills deal with the concept;
- the impact of the introduction of the concept of substantial financial power in a market;
- the impact of the introduction of an "effects test";
- the impact of the introduction of the test of "purpose or effect of substantially lessening competition" ; and
- other specific issues arising from each of the Bills.

6. For ease of reference the Trade Practices Legislation Amendment Bill (No. 1) 2007 will be referred to as the "**Government's amendments**" and the Trade Practices Amendment (Predatory Pricing) Bill 2007 as the "**Fielding amendments**".

C Section 46 – is there any need for change?

7. A review of the second reading speeches of both Bills makes it clear that they have been introduced in order "to improve the operation of the Trade Practices Act in relation to small business"[1]and to "give small businesses much needed protection from a practice that threatens to destroy their livelihood"[2]. There can be no argument that small business should be protected from illegitimate anti-competitive conduct by competitors. However, it is submitted that amending section 46 of the TPA in the manner, and for the purposes, referred to in the second reading speeches is both unnecessary and, particularly in the case of the Fielding amendments, contrary to the object of the Trade Practices Act.

8. The underlying rationale for amending section 46, as expressed in the second reading speeches, presupposes that section 46 is flawed in some way in that it does not adequately protect small businesses. In other words, it assumes a failure of section 46, at least as it impacts on small business. In this section we address the rationale and objectives behind the TPA and assess the effectiveness of the current section 46 to deal with issues facing small business.

C.1.1. What is the role of the TPA and section 46 in particular?

9. The object of the TPA is stated in section 2 of the Act as being:

> *"to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection".*

10. It is well established law that the purpose of the TPA "is to promote competition, not to protect the private interests of particular persons or corporations".[3]

11. It is significant that the objects of the TPA do not refer to the protection of competitors or to the protection of certain classes of competitors, whether they be big business or small business. There is a good reason for this. It is effective competition which underpins the operation of a market economy such as ours. Effective competition can best be assured, not by protecting one sector or one class of competitors over others, which distorts the competitive process, but by establishing rules and

[1] Second Reading Speech, Trade Practices Legislation Amendment Bill (No. 1) 2007 20 June 2007
[2] Trade Practices Amendment (Predatory Pricing) Bill 2007 Second Reading Speech 18 June 2007
[3] *Boral Besser Masonry Ltd v ACCC (*2003) 215 CLR 374, citing *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177 at 191; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 at 13 [17]

regulations which apply to certain practices. It is the focus on anti-competitive practices, rather than on competitors, which ensures that competition laws, such as the TPA, fulfil their function in a market economy of preventing abuses which are to the detriment of competition and, hence, consumers.

12. Since at least the enactment of the *Sherman Act* 1890 in the United States, monopolistic business practices have been recognised by the law as being illegitimately anti-competitive. In Australian competition law, and consistent with the stated objects of the TPA, section 46 of the TPA does not proscribe conduct merely by reference to particular competitors or classes of competitors. For the purposes of section 46, those practices are the taking advantage of a substantial degree of market power for one of three proscribed purposes being:

    - the elimination or substantial damaging of a competitor in the same or any other market;
    - the prevention of the entry of a person into the same or any other market; or
    - the deterrence or prevention of a person from engaging in competitive conduct in the same or any other market.

13. Amending section 46 to "skew" its focus towards a particular class of competitors, in this case, small business, has the potential to undermine the basic tenets of competition law.

C.1.2. Has section 46 failed small business - does the section prevent prosecution of predatory pricing as a form of anti-competitive conduct?

14. The very use of the term "predatory pricing" presupposes that the conduct in question must be, in some way, damaging. It has been variously defined[4] but in all cases involves conduct in which low prices are charged over a sufficiently long period to either drive a competitor out of the market or to prevent new competitors from entering the market. The question of whether the ability to raise prices and recoup losses once a competitor is driven out of the market is an essential element of the conduct remains a live issue[5]. However, provided that the preconditions set out in section 46, as described above, are met, there is currently nothing to prevent section 46 extending to circumstances of predatory pricing, whether it be by big business against small business or otherwise.

15. Proponents of amending section 46 to include specific reference to predatory pricing often point to the lack of successfully prosecuted cases of predatory pricing under the section as an illustration of the current section's failure to address the issue. It is submitted that it is incorrect to ascribe failure to section 46, particularly as it applies to small business, simply because there have been difficulties in obtaining success in cases of alleged predatory pricing under the section.

16. There is little doubt that, whilst section 46 in its current form encompasses predatory pricing as a form of prohibited anti-competitive conduct, the decided cases demonstrate that successfully prosecuting a company for alleged predatory pricing is another matter[6]. It is submitted that this is, and will be the case, no matter whether the section is amended to provide for a specific breach of the TPA by reason of predatory pricing, or otherwise.

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[4] See for example, Canada Bureau of Competition Predatory Pricing Enforcement Guidelines
[5] See for example, *Boral Besser Masonry Ltd v ACCC (*2003) 215 CLR 374
[6] The Boral case is an example of the difficulties in establishing that pricing is predatory.

17. The experience in other jurisdictions such as the United States, and in Canada (which has a specific prohibition in section 50(1)(c) of its Competition Act) [7] illustrates the inherent difficulties in establishing that pricing is predatory and anti-competitive. The problem lies, not in including predatory pricing as a specific offence, but in determining when, in fact pricing crosses the line between legitimate, but hard or aggressive competition and becomes illegitimate and predatory conduct. That issue is addressed more fully in section D of this submission.

D The concept and role of predatory pricing in competition law and how the Bills deal with the concept

18. As noted in section C above, the concept of predatory pricing as a form of illegitimate, anti-competitive conduct is not new to Australian law, nor, for that matter to the competition laws of other jurisdictions. This section looks at:

- how courts here and overseas have determined when pricing is predatory and becomes illegitimate and;
- the issues raised by the proposed amendments.

D.1 Predatory pricing as it has been considered by the courts

19. It is true to say that, in the pantheon of competition law cases, there are relatively few cases brought in the courts in which predatory pricing is alleged and even fewer cases in which there has been a successful prosecution for predatory pricing.

20. There can be little doubt that it is a difficult matter to prove that a company's pricing has been predatory such as to give rise to a breach of section 46. It is submitted, however, that the situation will not change by reason of the introduction of a specific offence of predatory pricing as contemplated by the Fielding amendments or by reason of the introduction of the new subsection 46(4) contemplated by the Government amendments. The reason for this lies with the concept of predatory pricing and the difficulty in establishing clear guidelines for when price cutting crosses the line from a normal and legitimate activity in competitive markets to behaviour which is abusive and damages competition.

21. Economists and courts, particularly in the United States, have long struggled with the concept of predatory pricing and whether it is beneficial for competition or anathema to it. Many have argued that a strategy of predatory pricing which relies on pricing at levels below cost until a competitor is forced out of the market is simply irrational[8] because it involves, amongst other reasons, loss of moneys from selling below cost with no certainty that price cutting will be successful or how long it will last. It is, therefore, a highly risky strategy without any guarantee of a positive or successful return. On the other hand, discounting or price cutting carries with it obvious benefits for consumers, at least in the short term.

22. It is because of the very real potential for low pricing to benefit consumers that competition laws both here in Australia and overseas require proof of something more than just low prices to establish a contravention. As Wilcox J said in *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1991) ATPR 41-128 at 52,897:

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[7] See for example, the Canadian decisions of R. v. Hoffman-La Roche, (1980), 109 D.L.R. (3d) 5; affirmed (1981) 125 D.L.R. (3d) 607 and R. v. Consumers Glass Co. (1981), 124 D.L.R. (3d) 274, and the US decision in Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 113 S. Ct. 2578, 2589 (1993.)

[8] See for example, John McGee, "Predatory Price Cutting: The Standard Oil (N.J) Case", Journal of Law and Economics 1 (April 1958)

"Traders commonly fix prices with the intention of diverting to themselves custom which would otherwise flow to their competitors. In doing so, they realise that, if they are successful, the result will be to damage – in extreme cases, even to eliminate – those competitors. But such conduct is the very stuff of competition, the result which Part IV seeks to achieve. It would be surprising if Parliament intended to proscribe competitive conduct when undertaken by a company with sufficient resources to compete effectively. Something more must be required."

23. That there are few cases where breach has been established should, it is submitted, be regarded as proof of the law working as it should to ensure the protection of competition and not as a failure of those laws.

24. In Australia, the High Court considered whether predatory pricing could be a breach of the TPA in *Boral Besser Masonry Ltd v ACCC (*2003) 215 CLR 374. In that case the ACCC was unsuccessful in proving that Boral had engaged in predatory pricing in breach of the TPA for a number of reasons. It is, however, worth citing in full the extract from the judgment of Gleeson CJ and Callinan J which deals with the role of predatory pricing in Australian competition law, as it is illustrative of the fundamental issues which the concept of predatory pricing raises:

"The purposes proscribed by s 46 include the purpose of eliminating or damaging a competitor. Where the conduct that is alleged to contravene s 46 is price-cutting, the objective will ordinarily be to take business away from competitors. If the objective is achieved, competitors will necessarily be damaged. If it is achieved to a sufficient extent, one or more of them may be eliminated. That is inherent in the competitive process. The purpose of the statute is to promote competition; and successful competition is bound to cause damage to some competitors.

It follows that, where the conduct alleged to contravene s 46 is competitive pricing, it is especially dangerous to proceed too quickly from a finding about purpose to a conclusion about taking advantage of market power. Indeed, in such a case, a process of reasoning that commences with a finding of a purpose of eliminating or damaging a competitor, and then draws the inference that a firm with that objective must have, and be exercising, a substantial degree of power in a market, is likely to be flawed. Firms do not need market power in order to put their prices down; and firms that engage in price-cutting, with or without market power, cause damage to their competitors. Where, as in the present case, a firm accused of contravening s 46 asserts that it is operating in an intensely competitive market, and that its pricing behaviour is explained by its response to the competitive environment, including the conduct of its customers, an observation that it intends to damage its competitors, and to do so to such a degree that one or more of them may leave the market, is not helpful in deciding whether the firm has, and is taking advantage of, a substantial degree of market power.

Section 46 does not refer specifically to predatory pricing, or recoupment, or selling below variable or avoidable cost. These are concepts that may, or may not, be useful tools of analysis in a particular case where pricing behaviour is alleged to contravene s 46. Care needs to be exercised in their importation

from different legislative contexts. In the United States, for example, predatory pricing is often discussed in the context of monopolisation, or attempts to monopolise, in contravention of the Sherman Act 1890. In Europe, Art 86 of the Treaty of Rome prohibits conduct which amounts to an abuse of a dominant position in a market. We are concerned with the language of s 46. We are principally concerned with whether BBM had a substantial degree of power in a market, and whether, in its pricing behaviour, and its upgrading of its production facilities, it took advantage of that power.

Predatory pricing is a concept that was examined in the evidence of economists, and in the judgments in the Federal Court. Ultimately, however, it is the language of the Act that must be construed and applied. The expression was used by Dawson J in Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd as an example of a practice that may manifest market power, but his Honour had no occasion to explain what he meant by it. One of the most important features of the decision in that case was a rejection of the argument that the concept of "taking advantage" in s 46 involves some form of predatory behaviour or abuse of power going beyond that which follows from the terms of the statute itself.

There is a danger that a term such as predatory pricing may take on a life of its own, independent of the statute, and distract attention from the language of s 46. There is also a danger that principles relevant to the laws of other countries may be adopted uncritically and without regard to the context in which they were developed.

Finkelstein J, in his reasons for judgment, pointed out that the context in which predatory pricing has been considered in the United States is materially different from that of s 46, and that an expectation of recoupment of monopoly prices at the end of a period of illegal pricing behaviour is not a statutory requirement for the application of s 46.

It may equally be said that there is nothing in s 46 that, as a matter of law, requires a distinction to be drawn between pricing below or above variable or avoidable costs. As has already been observed, the distinction is in some respects unsatisfactory. Furthermore, in the present case it is of limited utility. For some, but not all, of the relevant period, prices charged by BBM were below BBM's variable costs if no adjustment or allowance is made for the position of the wider Boral group. But we are not in a position to compare BBM's prices with Pioneer's variable costs; and, because C & M were substantially more efficient, it may be inferred that their variable costs were significantly lower than BBM's costs and they may well have been lower than BBM's prices. The process, outlined in the evidence as to pricing on major projects, by which BBM set its prices, clearly involved competitive pressure from Pioneer and C & M, and pressure from customers. In none of those cases is there any evidence that BBM set its prices lower than was necessary to win the business it was seeking. In some cases, BBM refused to reduce its quotes to match its competitors. To observe, as a matter of objective fact, that BBM's prices were often lower than BBM's variable costs is inconclusive if the prices were fixed as a result of competitive market pressure.

If one begins with the fact that a firm is a monopolist, or is in a controlling or dominant position in a market, then, by hypothesis, such a firm has an ability to raise prices without fear of losing business. If such a firm reduces its

> *prices, especially if it reduces them below variable cost, then it may be easy to attribute to the firm an anti-competitive objective, and to characterise its behaviour as predatory. But if one finds a firm that is operating in an intensely competitive environment, and a close examination of its pricing behaviour shows that it is responding to competitive pressure, then its conduct will bear a different character. That is the present case.*
>
> *While the possibility of recoupment is not legally essential to a finding of pricing behaviour in contravention of s 46, it may be of factual importance. The fact, as found by Heerey J, that BBM had no expectation of being in a position to charge supra-competitive prices even if Rocla and Budget left the market, leaving it facing Pioneer and C & M, was material to an evaluation of its conduct. The inability to raise prices above competitive levels reflected a lack of market strength. A finding that BBM expected to be in a position, at the end of the price war, to recoup its losses by charging prices above a competitive level may have assisted a conclusion that it had a substantial degree of market power, depending on the other evidence. But no such finding was made."*

25. As the Boral case demonstrates, the beauty of the current state of the law regarding section 46 is that it does not preclude a successful claim for breach based on predatory pricing being brought, whilst at the same time it does not proscribe pricing conduct which benefits both competition and consumers. As the majority stated in the Boral case:

> *"Even more than in the equivalent United States legislation, the Act, applicable to Australian corporations, does not spell out in detail the economic concepts that it seeks to uphold. This fact affords the Australian statute flexibility to adapt to changing economic conditions, altered corporate strategies inimical to competition and the interests of consumers, changing practices of recording internal corporate strategies and growing knowledge about economic science."*

26. It is submitted that the Fielding amendments, and to a lesser extent, the Government amendments, which seek to introduce a definition of predatory pricing, threaten this flexibility.

D.2 Issues raised by the proposed amendments

D.2.1 The Government amendments

27. The Government amendments state that, in determining whether there has been a breach of section 46 the Court may have regard to:

> *"(a) any conduct of the corporation that consisted of supplying goods or services for a sustained period at a price that was less than the relevant cost to the corporation of supplying such goods or services; and*
>
> *(b) the reasons for that conduct."*

28. It is submitted that these amendments do not add anything of any significant substance to section 46 and, in fact, will be liable to create greater uncertainty and confusion for all market participants when it comes to determining whether pricing is

legitimate or otherwise. There are a number of reasons for this which are examined below.

29. First, in providing for the ability of the Court to consider the reasons for the pricing conduct, the amendments simply re-state the current position, which is that the Court must look at all of the factors surrounding the pricing in question in order to determine whether it is predatory, in breach of section 46. For example, it may be entirely rational for a company to price some, or all of its goods or services at prices below “cost” (by whatever means that is measured) for a period of time. Even if such a company has a substantial degree of market power and a proscribed purpose of damaging or eliminating a competitor, such conduct may not amount to a taking advantage of market power so as to bring it within the purview of section 46. Examples might include a clothing company which seeks to move last season’s fashions by offering them at reduced prices until they are sold, or a company which seeks to move stock which is close to its use by date by offering it at below cost prices in the period leading up to expiry of the use by date. In both cases, the companies could conduct the discounted sales irrespective of the extent of their respective market power.

30. Secondly, the lack of definition of what constitutes a “sustained period” or what is the “relevant cost to the corporation” can only create uncertainty. In each case, the definition will depend on the facts of the case and raises a number of vexed questions which will require judicial determination. For example, does “sustained” require something more than a short, sharp period of discounting, which can be equally as harmful to a competitor as a longer period, if undertaken at a particularly vulnerable time in the life cycle of that competitor? At what point in time does the period of price cutting become sufficiently “sustained” as to warrant bringing an action – must a party wait until the alleged damage to it has been completed, or at least commenced? In Victorian Egg Marketing Board v Parkwood Eggs Pty Ltd (1978) ATPR 40-081, Bowen CJ held that “temporary” or “sporadic” pricing was an essential element of predatory pricing in breach of section 46. The Fielding amendments, however, offer no guidance to Courts as to how this requirement fits with a requirement that the conduct in question be for a sustained period. Similarly, what is meant by the term “relevant cost”? Does this refer to pricing below or above variable or avoidable costs, concepts which the High Court in the Boral case has recognised may be of “limited utility”?

31. Definitional problems aside, the amendment raises some significant questions surrounding the prosecution of such claims. The amendment does nothing to assist a party who is on the receiving end of price discounting by a competitor, to know what is the actual “relevant cost” of that competitor. This creates a dichotomy for competition law, which, on the one hand, rightly prohibits practices where competitors share information about costs and prices but on the other hand creates an offence, the initial allegation of which may only be brought on a suspicion about, and can only be established by, actual knowledge of the competitor’s costs. It would be a brave competitor who embarks on an allegation of predatory pricing under the amendments based on a mere suspicion about a competitor’s costs.

32. Of course, aggrieved parties may seek the assistance of the Australian Competition and Consumer Commission (ACCC) to determine the costs of alleged offenders, using its powers under section 155 of the TPA. It is hard to see how the ACCC can be in a position to reasonably suspect a contravention of the TPA such as to trigger its rights to use section 155 in such a situation, unless it has some indication of the costs in question. This issue of such a notice, itself, can place an unrealistic burden on a company. Experience indicates that few, if any, companies conduct their

businesses by analysing costs on a variable basis, to the extent which may be necessary to establish or defend a claim of predatory pricing. It is entirely possible that an allegation of predatory pricing and the subsequent cost and difficulties with complying with a section 155 notice may themselves become powerful weapons in the hands of companies who "do not want to match their competitors' price cutting".[9]

D.2.2 The Fielding amendments

33. The Fielding amendments raise a number of the same issues as are raised by the Government amendments (eg uncertainty regarding the period of time required for pricing to become predatory and difficulties of proof of costs). The Fielding amendments also raise other significant concerns which are discussed below.

34. Although the amendments provide some certainty by specifying that the costs to be considered are "the average total (fixed plus variable) cost of producing and supplying the goods or services", it is the concept of "unreasonably low" which governs whether pricing will be predatory. The amendments, however, do not give any real guidance as to what is "unreasonably law" pricing and are, in fact, circular in that regard insofar as the proposed subsection 46AA(3) (c) says that one of the factors the Court may take into account in considering whether a corporation has engaged in predatory pricing is "*the period of time for which the goods or services are offered at an unreasonably low price".*

35. It is worth noting that Canada, which prohibits companies from selling products at unreasonably low prices, has formulated extensive guidelines as to how the determination will be made but, if decided cases are any measure of success, does not appear to have been any more successful in establishing predatory pricing than has been the experience in Australia under the current section 46.

36. The Fielding amendments demonstrate a lack of understanding of the operation of markets and the factors which affect companies in their pricing decisions. This is demonstrated by the inclusion of subsections 46AA(3)(b) and (d) which provide, respectively, that the Court may take into account "*the price for which competitors of the corporation are offering the same goods or services*" and *"whether the corporation is offering the same goods or services in other markets for higher prices".* Whilst a monopolist may be able to set prices without regard to competitors' pricing or other market factors, in a functioning competitive market, a number of factors will impact on pricing. This was clearly recognised by the High Court in the Boral case. Such factors include not just costs and the pricing of competitors but also the power of customers. Those factors may not be the same in all markets in which the particular company operates. Thus, the prices charged in other markets may have no relationship to the prices charged in the market complained of.

37. The proposal that the Court may take into account "*the price for which competitors of the corporation are offering the same goods or services*" (subsection 46AA(3)(b)) raises another issue. It is not implausible that a company which has the requisite degree of market or financial power required to trigger the section, would regard this subsection as setting a floor price (being its competitors' pricing) below which it should not go. In the context of a supplier - reseller relationship, the setting of minimum or floor prices is absolutely prohibited under the TPA as resale price maintenance. It is submitted that the Fielding amendments provide a significant

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[9] Predatory pricing as a "convenient weapon" was suggested by Thomas J DiLorenzo in *The Myth of Predatory Pricing* Cato Institute Policy Analysis No. 169 (1992)

disincentive to companies to offer low prices, a practice which, if it occurs, can only be to the detriment of consumers and competition.

38. The Fielding amendments expressly provide that a company may be held to have engaged in predatory pricing "*even where the corporation has no intention of recouping the costs of its predatory conduct".* This echoes the views expressed by the High Court in the Boral case that *"the possibility of recoupment is not legally essential to a finding of pricing behaviour in contravention of s 46".* The High Court, however, went on to state that *"it may be of factual importance"*. The factual importance of the possibility of recoupment should not be under-estimated – it has a very important role in assisting the determination whether pricing conduct is rational and legitimate or irrational and illegitimate. There is a very real danger in the Fielding amendments that the factual importance of the possibility of recouping the losses suffered by reason of the low prices will be overlooked.

39. As noted in section D.2.1 above, there are inherent difficulties in determining the costs which should be taken into account when assessing whether pricing is predatory. This issue takes on greater difficulty when at least two of the three "markets" to which the Fielding amendments apply are considered. They are the grocery "market" and the "market" for pharmaceutical products, proprietary medicines and toiletries, each of which comprise large numbers of different products. In determining whether a supermarket chain has been guilty of predatory pricing, the amendments are silent as to whether such predatory pricing can occur across the entire range of products, across individual products or, perhaps across those products which are used to entice people into the store. This problem of market definition by reference to channels or sectors is discussed more fully in Section H below but its implications for determination of when and what prices are "unreasonably low" creates significant uncertainty.

40. Finally, the introduction of the concept of substantial financial power (discussed in detail in section E below) and the removal of the linkage between the pricing conduct and that power (whether it be market power or financial power) which is currently found in the requirement in section 46 that a company must take advantage of its power before it can breach the section provides a significant disincentive to any financially powerful company to charge low prices. The failure of the amendments to take account of the many legitimate factors which will impact on a company's pricing and ability to price at low levels, such as the cost of rent and labour and the efficiencies and economies of scale to be obtained from volume will all impact on the reasonableness or otherwise of pricing. Without some express ability to take these factors into account, the Fielding amendments are almost certainly liable to create confusion. This confusion and the risk of becoming embroiled in a predatory pricing investigation will hamper the ability of such companies to respond to price competition, with the result that consumers will pay higher costs.

E The impact of the introduction of the concept of substantial financial power in a market

41. The definition of predatory pricing proposed by the Fielding amendments applies to corporations which have substantial market power as well as to corporations which do not have substantial market power but have substantial "financial power". The proposed amendments do not define or attempt to provide any guidance on what may be considered to be financial power.

42. While there may be disagreement as to the exact nature of the test to be applied in determining whether a corporation has substantial market power, the concept is well

known in the jurisprudence surrounding section 46. On the other hand the concept of financial power or strength, while mentioned in the authorities, has not received any substantial judicial exegesis. It is submitted that inclusion of this concept will only serve to increase uncertainty in the law regarding predatory pricing and to stifle legitimate pricing behaviour by efficient but financially strong companies, including those who are new market entrants.

43. In the report of The Senate Economics References Committee “The effectiveness of the Trade Practices Act 1974 in protecting small business” March 2004 the Committee noted concerns expressed in submissions by the Business Council of Australia as to the difficulties which may be faced by a Court in defining with any degree of certainty, what constitutes substantial financial power[10]. An example provided was where a parent or related corporation had substantial funds or ability to raise such funds, but these were not accessible by the corporation whose conduct was impugned.

44. A further concern is whether the concept of substantial financial power necessarily involves a relative assessment of the financial power of other competitors in a particular market. Section 46(4) specifically provides that a reference to power in that section is a reference to market power and section 46(3) specifically directs a Court in determining the degree of market power held by a corporation, to have regard to the extent to which the conduct of the corporation is constrained by actual or potential competitors or customers or suppliers of the corporation. No similar guidance is provided by the Fielding amendments. One can readily envisage a scenario in which, as was the situation in Boral, vigorous competition results in one firm in a market lowering its price below that of its competitors, which then respond in kind. If say, 9 out of 10 competitors in such a scenario have ‘deep pockets’ and one does not, each of the 9 runs the risk of breaching proposed section 46AA if the purpose or effect of the discounting is to take market share from (damage) a competitor or if the firm without deep pockets exits the market, despite the fact that the welfare of consumers has been enhanced and, in the latter example, the competitive environment is unlikely to result in increased prices consequent upon and subsequent to that exit.

45. Similar concerns arise with the example of a new entrant to a market which invests significant amounts of capital in infrastructure and marketing and prices its product or services competitively in order to gain customers and achieve economics of scale. At the entry stage the prices set by the new entrant may well exceed its fixed and average variable costs, but may be profitable as its market share grows. Under proposed section 46AA if such pricing were to result in the exit of a competitor the new entrant would likely be in breach. In its March 2004 Report the Senate Economics Referees Committee used Virgin Blue as an example of such an entrant, without any criticism. Another example in the last 10 years has been the entry of Aldi into the grocery sector.

46. The likelihood that the criterion of financial power might have such a deleterious effect on competition was recognised by the Senate Economics Reference Committee when referring to a submission from the Law Council of Australia[11]. The Committee also recommended that ‘financial power’ be defined in terms of access to financial, technical and business resources. Interestingly, the LCA did not propose an effects test but did propose that where conduct was engaged in by a corporation with

[10] para 2.54
[11] at paragraphs 2.51 and 2.52

substantial financial power for a prescribed purpose it should only be a breach where it also resulted in a substantial lessening of competition.

47. Ultimately, the Senate Economics Reference Committee rejected submissions that substantial financial power should be a separate criterion to substantial market power, however the Committee recommended that a Court should be permitted to have regard to a corporation's financial power in determining whether a corporation had a substantial degree of power in a market[12]. We consider that the Committee's recommendation in this regard is consistent with the judgment of Gleeson CJ and Callinan J in Boral where their Honours stated[13]:

> *"Financial strength is not market power, although if a firm has market power, its financial resources might be part of the explanation of that power….Power in a supplier ordinarily means the ability to put prices up, not down, but if a market is not competitive, and a firm puts prices down, seeking to eliminate a potential rival, ….., its ability to act in that manner may reflect the existence of market power.*

48. We note that in commenting on the decision of the High Court in Rural Press Limited v ACCC [2005] HCA 75 the Committee formed the view that the High Court had rejected the notion that financial power or strength may be relevant in determining whether market power existed.[14] While the judgment of the majority is capable of such an interpretation, we disagree that the High Court has moved away from the views expressed by Gleeson CJ and Callinan J in Boral. What distinguished Rural Press from Boral was the fact that the High Court, and the Full Federal Court considered that Rural Press were in the same position in regard to the relevant market as if it had been a new entrant, notwithstanding its access to under utilized resources in another market.[15]

F The impact of the introduction of an "effects test"

49. The Fielding amendments seek to introduce an "effects test", that is, a company with a substantial degree of market or financial power which engages in predatory pricing which has the purpose or effect of substantially lessening competition or eliminating competitors will be in breach of the TPA.

50. The question of whether section 46 should be amended to include an effects test is not new. It is instructive to examine in some detail the reasoning for rejection of an effects test on previous occasions.

51. The Dawson Committee Report **(Dawson Report**)[16] notes that, prior to its recommendations, the proposal for the introduction of an effects test into section 46 of the TPA had been considered on a least nine previous occasions and had never been recommended. The Dawson Report also notes that the major reason why such a proposal was rejected was the concern that such a test would capture legitimate business conduct and would result in uncertainty for business and further result in a loss of at least part of the current jurisprudence surrounding section 46 [17]. It is

[12] Recommendation 2.4 paragraph 6.1
[13] at paragraph 138
14 at paragraph 2.58.
[15] see Rural Press paragraph 53
[16] Trade Practices Act Review 2003, Chapter 3, page 82 and following
[17] Dawson report at p84

submitted that the views of the Dawson Committee, based on an extensive investigation of the matter, remain as valid today as they were in 2003.

52. In the Dawson Committee's view the requirement that a corporation 'take advantage' of its market power for one of the proscribed purposes had been interpreted by the High Court as meaning little more than the corporation 'use' its market power for a proscribed purpose in the sense that the existence of market power 'facilitate' the corporations action's[18]. In its submission to the Dawson Committee the ACCC recommended the adoption of an effects test principally on the basis that there were difficulties in establishing that market power was taken advantage of for an illegitimate purpose.

53. In its submission the ACCC argued that legitimate competition on pricing would not be caught by the inclusion of an effects test within section 46 by reason of the fact that aggressive pricing behaviour would not fall foul of the section unless it had occurred as a consequence of the corporation in question having 'taken advantage' of its market power for an illegitimate purpose, the appropriate test for this limb of section 46 being determined by answering the question whether the corporation 'would be likely' to engage in the same conduct in a competitive market, which required that the conduct in question be measured against the norms of competitive market behaviour determined by economic theory[19]. In response the Dawson Committee noted as follows:

> "*The ultimate test of the use of market power is whether the corporation's conduct was made possible by the absence of competitive conditions, but the application of that test may lead to somewhat unpredictable results and, of its self, it affords an uncertain safeguard against the capture by an effects test of legitimate business conduct"*[20]

54. It is significant to note that the requirement of "taking advantage", which was relied upon by the ACCC to mitigate against inappropriate results flowing from an effects test, is absent from the Fielding amendments. In the event, the Dawson Committee did not accept the ACCC's submission noting the extensive investigatory powers available to the ACCC under the TPA[21].

55. In *Melway Publishing Pty Limited v Robert Hicks Pty Limited* [2001] HCA 13 at paragraph 8, the majority of the High Court noted that a breach of section 46 potentially gave rise to significant pecuniary penalties and, as such, there was force in the suggestion that the section should be construed in such a way as to enable a corporation, with a substantial degree of power in the market, to know with some certainty whether a proposed course of conduct is or is not lawful before that conduct was engaged in.

56. It is submitted that, for all the reasons accepted by the Dawson Committee, the adoption of an effects test in the context of section 46 may have the effect of inadvertently capturing lawful competitive business conduct and, at the very least, will lead to uncertainty within the business community as to whether any proposed course of conduct is legitimate or not, with the likelihood that legitimate competitive

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[18] p81

[19] ACCC Submission to the Committee of Enquiry for the Review of the Competition Provisions of the Trade Practices Act 1974, Chapter 2, pp 91-93

[20] Dawson Report p81

[21] Dawson Report, Chapter 3, pp77-79

behaviours with regard to pricing strategy and activities, will be stifled to the detriment of consumers.

57. The difficulties for legitimate competitive behaviour which is likely to be encountered in adoption of an effects test are magnified, made patent and compounded, when coupled with the concept of 'financial power' as is proposed to be included by the Fielding amendments. Unlike the current section 46, the proposed section 46AA makes no reference to a requirement that the 'financial power' (the uncertainties of which concept have been discussed in the previous section of this submission) be 'taken advantage of' for a corporation to breach the proposed section.

58. The definition of predatory pricing in the proposed section 46AA, in the context of substantial financial power, merely requires that three elements be established for it to be breached:

- substantial financial power;
- the offering of unreasonably low prices; and
- the offer be made with the effect of lessening competition or the elimination of a competitor.

59. In determining whether the proposed section has been breached, but not necessarily whether any particular element described above has been established, a Court may have regard to the matters set out in subsection 46AA(3), which matters include whether the goods or services are offered at a price less than their cost and the price for which competitors of the corporation are offering the same goods or services. For this purpose "cost" is defined to mean the average total (fixed plus variable) cost of supplying the goods or services (see proposed section 46AA(2)).

60. In *Boral* [22] Gleeson J and Callinan J stated that financial strength was not market power, although if a corporation was found to have market power, its financial resources might be part of the explanation of that power. A determination as to whether a corporation had market power required a detailed consideration of, among other matters, the competitive dynamics of the market, including the conduct of customers and their countervailing power[23]. Their Honours stated that the essence of market power was the absence of constraint from the conduct of competitors or customers[24] and that if a corporation was operating in an intensely competitive environment, and its pricing behaviour showed it was responding to competitive pressure, then it could not be considered to be engaging in 'predatory' conduct.

61. In Boral, the ACCC argued that Boral's pricing of masonry blocks below its 'avoidable' or 'variable' costs (being those costs Boral was required to incur over and above its fixed costs in order to manufacture the products) demonstrated that Boral's pricing behaviour was predatory. Gleeson J and Callinan J commented that this argument involved a considerable risk of over simplification and that there may be legitimate and commercially rational reasons for pricing below variable cost depending on the dynamics in the market and the alternatives available to such

[22] at paragraph 138,
[23] at paragraph 103
[24] at paragraph 121

pricing behaviour, at any given time[25]. Other examples of legitimate pricing below average variable cost include circumstances where a competitor is introducing a new product into a market in order to be able to build market share and obtain the benefit of economies of scale, at which time the price may be profitable, and situations where the product is being delisted, inventories of the product are excessive, the product has a use by date, or, finally, where companies in a competitive environment engage in a price war.

62. It is unclear from the Fielding amendments whether proposed section 46AA(3) is intended to circumscribe the range of matters a Court may have regard to in determining whether a corporation has engaged in predatory pricing. Importantly, it is submitted that the price at which competitors of a corporation are selling the same products is irrelevant in determining whether a corporation is engaging in the practice of predatory pricing unless there is also a consideration of the fixed, variable and total costs of those competitors. A glaring omission from the proposed section 46AA(3) is any requirement that a court have regard to the costs of a corporation's competitors in determining whether the section is contravened.

63. A key goal of effective competition policy is to encourage competitors to achieve operational efficiencies, reduce costs and pass on benefits to consumers in the form of lower prices. The introduction of an effects test into section 46 of the TPA together with the introduction of a concept of 'financial strength' runs directly contradictory to this goal. It is submitted that these amendments will result in significant uncertainty for any corporation which may be found to have financial strength in a market, in determining its pricing strategy, and are likely to result in floor prices in the market being set by the most inefficient and/or profit maximising competitor.

G The impact of the introduction of the test of "purpose or effect of substantially lessening competition"

64. As presently drafted, section 46 is directed at three proscribed purposes being:

- the elimination or substantial damaging of a competitor in the same or any other market;
- the prevention of the entry of a person into the same or any other market; or
- the deterrence or prevention of a person from engaging in competitive conduct in the same or any other market.

65. Merely having a purpose of substantially lessening competition is not enough to breach section 46. The Fielding amendments, however, provide that a company will be found to have engaged in predatory pricing if it:

- has a substantial degree of market power or substantial financial power;
- has priced at unreasonably low prices;
- with the purpose or effect of substantially lessening competition or eliminating a competitor.

66. It is submitted that the addition of a test which focuses on the purpose or effect of substantially lessening competition, as regards pricing is more likely than not to capture legitimate pricing behaviour and will have the undesirable result of stifling legitimate price competition. As Wilcox J recognised in the Eastern Express case,

[25] at paragraph 70

it is the "very stuff of competition" for "traders" to fix prices with the intention of effecting competition. To stifle such conduct, especially for companies whose efficiencies are either the result of, or have been enhanced by their financial power, is to stifle competition itself. The ACCC, although supportive of an effects test generally, recognised in its submission to the Dawson Committee that :

> "*the Act is intended to encourage increased efficiency that is, producing the goods and services most wanted by consumers at the lowest cost*"[26].

H Specific issues arising from each of the Bills

H.1 The Fielding amendments

67. The Fielding amendments are directed at three specific markets only, being the markets for "groceries", "sale of fuel" and "pharmaceutical products, proprietary medicines and toiletries". It is submitted that amendments which are sector specific should only be made where there is a clear case of market failure in those sectors. Aggressive competition and the existence of efficient participants which is evidenced by low prices is a sign of competition working effectively, to the benefit of consumers. The introduction of regulation designed to protect particular classes of competitors in particular sectors distorts the competitive process and is anathema to the principles which underpin competition law.

68. The Fielding amendments leave open what constitutes the three identified markets, either by reference to the specific products included in the markets (other than in the case of the fuel market) or the extent of the geographic coverage of the same.

69. For markets such as the grocery market there are many products which fall within the definition of a grocery item (being "foodstuffs and other household supplies"[27]). However, not all of those products will be substitutable in the economic sense required for a product to fall within a given market (toothpaste and tinned tomatoes being one obvious example). Without any definition in the amendments we are left to ask, what products constitute the "groceries" market? Is it every product offered for sale at a supermarket? Does it, therefore, also include the toiletries which are available for sale in a supermarket but which are said to be the subject of a separate market in the Bill. The problem also arises with regard to the "pharmaceutical products, proprietary medicines and toiletries" market, as we are left to wonder whether this market includes all products sold through pharmacies, including prescription drugs, consumer healthcare products and toiletries.

70. It is submitted that this confusion between markets and channels or sectors is a fundamental flaw of the Fielding amendments and a misuse of competition laws. It can only create confusion and increased uncertainty for all participants in those channels and will only make it more difficult to obtain successful prosecutions under section 46 of the TPA because participants will be forced to seek clarification of the meaning of the amended section from the Courts.

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[26] at p 80

[27] Collins Australian dictionary definition

H.2 The Government amendments

71. This submission does not address in detail the remaining provisions of the Government amendments to section 46, other than to submit that those amendments, whilst not objectionable, are superfluous insofar as they express the law as it has already been decided in cases concerning section 46.

I Conclusion

72. While the goal of preserving legitimate competition in order to enhance the welfare of consumers is to be pursued and encouraged, unfortunately the proposed bills will not facilitate the achievement of this goal. On the contrary, it is submitted that the Fielding amendments will result in significant uncertainties for businesses and positively encourage anti-competitive pricing behaviour which, while potentially to the benefit of small business in the short term, will be of significant detriment to the welfare of consumers.

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