The Search for an Effective Predatory Pricing Provision

INTRODUCTION

Predatory pricing usually occurs when a large market participant unfairly lowers its prices so as to damage its competitors, drive them from a market, or deter them from entering a market, and then raises its prices to take advantage of the reduction in competition it has generated.

Since the adoption of the US *Sherman Antitrust Act* (***Sherman Act***) in 1890, jurisdictions around the world have attempted to penalise predatory pricing. However, determining whether pricing is unfair or predatory as distinct from legitimate and competitive is a difficult task, as legitimate competitive pricing can also damage competitors, and it is hard to distinguish from predatory pricing. Inadvertently penalising legitimate competitive pricing will also have a serious and broad based anti-competitive effect in the economy due to the central function that competitive pricing performs in any free market economic system. Any provision targeting predatory pricing must therefore be drafted carefully so as to avoid capturing legitimate competitive pricing.

As a means of dealing with this issue, most jurisdictions have attempted to proscribe predatory pricing by way of a general provision drafted to prohibit "monopolization", or a "misuse of market power", or target "unfair pricing". These provisions give courts wide latitude of interpretation to make a determination on specific allegations of predatory pricing based on their own logic and jurisprudence, therefore avoiding the pitfall of inadvertently legislating a prohibition on legitimate competitive pricing. The problem with these provisions is that they do not attempt to make further inroads at a definition of what is unfair, predatory, or monopolistic, and therefore lack certainty, making it difficult for businesses, large and small, to know when a breach has occurred.

An effective predatory pricing provision is one that accurately defines predatory pricing so as to efficiently capture predatory pricing conduct and give certainty of application, but without capturing legitimate competitive pricing behaviour. By reference to overseas

and Australian legislation and jurisprudence, this paper will attempt to find an answer to the difficult question of how to draft an effective predatory pricing provision.

THE AUSTRALIAN MISUSE OF MARKET POWER PROVISION

In Australia, many attempts have been made to capture predatory pricing under section 46 of the *Trade Practices Act* 1974 (*Cth*) (***TPA***)[1], which, until recently, relied on a general misuse of market power provision to prosecute predatory pricing. Section 46 of the *TPA* has been amended several times since its enactment with predatory pricing in mind, but to date only one prosecution for predatory pricing under this section has been successful[2]. Consequently, section 46 has attracted a large volume of criticism for its inability to capture predatory pricing behaviour.

In September last year, section 46 was amended again, to include a group of amendments that have been described as the Birdsville Amendment[3] (**Birdsville Amendment**). Unlike general misuse of market power provisions, the Birdsville Amendment boldly attempts to proscribe predatory pricing by way of a more proscriptive definition of predatory pricing conduct. In one sense, this new approach has already had positive results. Since the date of enactment of the Birdsville Amendment and up to 11 April 2008, none of the 47 predatory pricing complaints received by the Australian Competition and Consumer Commission (**ACCC**) have been found to warrant a prosecution or further investigation due to falling short of one specific criteria or another required by the Birdsville Amendment[4]. It seems that accurately defining predatory pricing has allowed the ACCC to make an early and more certain determination regarding the merit of predatory pricing complaints, saving time and money that might

[1] Predatory pricing was initially prohibited under a similar provision in the *Australian Industries Preservation Act* 1906 (*Cth*).
[2] *Victorian Egg Marketing Board –v- Parkwood Eggs Pty Limited* (1978) 33 FLR 294. See the Explanatory Memorandum, *Trade Practices Legislation Amendment Bill (No. 1) 2007*, p 7. As of June 2007, only five (5) of the 33 cases in which a breach of section 46 of any kind was argued were successful.
[3] The major component of which is ssn 46(1AA).
[4] Letter from Graeme Samuel to Minister Bowen outlining the ACCC's position on misuse of market power, 11th April 2008, published on Minister Bowen's website at http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/027.htm&pageID=003&min=ceb&Year=&DocType=0

otherwise have been spent on investigation or proceedings. This same certainty would also apply to businesses assessing their own or their competitors' pricing conduct.

However, the Birdsville Amendment has also attracted a large amount of criticism, both in relation to its perceived ability to capture legitimate competitive pricing conduct and for its incorporation of new undefined terms which require further judicial definition[5]. Recently, the Commonwealth Government has indicated that it intends to amend section 46 again to more accurately capture predatory pricing behaviour, although a new bill has not yet been tabled[6].

Subsection 46(1) of the *TPA*, the general misuse of market power provision, provides that a corporation with a "substantial degree of power in a market" must not "take advantage of that power" for the purpose of:

(a) eliminating or substantially damaging another competitor;

(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."

As a result of significant levels of criticism of section 46, the *Trade Practices Legislation Amendment Act (No 1)* 2007 (***TP Amendment Act***) recently amended section 46 in a number of aspects (**New Amendments**). One of the amendments of particular interest to the determination of predatory pricing was the addition of the words "in that or any other market" after the words "of that power" in subsection 46(1) as mentioned above (the **Cross-market Amendment**). Another was the Birdsville Amendment, which is actually several related amendments proposed by Senator Barnaby Joyce. These amendments will be considered further below.

[5] See Graeme Samuel, *Promoting competition or protecting consumers – the role of competition policy and its implications for Australian businesses*, Address to the John Curtin Institute of Public Policy Forum, Perth, 12 October 2007.

[6] See Hon Chris Bowen MP and Hon Craig Emerson MP, *Rudd Government Acts to Strengthen Laws to Promote Fair Competition,* Media Release of 28/04/08 No 027.

The central provision of the Birdsville Amendment is a new subsection 46(1AA) which provides that any corporation with:

(a) "substantial share of a market";

(b) must not price their product below its "relevant cost";

(c) for a "sustained period"; and

(d) for any of the same proscribed purposes as subsection 46(1).

These new terms quoted above have not been defined in the *TPA*, and have been the subject of some criticism due to their current lack of definition, despite providing a more detailed definition of predatory pricing than the previous general misuse of market power provision. Certainly, the lack of definition of these terms is only a short term problem and may disappear once the courts have had a chance to consider the new provision.

THE OBJECT OF SECTION 46: PROTECTION OF SMALL BUSINESS OR PROTECTION OF COMPETITION?

In his second reading speech for the *Trade Practices Revision Act* 1986 (*Cth*), referring to section 46 of the *TPA*, the Attorney General stated that:

> an effective provision controlling misuse of market power is most important to ensure that small businesses are given a measure of protection from the predatory actions of powerful competitors. .... According to the Blunt Committee:
>
> > the primary thrust of the competitive provisions of the Act should be towards efficiency. However, … the diminution of competition consequent upon small businesses being denied the opportunity to compete may well work, in the long term, against efficiency because the firms with market power would eventually be free of the disciplines of the market place.

In other words, section 46 has the unenviable and sometimes conflicting task of the protection of competition through the protection of smaller competitors, potentially prohibiting conduct that benefits consumers in the short term, in order to preserve the

competitiveness of the market in the long term. Section 46 is unique in this regard. A predatory pricing provision would have the same objectives.

The object of the *TPA* is provided to be:

> to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.[7]

All three branches of this object, being the promotion of *competition*, *fair trading* and *consumer protection* are advanced by a provision which protects smaller competitors from the predatory conduct of larger competitors, and section 46 therefore has the same objectives as the *TPA*, albeit applied in a specific context. Those same objectives will however be harmed by a predatory pricing provision which inadvertently captures legitimate competitive business practices as well as predatory conduct.

JUDICIAL TREATMENT OF SECTION 46

Australian judicial treatment of section 46 initially focussed on the objective of protection of smaller competitors. In the *Pont Data*[8] case, the Full Federal Court held that the ASX, by virtue of its dominant position in the market of the provision of market data, had breached section 46 by imposing a fee structure designed to deter retail competitors of its subsidiary. A similar approach was followed by the Federal Court in *Taprobane Tours*[9].

A more modern line of reasoning has focused instead on the protection of competition, and had its genesis in *Queensland Wire*[10], where the High Court majority held:

> [t]he object of section 46 is to protect the interests of consumers, the operation of the section predicated on the assumption that competition is a means to that end.[11]

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[7] Section 2, *Trade Practices Act* 1974 (*Cth*).
[8] *Pont Data Australia Pty Ltd v ASX Operations Pty Ltd* (1990) 21 FCR 385.
[9] *Taprobane Tours WA Pty Ltd v Singapore Airlines Ltd* (1990) 96 ALR 405.
[10] *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177.
[11] ibid. at 191 per Mason CJ and Wilson J.

This approach was further developed in *Besser Masonry Limited v ACCC*[12] (***Boral***), where Gleeson and Callinan J stated:

> [t]he purpose of the Act is to promote competition, not to protect the private interests of particular persons or corporations. Competition damages competitors. If the damage is sufficiently serious, competition may eliminate a competitor.

The other majority judgments in *Boral* incorporated similar arguments.

The High Court, in the three recent decisions of *Melway*[13], *Boral*, and *Rural Press*[14] (**Three Decisions**) all found no breach of section 46. In his dissenting High Court judgment in *Rural Press*, Kirby J detailed his concerns with the judicial treatment of section 46 by the High Court in the following statement:

> *[a] trilogy and the doctrine of innocent coincidence:* This is the third recent decision of this court … in which a majority has adopted an unduly narrow view of s 46 of the Act. In effect, it has held, in each case, that the established large degree of market power enjoyed by the impugned corporation was merely incidental or coincidental to the anti-competitive consequences found to have occurred. Notwithstanding the proof of market power, the court has held that the impugned corporations did not directly or indirectly "take advantage" of that power to the disadvantage of competition in the market…
>
> Judicial lightning strikes thrice. A novel doctrine of innocent coincidence prevails. Effective anti-competitive threats can be made without the redress which s 46 appears to promise. Once again I dissent.[15]

Justice Kirby's criticism of the majority of the High Court's approach to section 46 focuses on what is an overly expansive view of the 'take advantage' element, and is well founded. This element of section 46 will be addressed further below.

Not surprisingly given the history of lack of success of actions under section 46 of the *TPA*, and the shift in judicial focus away from the protection of small business towards

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[12] (2003) 195 ALR 609.
[13] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] ATPR 41-805.
[14] *Rural Press Limited and Others v Australian Competition and Consumer Commission and Others (A 197 of 2003), Australian Competition and Consumer Commission v Rural Press Limited and Others (A 203 of 2003)* [2003] 203 ALR 217.
[15] Ibid [2003] 203 ALR 217 per Kirby J at 256.

the protection of competition, there has been a significant amount of criticism of section 46, in part from the small business lobby. The High Court's decision in *Boral*, a case dealing with alleged predatory pricing in which the High Court found no breach of section 46, has attracted a particularly large proportion of this criticism.

Almost immediately after the *Boral* decision was handed down, the Senate passed a motion requiring the Senate Economics References Committee to report on "whether the [Act] adequately protects small business from anti-competitive or unfair conduct". The resulting report tabled on 1 March 2004 (**References Committee Report**) included six recommendations for the amendment of section 46, some of which were incorporated into the *TP Amendment Act*. Just how effective these amendments are is the subject of much debate and will be discussed further below.

FOREIGN PROVISIONS

Overseas jurisdictions have dealt with the regulation of market power in a number of different ways. However, the majority of jurisdictions rely on general provisions similar to section 46 (prior to the New Amendments) to proscribe predatory pricing. Indeed, of the 35 countries which responded to the International Competition Network (**ICN**) *Report on Predatory Pricing*[16] (**ICN Report**), 11 relied on general monopolisation or misuse of market power style provisions, 14 relied on a provision that incorporated the term "unfair pricing" or its equivalent without further definition of "unfair", and only 7 attempted a small further definition of predatory pricing by reference to a cost threshold combined with the term "unfair pricing" or its equivalent[17]. This has left a lot to the courts in various jurisdictions to determine through their own jurisprudence. A review of the jurisprudence in other major jurisdictions in the context of the relevant legislation may therefore prove instructive as to how to form an effective Australian predatory pricing provision.

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[16] ICN, Unilateral Conduct Working Group, *Report on Predatory Pricing*, presented at the ICN conference in Kyoto, April 2008.
[17] ibid. at pp 5-6.

The United States

Section 2 of the *Sherman Act*[18], the provision relied upon in the US to prosecute predatory pricing, provides that:

> [e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.

The *Clayton Act*[19] extended the right to sue under the *Sherman Act* to private parties, and provides a maximum award of treble damages and costs should they prevail.

The general nature of section 2 of the *Sherman Act* has left it to the Courts to develop a jurisprudence to deal with specific instances of attempts at "monopolization", and different economic theories have influenced judgments as to whether monopolisation has occurred in individual instances. Two different schools of economic theory dominate the discussion on monopolisation and predatory pricing in the US, namely the Chicago School and the Post-Chicago School. The Chicago School relies on theories of economic rationalism to argue that an efficient market will inflict an irrecoverable loss to participants engaging in predatory pricing, as once prices rise, competitors will again enter the market. This theory states that predatory pricing is an irrational activity that very rarely, if ever, occurs. The Chicago School has been criticised for a rigid reliance on economic theory resulting in a corresponding over-simplification of the possible motivations for predatory pricing.

The Post-Chicago School relies on new theories to show that predatory pricing can be rational where there are imperfections in the market, such as barriers to entry, a lack of knowledge of a product in the market, or where the predatory conduct results in a

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[18] *Sherman Antitrust Act*, July 2, 1890, ch. 647, 26 Stat. 209, 15 U.S.C § 1-7

[19] *Clayton Antitrust Act,* October 15, 1914, ch. 323, 38 Stat. 730, codified at 15 U.S.C. § 12–27, 29 U.S.C. § 52–53.

reputation for predation which keeps other competitors from entering the market, a practice known as "signalling". The Post-Chicago School suggests that predatory pricing is more prevalent than previously thought.

The leading case on the application of the *Sherman Act* to predatory pricing is the US Supreme Court's 1993 decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.* (***Brooke Group***)[20]. In *Brooke Group*, the US Supreme Court held that to succeed on a predatory pricing claim, a plaintiff must show that the defendant priced its product below an appropriate measure of its costs, and the defendant had a reasonable probability of recouping its losses by raising prices to supracompetitive levels at a later date. This decision was referred to with approval by the Australian High Court in *Boral*, the leading Australian authority on predatory pricing under section 46(1) of the *TPA*. Purpose was not a required element for a finding of predatory pricing under the *Brook Group* test of monopolization, but is still a component of the "attempt to monopolize" arm of the provision.

The requirement for recoupment in *Brook Group* implicitly recognised the Chicago school's theories, as it did not consider the other less obvious motivations for predatory pricing recognised by the Post-Chicago School. It is interesting to note that predatory pricing cases in the United States since *Brook Group* have had a similar lack of success to their Australian counterparts, with no successful prosecutions[21]. However, in areas other than predatory pricing, the Post-Chicago school has been gaining ground in the US[22], and this may indicate a change in judicial treatment of predatory pricing claims in the future.

In Australia, the requirement for recoupment as a component of predatory pricing has been specifically rejected by the Government, and the New Amendments can be seen to implicitly recognise the Post-Chicago theory of predatory pricing. However, it is interesting to note that *Brooke Group's* utilisation of the "appropriate measure of costs" term is similar to the Birdsville Amendment's "relevant cost" threshold.

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[20] 113 S Ct. 2578, 2589 (1993).
[21] As reported by David Magnes in *Getting Past Summary Judgment in Predatory Pricing Cases after American Airlines: Will Post-Chicago Analysis Ever Prevail?,* (2005) 5 HBTLJ 424.
[22] See Magnes ibid at 433-435.

The European Economic Community

Article 82 of the European Community competition law, the provision used to prosecute predatory pricing claims under European Economic Community (**EEC**) law, provides:

> [a]ny abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

which can mean:

> directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

As with the US provision, Article 82 is an example of the broad approach to a misuse of market power provision, leaving much for the courts to interpret.

In a leading European Court of Justice (**ECJ**) decision on Article 82, *Hoffman La Roche* v. *Commission*,[23] the term "abuse" was held to mean:

> an objective concept relating to the behavior of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.

In other words, Article 82 has been interpreted by the European courts as requiring an anti-competitive effect *and* the absence of a normal competitive or business rationale in order for a breach to be made out.

In another Article 82 case, *AKZO v Commission*[24], the ECJ held that where there is an anti-competitive effect and no legitimate business rationale and where prices are above

[23] (Case 102/77) *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH* (1978) E.C.R 1139.
[24] C-62/86 *AZKO v Commission* [1991] ECR I-3359, [1993] 5 CMLR 215.

average variable cost (**AVC**) but below average total cost (**ATC**), the pricing strategy will be regarded as abusive if the prices are determined as part of a plan which is aimed at eliminating a competitor. This case introduced two tiers of pricing into European jurisprudence. The first, pricing below AVC, where if there is an anti-competitive effect there is a presumption that predatory pricing has occurred, and the second, pricing below ATC but above AVC, where there is an additional requirement for an intention on the part of a dominant firm to eliminate a competitor in order for a predatory pricing breach to be found. This extra requirement in the second tier test is similar to the purpose test under section 46 of the *TPA*.

The United Kingdom

Section 60 of the *Competition Act* 1998 (*UK*) requires that UK law deal with competition questions as far as possible in a manner which is "*consistent with the treatment of corresponding questions arising in Community law*". This requirement stops short of absolute adherence to EEC law, but so far, has resulted in few differences in the treatment of predatory pricing between UK law and EEC law, and where differences exist, they are in the area of the definition of the pricing threshold below which predatory pricing is held to have existed. It is logical that pricing strategies will vary from industry to industry due to different input cost structures and this will have a corresponding effect on measures of cost used to determine predatory pricing conduct. A similar approach is taken by other EEC member states.

France

In France, the recent decision of the French Competition Council in *French Competition Council v GlaxoSmithKline France*[25] (*GlaxoSmithKline Case*) implicitly recognised the Post-Chicago school of thought as the basis of its decision. In this case, the French Competition Council issued a €10 million fine to GlaxoSmithKlein France (**GSK**) for predatory pricing in a market in which GSK was not dominant, but later became dominant with the withdrawal of its main rival, the manufacturer of a generic alternative to one of its antibiotic drugs. The case is also a good example of the use of "signalling",

[25] French Conseil de la Concurrence, GlaxoSmithKline France, Decision n°07-D-09 of 14 March 2007.

as one of the motivations of GSK was held to be stopping generic rivals from entering into markets for its other products in which it did have the only (and therefore dominant) market share. Another notable feature of this case was the use of transfer costs between related GSK corporate entities as the costs measure below which predatory pricing was presumed to have occurred, the cost threshold being the cost GSK paid to another subsidiary of its parent company GSK plc for the antibiotic drug.

Canada

Section 50(1)(c) of the Canadian *Competition Act* provides:

> [e]very one engaged in a business who engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

Section 36(1) of the *Competition Act* gives a priviate litigant the ability to recover damages for breaches of section 50. To put section 50(1) into the language of the Australian competition debate, this provision has no threshold of company size or power, requires either a purpose test or *in the alternative* an effects test, and requires that predatory prices must be "unreasonably low" for a breach, leaving it to the courts to determine what pricing behaviour should be captured.

In *Regina v. Hoffmann-LaRoche Limited*, the leading Canadian authority on section 50(1), Linden J stated:

> [r]easonableness has a flexible meaning, depending on all of the facts. Parliament chose to enact that word in order to give the Courts some latitude in making their decisions about the legality or illegality of the prices charged. There is nothing rigid about the concept of reasonableness. Business decisions should not be condemned, unless the Courts find that the price charged is unreasonable in all the circumstances.[26]

While some guidance can be gleaned from previous decisions interpreting section 50(1) of the Canadian *Competition Act*, given the current judicial definition of reasonableness

[26] (1980), 28 O.R. (2d) 164 (H.C.J.), aff'd (1981), 33 O.R. (2d) 694 (C.A.)

in relation to this provision, the application of the section is not fixed, leading to a lack of certainty. The flexibility given by the Court to section 50(1) makes it difficult to assess and this provision is therefore not a good model for an Australian predatory pricing provision, although it is interesting to note the inclusion of an effects test in the Canadian provision.

Japan

In Japan, predatory pricing can be dealt with mainly under two provisions of the *Act Concerning Prohibition of Private Monopolisation and Maintenance of Fair Trade* (1947, revised 2005), otherwise known as the *Antimonopoly Act*. Article 3 of that act provides:

> [n]o entrepreneur shall effect private monopolisation or unreasonable restraint of trade.[27]

The term "private monopolisation" in the *Antimonopoly Act* is defined to mean business activities by which any entrepreneur excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade[28]. The term "exclude" in this definition includes both eliminating competitors and preventing competitors from entering the market.

Article 19 of the *Antimonopoly Act*, the other provision under which a prosecution for predatory pricing can be brought, provides:

> [n]o entrepreneur shall employ unfair trade practices.[29]

Unjust low price sales have been designated by the Japan Fair Trade Commission (**JFTC**) as one of the unfair trade practices referred to in Article 19, and has been defined to mean:

> without justifiable grounds, supplying goods or services continuously for a consideration which is excessively below the cost incurred in the said supply, or otherwise unjustly supplying goods or

[27] This translation comes from the unofficial English language version, which while published by the Japan Fair Trade Commission has no legal effect. See http://www.jftc.go.jp/e-page/legislation/index.html.
[28] Article 2(5) ibid.
[29] ibid.

> services for a low consideration, thereby tending to cause difficulties to the business activities of other entrepreneurs. [30]

Articles 3 and 19 of the *Antimonopoly Act* have been applied in different ways by the JFTC. Article 3 has been held to apply to firms with a large market share of over 70%. Article 19 however has been held to apply to firms with smaller market shares and not in a dominant market position. Article 19 is of the most interest as a model for the Australian provision due to its wider applicability which corresponds to its Australian counterpart.

The cost benchmark for Article 19 depends on the industry in which the allegation of predatory pricing is made. AVC is used as an appropriate cost measure in the retail industry, however, other industries may have different cost thresholds depending on the characteristics of that industry[31]. Regardless of the industry, prices must always be below ATC for a breach of Article 19 due to predatory pricing.

The Supreme Court of Japan has held that as a part of the defence of "justifiable grounds" enshrined in Article 19, that "the existence of proper justification for the conduct is judged in the totality of the circumstances, taking into consideration the firm's intent and purpose, state of the conduct, status of competition and condition of the market in the case, from the viewpoint of maintenance of fair competition"[32]. This means that the Japanese predatory pricing provision requires an anti-competitive effect as a minimum standard, but incorporates purpose as a consideration for a justification defence.

New Zealand

Section 36 of the *Commerce Act* 1986 (*NZ*) is the New Zealand equivalent to section 46 of the TPA, being a general misuse of market power provision in substantially similar

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[30] Japan Fair Trade Commission, notification (Designation of Unfair Trade Practices), unofficial English translation.
[31] Interestingly, there is no specific cost threshold for Article 3.
[32] Decision of the Supreme Court December 14, 1989 as reported by the Japan Fair Trade Commission in their response to the International Competition Network Questionnaire on Predatory Pricing, published at http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/2007QuestionaireDocs/JAPAN_RESPONSE.pdf.

terms to the old section 46 without the Birdsville Amendment. There is no specific predatory pricing provision in New Zealand legislation.

Intent or Anti-competitive Effects?

Across the 35 jurisdictions that responded to the ICN Report, the majority of 21 employ an anti-competitive effects test as a requirement for a breach, and only 9 do not. On the consideration of purpose or intent, 24 consider intent as relevant to a determination of predatory pricing, although intent is generally not a mandatory requirement, but merely a factor to be considered, and seven jurisdictions do not consider intent at all relevant[33]. The relative importance given in overseas jurisdictions to an anti-competitive effects test over the requirement for proof of purpose or intent is of importance to the Australian debate, and will be discussed further below.

THE EFFECTIVENESS OF SECTION 46

The effectiveness of any provision can be determined by comparing the outcomes of the provision with its object. The object of section 46 provides a good benchmark against which performance of this section can be measured by way of court decisions. While of the Three Decisions, only *Boral* has involved a claim of predatory pricing, the decisions in *Melway* and *Rural Press* also provide insight into the workings of section 46 and are relevant to its operation with respect to predatory pricing claims.

Melway and the 'take advantage' element

In *Melway*, the alleged infringer, Melway Publishing Pty Limited (**Melway Publishing**), a manufacturer of street directories based in Melbourne, had an exclusive distribution system for its street directories, whereby each of Melway Publishing's chosen distributors had an exclusive right to distribute the street directories within its assigned territory. Melway Publishing terminated one of its exclusive distributors in Melbourne and this ex-distributor then ordered a bulk quantity of Melway street directories in an attempt to set

[33] ibid at pp 22-24.

up a parallel distribution system in competition with Melway Publishing's exclusive distribution system. Melway Publishing refused to supply the ex-distributor's order for street directories, and the ex-distributor brought an action against Melway Publishing for a breach of section 46.

The High Court (Kirby J dissenting) found that although Melway Publishing had substantial market power at the time of the conduct complained of, and the purpose of excluding the ex-distributor from the market, Melway Publishing could have, and in fact had, maintained its distributorship system without its market power, and therefore did not take advantage of its market power in operating its exclusive distribution system. The findings of the Court were based on the fact that Melway Publishing's distribution system had been set up in Melbourne before Melway Publishing had achieved substantial market power there, and because the same system was being used in Sydney where Melway Publishing did not have substantial market power.

The phrase "take advantage" in subsection 46(1) has been the subject of shifting judicial interpretation since its inception. In *Queensland Wire*, the High Court held that the term "take advantage" did not involve anything more than the use of market power, and did not require consideration of predatory intent or morality. This interpretation was modified in *Melway*[34], where the Court held:

> the Act requires, not merely the co-existence of market power, conduct, and proscribed purpose, but a connection such that the firm whose conduct is in question can be said to be taking advantage of its power.[35]

This reasoning was later developed further in *Boral*, as summarised by Heerey J and quoted with approval by the majority in the High Court:

> [i]f the impugned conduct has a business rationale, that is a factor pointing against any finding that conduct constitutes a taking advantage of market power. If a firm with no substantial degree of market power would engage in certain conduct as a matter of commercial judgment, it would ordinarily follow that a firm with market power which engages in the same conduct is not taking advantage of its power.

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[34] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] ATPR 41-805.
[35] ibid at [44].

The High Court in *Melway* and later in *Boral* has essentially formulated a broad 'business rationale' defence to an action under section 46(1), whereby a corporation which has a business rationale for its conduct which is not dependant on its market power will escape the censure of section 46(1) altogether regardless of the effect that conduct has on competition.

The process of reasoning required by this 'business rationale' defence is to isolate the actions of the actual corporation, and then consider the possibility or rationality of those actions when taken by a hypothetical corporation in the same position as the actual corporation but without market power (ie in a highly competitive market - the counterfactual). However, the use of the counterfactual in a prosecution for misuse of market power is inappropriate, as by taking as its standard a legitimate business rationale in a competitive market, the counterfactual is blinded to the anti-competitive effects of this rationale where those effects depend on the use or presence of market power. The use of the counterfactual in this way ignores the very reason for the enactment of section 46 in the first place; the fact that a corporation with substantial market power is in a position to significantly effect competition in a way that a corporation without such market power is not. A business rationale may be legitimate in a hypothetical competitive market, but have serious anti-competitive effects when coupled with market power. As a result, the use of this test will absolve corporations from liability for many actions that section 46 was designed to prohibit. This is a fundamental problem with the business rationale defence as currently defined by the High Court.

In fact, the 'business rationale' defence as defined by the High Court in *Melway* went even further in that it didn't consider anti-competitive effects of the conduct at all, even in a competitive market, as long as there was a demonstrated business rationale for the conduct.

Given the objectives of the *TPA*, a "legitimate" business rationale defence would be one where the anti-competitive effects of any proposed business rationale defence were considered in the real market situation. One method of achieving this would be to determine the value of the rationale to the business and to the economy, and weigh that

value against the negative effect of the rationale on competition and competitors. No such exercise was undertaken by the High Court. Indeed, due to the use of the counterfactual, no consideration of the anti-competitive effects of the business rationale due to market power is currently possible. By failing to incorporate such an assessment, the business rationale defence fails to discern what is a 'good' or a 'bad' business rationale, and by extension, what is 'good' or 'bad' corporate conduct. This lack of discrimination on the part of the business rationale defence negates the original purpose of the 'take advantage' element of section 46, which was to discriminate between good and bad corporate behaviour.

It is manifest that the *TPA* objectives of the protection of competition and the protection of consumers were not met by the decision in *Melway*, as it is likely Melway Publishing's exclusive distributorship system would have resulted in higher prices due to the lack of competition in the distribution market. On the other hand, the objective of fair trading may or may not have been met, depending on the value of the exclusive distribution system to Melway Publishing and its distributors, compared to the loss of opportunity suffered by potential distribution competitors. It may be that an exclusive distribution system is a valid rationale, depending on this cost/benefit analysis. On balance, it would appear that the objectives of section 46 have not been met in this case, but without a proper assessment of the level of damage to competition the exclusive distribution system engendered, and its value to Melway Publishing and its distributors, it is not possible to make a final pronouncement.

Rural Press **and 'market power'**

Rural Press concerned the distribution of two rural newspapers, one owned by a subsidiary of Rural Press (Bridge) and the other owned by a smaller entity called River News. Rural Press' paper was generally circulated in the Murray Bridge market, and River News' paper in the proximate but geographically distinct Riverland market, both in South Australia. Each paper had a near monopoly in their respective market.

In the second half of 1997, River News' paper commenced circulation in a portion of Rural Press' Murray Bridge market. In response, Rural Press issued a threat to distribute

its paper for free in the River News' Riverland market unless River News withdrew from the Murray Bridge market. This threat was successful.

At first instance, Mansfield J had held that there was a breach of section 46, and stated in his judgment that:

> [t]he power of Rural Press and Bridge in the relevant market should be measured as including the financial resources and strength of Rural Press, as well as its existing publishing resources and expertise.[36]

The Full Federal Court rejected this argument, finding no breach of section 46 and that the term "market power" did not include financial or organisational power, and upheld the Full Federal Court's decision on this point. The majority in the High Court held that Rural Press was equivalent to a start up in the Riverland market, therefore having no market power in that market. This meant that although Rural Press had substantial market power in the Murray Bridge market, it could not be held to take advantage of that power in the Riverland market as by definition its market power only existed in the Murray Bridge market. On the High Court definition of market power, by making the threat, Rural Press did not translate the effect of its market power into the Riverland market.

In essence, the outcome in *Rural Press* was that a publisher was able, through a threat of engaging in unfair competition in another market, to reduce competition in its own market, and thus maintain its monopoly, without breaching section 46. Of the Three Decisions, this outcome is most clearly at odds with all three of the objectives of the *TPA*, as the effect of the conduct was to reduce competition, reduce the choice of papers available for consumers and possibly increase the price of the two papers, and the conduct was not fair trading due to the threat used by Rural Press to force River News out of the market.

[36] [2001] FCA 116 at para 130.

***Boral* and the High Court's approach to predatory pricing**

The facts of *Boral* were that Boral Besser Masonry Limited (**BBM**), a wholly owned subsidiary of Boral Limited, manufactured concrete masonry products (**CMP**) in the form of blocks, bricks and pavers for use in the Victorian building industry. In the early 1990s, the Victorian economy went into a severe recession.

In late 1993, a price war broke out in the Victorian CMP market. It was unchallenged evidence that BBM did not start the price war, but reduced its prices in order to compete in the market. However, the Courts found that during the relevant period from April 1994 to October 1996, there were some extended periods when BBM's prices for CMP were less than its avoidable costs (not taking into account the effect of vertical integration within the Boral group of companies and the efficiencies that they brought – this issue will be discussed further below).

At first instance, Heerey J in the Federal Court found that despite the period of below cost pricing, BBM did not have substantial market power and therefore did not breach section 46. Heerey J based his decision on the finding that any of the three largest participants in the market at that time (BBM, Pioneer, or C&M) could have supplied the entire state's demand with its plant and facilities operating at full capacity, and there were also numerous smaller players in the market which increased market capacity even further. In other words, the market for CMP in Victoria was one in which there was significant excess capacity, quite a number of suppliers, and during the period in question, also a general downturn in the market.

The Full Federal Court overturned Heerey J's decision and found that BBM had breached section 46 by engaging in predatory pricing during the relevant period. Particularly important to the decision was the existence of a large amount of evidence showing BBM's desire to see some of its competitors leave the market.

On appeal from the Full Federal Court, the High Court overturned the Full Federal Court decision, and found that the general lack of control over the price of CMP by BBM meant that it did not have substantial market power, and also that it did not take advantage of its

market power. The High Court in *Boral* found that competitive factors in the market had forced BBM (Boral) to cut its prices, even to the extent that they were below variable cost. In other words, the Court found that there was a reasonable business rationale for BBM cutting prices, and the conduct amounted to "lawful, vigorous, competitive behaviour" only[37]. Gleeson CJ and Callinan J said:

> [t]he critical question in the present case is whether BBM's behaviour involved the taking advantage of a substantial degree of power in a market. …
>
> It emerges clearly from the evidence in the present case that BBM set its prices by reference to the market.[38]

Competitive pressures in the market were demonstrated in *Boral* by way of evidence which included failed tender bids by BBM and generally low prices of its competitors pre-dating BBM's own discounting.

In *Boral*, the High Court further developed the 'business rationale' defence under the take advantage element of section 46. The majority of the High Court commented that the Full Federal Court's reasoning in *Boral* suffered from a similar deficiency to that which affected its decision in *Melway*, in that the Court had focused on the purpose element, and on finding that the proscribed purpose existed, had moved too quickly to determine that there was a breach, without looking first at the requirements for substantial market power and the take advantage element.

THE EFFECTIVENESS OF THE NEW AMENDMENTS AND THE ANTICIPATED PREDATORY PRICING PROVISION

As there are as yet no decided cases on the New Amendments, one way to make an assessment of the effectiveness of the New Amendments is to apply them to the facts of the Three Decisions, in effect re-deciding these cases on the current law, and gauge the effectiveness of these amendments by the projected outcomes in the Three Decisions when applying the amendments, as against the objectives of the *TPA* and the section.

[37] Above n. 12, at p 411.
[38] Ibid at pp 411-412.

Again, the numerous judgments from the Federal Court, Full Federal Court and High Court in the Three Decisions provide us with a significant amount of factual material on which to make a redetermination.

Melway

Where there is a claim involving a misuse of market power which is not predatory pricing, section 46(1) as amended still requires a 'take advantage' element to sheet home liability. The claims in *Melway* did not involve any predatory pricing, and none of the New Amendments apply to the facts, so the take advantage element and its business rationale defence as defined by the High Court in *Melway* would still apply. The New Amendments would therefore make no difference to the High Court's decision in this case and there would be no breach found.

Rural Press

The Cross-market Amendment is an attempt by Parliament to remedy an issue highlighted by the Full Federal Court decision in *Rural Press* that the section did not operate across markets[39]. However, the High Court decided in *Rural Press* that the power used to back up the anti-competitive threat was financial and organisational power, not market power. In light of the restricted scope given to the definition of market power in the High Court's decision subsequent to the Full Court decision, it is unlikely that a corporation can ever be held to have taken advantage of its market power outside the market in which that power exists, because it is likely that market power, as defined by the High Court majority in *Rural Press*, can not translate across markets.

The Cross-market Amendment refers to market power, and is therefore completely ineffective when combined with the High Court definition of market power, and would not change the decision in *Rural Press* were it to be applied to the facts in that case. There would be no breach found on the application of the New Amendments to the facts in *Rural Press*.

[39] Explanatory Memorandum, at n.2.

Boral

Unlike *Melway* and *Rural Press*, the facts in *Boral* involved an allegation of predatory pricing. The High Court's decision turned on the issues of the degree of market power and to some extent the take advantage element, both of which are elements of subsection 46(1) that have not been replicated in the Birdsville Amendment. For this reason, *Boral* may be decided differently were the Birdsville Amendment to be applied to the facts of that case, and it therefore provides an interesting opportunity to see just how effective the Birdsville Amendment would be.

The Birdsville Amendment requires the following elements be satisfied for a breach of section 46:

1. a corporation must have priced its product below the "relevant cost" to the corporation;

2. the corporation must have had a "substantial share of [the] market" while the below relevant cost pricing conduct was occurring;

3. the corporation must have engaged in the below relevant cost pricing conduct for a "sustained period"; and

4. the corporation must have engaged in the below relevant cost pricing conduct for a proscribed purpose.

According to the recent media release from Chris Bowen MP and Hon Craig Emerson MP, the Prospective Predatory Pricing Provision will replace the "substantial share of the market" term in the Birdsville Amendment with "substantial degree of power in a market", and a 'take advantage' element will also be introduced. Both of these terms are well defined due to their inclusion in the old version of section 46. However, there is as yet no bill defining the Prospective Predatory Pricing Provision before Parliament, and the Birdsville Amendment is currently in force. No doubt there will also be considerable discussion of the precise drafting of the new provision, and the final version may differ from the version anticipated by the media release. In order to gauge the effectiveness of

both provisions and gain insight into the form of a new predatory pricing provision, this paper will consider both the Birdsville Amendment and the Prospective Predatory Pricing Provision as it is currently foreshadowed, and apply them to the facts of case in *Boral*.

1. Relevant Cost

Both the Birdsville Amendment and the Prospective Predatory Pricing Provision (together the **Predatory Pricing Provisions**) incorporate a "relevant cost" term, and helpfully, many of the judgments in *Boral* did consider the cost threshold below which a price would become predatory. These judgments are instructive as to what cost a court would consider as the relevant cost threshold for an infringement under the Predatory Pricing Provisions. Relevant cost is perhaps the most important issue to the operation of these new provisions, due to its pivotal effect on the sustained period element.

At first instance, given his finding that there was no infringement, Heerey J was not required to calculate the actual measure of costs below which predatory pricing would have occurred, but for simplicity he used the avoidable costs figure as the costs threshold in his analysis. Avoidable cost as defined by Heerey J was a measure of the costs of the raw materials associated with producing each extra unit of product, neglecting the fixed costs that did not change with an increase in output. This is a very similar calculation to AVC, and avoidable was also erroneously interchanged with the term "variable cost" by Heerey J in his judgment, perhaps due to this similarity.

Heerey J did however throw some light on a more accurate figure that should be used as the cost threshold, and made the following statement in his judgment:

> [f]or the moment it is sufficient to observe that I do not see the question whether a whole of business basis is appropriate as a matter of law which will be determinative of the case. One cannot ignore the profits or losses a firm makes on a whole of business basis. On the other hand, it is conceivable that within an overall profitable period there might be such deep discounting of a particular product that, assuming the existence of the other criteria postulated by s 46, a contravention could be established.[40]

[40] *ACCC v Boral Limited and Another* (1999) 166 ALR 410 at 432.

As 100% of BBM's raw materials came from the wider Boral group, there would have been significant benefits and profits that would have accrued to the wider Boral group through BBM's operation should a "whole of business" approach have been taken to determine the cost threshold in *Boral*. Applying a whole of business approach to the facts of *Boral* would require the profits and other similar benefits derived from supplying BBM with raw materials be quantified and deducted from the figure for avoidable cost used as the threshold for predatory pricing conduct by Heerey J.

One of the most significant faults of the Full Federal Court decision in *Boral* was that despite their finding that BBM had breached section 46 of the *TPA*, the Court did not properly consider the issue of what was the appropriate measure of cost below which predatory pricing could occur.

Beaumont J in the Full Federal Court decision referred to the abovementioned *obiter* of Heerey J and went into some detail of the pricing of BBM, but did not make any attempt to determine what was an appropriate measure for a cost threshold, referring simply to evidence of pricing below "costs" as establishing a contravention. One can only assume by the general adoption of Heerey J's analysis that by "costs", Beaumont J meant avoidable costs, being the same simplified figure used by Heerey J, but no attempt at quantification or further development of this threshold was made by Beaumont J. [41]

For his part, Merkel J simply sidestepped the issue and assumed that avoidable cost was the appropriate measure without any discussion or quantification at all, impliedly adopting the simplified analysis of Heerey J.

Finklestein J, the third judge in the Full Federal Court decision in *Melway*, stated the following:

> [i]n my opinion the existence of predatory pricing should not be determined by reference to some precise formula or definition. Predatory pricing is no more than a price set at a level designed to eliminate a competitor or keep a potential competitor from the market. That is the gist of the definition given by Professor Hay that I mentioned earlier in these reasons. It is all that is necessary for the purposes of s46. In particular, in my view, it does not matter that the price

[41] *ACCC v Boral Limited* (2001) FCA 30 (BC200100518), per Beaumont J, paras 90-91.

> charged might exceed either the average total cost or average variable cost. In the circumstances of a particular case it may nevertheless be a predatory price.[42]

By focussing on the "design" of the pricing behaviour, Finklestein J's judgment focuses on the purpose element of ssn 46(1). However, the effect of Finklestein J's judgment is to deny the operation of the 'take advantage' element to differentiate good corporate behaviour from bad. Without a threshold price below which pricing can be considered predatory, corporations would not be able trade on their efficiencies to price so as to out compete and damage or win market share from their competitors. The result would be protection of inefficient competitors from price competition, at the expense of competition in the market and lower prices for consumers. If, on the other hand, we accept that pricing must be below cost as a minimum threshold to be described as predatory or 'bad', then the measure of cost below which the pricing can be predatory becomes an important issue, contrary to the approach taken by Finklestein J.

In the High Court's *Boral* decision, Gleeson CJ and Callinan J agreed with Heerey J that the cost figure used to determine predatory pricing should be avoidable cost, taking into account transfer costs and benefits to the wider Boral group both tangible and intangible. The learned judges further stated that the business case to take short term losses in order to stay in business for the longer term, and the costs involved in withdrawal from the market, should also be taken into account.[43] However, it is difficult to see how intangible benefits and future contingent costs of exiting the market can be classified as a "relevant cost" to BBM of the CMP products themselves. It is therefore unlikely that unquantifiable elements such as these will be considered as a part of the "relevant cost" figure in the Birdsville Amendment.

For their part, Gaudron, Gummow and Hayne JJ simply referred to the US decision of *Brooke Group* and its definition of predatory pricing where a plaintiff must prove it's rival priced below "an appropriate measure of its rival's costs" and where there was a

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[42] ibid, per Finklestein J, paras 266-269.
[43] Above n 12 per Gleeson CJ and Callinan J at 622.

reasonable prospect of the rival recovering the losses suffered.[44] The learned judges did not discuss the matter any further.

McHugh J based his analysis on recoupment theory and made the following statement:

> [w]hat is required is not a bright line rule about costs but a more sophisticated analysis of the firm, its conduct, the firm's competitors, and the structure of the market not only at the time in which the firm has engaged in conduct allegedly in breach of the Act but also before and after that conduct.[45]

By looking at the structure of the market before and after the conduct, McHugh J seems to be looking to see if the pricing conduct in question has resulted in a lessening of competition, which would in turn allow for recoupment at a later date. However, this approach is of no use to an application of the Predatory Pricing Provisions, which obviously does require a bright line rule about costs.

In his dissenting judgment, Kirby J simply referred to the judgment of Beaumont J (which in turn referred to the judgment of Heerey J) and assumed that pricing below avoidable cost was the appropriate measure for predatory pricing.

To sum up, there was some discussion in *Boral* of the requirement for an appropriate cost threshold to be calculated, but there was no actual or satisfactory calculation in any of the judgments of the appropriate cost threshold figure below which BBM would have engaged in predatory pricing. Three out of the seven judges of the High Court agreed generally with Heerey J that the appropriate measure of cost in *Boral* should be avoidable cost, adjusted through a whole of business approach to incorporate a measure of the transfer costs of the supply to BBM by the wider Boral group, and deducting a quantification of the profit and benefits to the wider Boral group from BBM's continued operation. It is this formulation of "relevant cost" which would be the most likely one used were the case to be decided on the Predatory Pricing Provisions.

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[44] Above n 12 per Gaudron, Gummow and Hayne JJ at 641.
[45] Above n 12 per McHugh J at 666.

2. Substantial Market Share and Substantial Market Power

To determine the market share element of the Birdsville Amendment, one must first determine the market in which the share is to be measured. There is no conceptual reason that the relevant market for the purposes of ascertaining market power and for the purposes of calculating market share should differ to any significant extent. In both cases the determination of the relevant market is based on a measure of the substitutability of the products for which predatory pricing is alleged.

In order to determine whether a corporation has substantial market *power* under ssn 46(1), the Courts have held that:

> [f]or a corporation to have a substantial degree of market power it must have a considerable or large degree of such power. The difficulty lies not in defining the word "substantial" but in applying the concept of a substantial degree of market power to the circumstances of each case and in identifying whether the requisite degree of market power exists.[46]

In other words, "substantial degree of power in a market" is not a divisible concept. It is therefore unclear how the words "substantial share of a market" in the Birdsville Amendment would be affected by the interpretation given to "substantial degree of power in a market" thus far. The subjective concept of "power in a market" is far more complex than "share of a market". However, the determination of substantial share of a market may be a complicated if the Court decides that the word "substantial" is relative, rather than by way of reference to a strict numerical standard. For example a market share of 10% in a market where no participant holds more than 10% may be more "substantial" than a market share of 10% in a market where there are three other players each with 30%.

Heerey J, the judge at first instance in *Boral*, found that the relevant market was the market for materials for use in walls and paving in metropolitan Melbourne, although he used figures for market share of CMP as a reference. During the entire period of the

[46] *Eastern Express Pty Ltd v General Newspapers Ltd* (1992) 106 ALR 297 at 317 per Lockhart and Gummow JJ (with whom Beaumont J generally agreed) quoted with approval by Heerey J in *Boral* and not challenged.

alleged predatory conduct, Heerey J found that BBM's market share was relatively steady at between 25-30%. The Full Federal Court and High Court judges accepted the ACCC's submission that the market was the market for CMP, and adopted the ACCC's figures for market share which showed that BBM's market share of the CMP market fluctuated between 28-33% during the period of the alleged predatory pricing conduct. Whichever figures are used to estimate CMP market share, the market share of BBM was between 25-33% during the relevant period of April 1994 through October 1996, and BBM had the largest market share of all the participants in the market during this period. On these figures, it is undoubtedly the case that BBM would be held to have a substantial market share and satisfy this element of the Birdsville Amendment.

Given the High Court's determination in *Boral* that BBM lacked substantial market power, in contrast to the Birdsville Amendment the Prospective Predatory Pricing Provision would be interpreted in the same way as the old section 46, and a finding of a lack of substantial market power would result in no breach on application of the Prospective Predatory Pricing Provision to the facts in *Boral*.

3. Sustained Period

Both Predatory Pricing Provisions incorporate this term. As a matter of logic, the time period over which predatory pricing occurs would have to be at least long enough to achieve one of the proscribed purposes of the Predatory Pricing Provisions for this term to be satisfied. One could use this requirement as a measure of "sustained" or there could me a more onerous and therefore lengthy requirement. Unfortunately, no other Australian legislation uses this term, and therefore there is no previous judicial interpretation on which to rely.

Another difficulty in interpretation of the term "sustained period" is the lack of a finding of what was the relevant cost below which predatory pricing conduct had occurred in *Boral*. It is correspondingly difficult to determine whether or not the time period over which the predatory pricing occurred in *Boral* was "sustained". Heerey J's finding that it was "conceivable that within an overall profitable period there might be such deep discounting of a particular product that … a contravention could be established", does

nothing to resolve the issue, and none of the other judgments in *Boral* shed any further light on the period of time over which it could be found that predatory pricing conduct occurred.

However, what can be determined is that if the relevant cost threshold used did incorporate a whole of business approach, then the threshold cost figure would be lower than the avoidable cost figure used by Heerey J, and the period of possible infringement would be a subset of the April 1994 through October 1996 period found by Heerey J. It may be that this smaller period would not be held to be "sustained", but without knowing the actual period involved, it is difficult to make any final determination on this point.

4. A Proscribed Purpose

The Birdsville Amendment has neither the threshold of substantial market power nor the take advantage element. The absence of the take advantage element in the Birdsville Amendment means that the purpose element becomes the only method for discrimination between 'good' and 'bad' below cost pricing in the provision. By contrast, both these terms are foreshadowed to be incorporated in the Prospective Predatory Pricing Provision, which will therefore not suffer the same reliance on the purpose element, although the proscribed purposes will presumably still play a part.

Purpose can be found in one of two ways: by direct evidence of the purpose of the officers and employees of the alleged infringer; or by way of indirect evidence of purpose through inference from the conduct of the corporation or of any other person, or from other relevant circumstances.[47] Also, a proscribed purpose of the pricing conduct need only be one of many purposes of that conduct, as long as it is substantial.[48]

The judgments in both the Federal Court and the Full Federal Court have been forceful in their finding that the requisite purpose existed in *Boral*, largely due to the prevalence of direct evidence of purpose in the business strategy statements published by BBM. Given the High Court's decision that there was no predatory conduct by BBM, it is to the Full

[47] Section 46(7) of the Act.
[48] Section 4F of the Act.

Federal Court's decision that we must turn for an examination of the purpose element in the most detail. Indeed, the Full Federal Court examined purpose far more carefully than they examined the actual conduct, an approach which the High Court justifiably criticised.

The Full Federal Court referred to the many statements of BBM executives and BBM's various Strategic Business Plans in support of its finding on purpose. Beaumont J has usefully summarised the "uncontested primary facts" in his judgment, and has several references to BBM's stated objective to "drive at least one competitor out of the market"[49], for which purpose there is ample direct evidence. In addition, the Victorian manager of BBM was reportedly instructed in the middle of 1992 to "meet competitors prices, or if necessary, to just beat those prices by the smallest margins".

However, in contrast to the direct evidence of purpose, there is very little indirect evidence of a proscribed purpose based on the conduct of BBM, which would perhaps reveal itself in BBM leading the market price downwards in order to drive competitors out of the market. In contrast, there is a significant amount of evidence that BBM priced either at or above its competitors, and used other advantages, such as capacity, efficiency, and marketing to increase its market share during the relevant period.

It was uncontested evidence that the price war which commenced in October 1993 was caused by "Rocla's quotation on the Eastland Project, the distribution of Pioneer's October 1993 price list, and the entry of C&M into the market"[50]. In October 1993, Pioneer distributed a price list that significantly undercut the market. In response, BBM distributed a price list substantially identical to that of Pioneer's.

By mid-1994, the approximate time of the commencement of the alleged predatory conduct, BBM's Strategic Business Plan states that BBM had a market share of 28% and had "rebuilt its position as market leader" through "customer focus and manufacturing efficiency".

In March 1995, BBM's Business Plan stated:

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[49] BBM Strategic Business Plan 1994-2000, 1995 update, *Boral* above n 41 per Beaumont J, para 172.
[50] *Boral* above n 41 per Beaumont J para 163.

> [o]ur ability to supply the market has been constrained by our lack of capacity. Our marketing efforts have been successful to the extent that **our customers are prepared to buy from us even though our prices may be slightly higher**. Our aim through 1996/97 and 1997/98 is to drive one competitor out of the market. The new plant gives us the ability to do this…
>
> At the present time no Victorian masonry manufacturer is believed to be trading profitably…
>
> To take advantage of the downturn which will put pricing and volume pressure on the market prior to the recovery is the rationale for **additional production capacity**. When the market turns down our volume capacity will enable us to apply pressure to our competition.

The actual evidence of pricing supports BBM's statement above[51]. Of the 19 deals over the relevant period in which BBM bid for CMP contracts, BBM lost the deal to C&M or Pioneer on nine of those 19 deals, on seven of those nine occasions due to C&M or Pioneer supplying CMP at lower prices than BBM. Of the ten deals that BBM won, on four occasions BBM won the contract by matching a competitor's prices, and on five occasions due to some other factor such as a relationship with the relevant builder or architect, despite pricing on some occasions above its competitors. There was only one instance considered by Heerey J where it was shown that BBM had priced below its rivals in order to win a contract, and in that instance, it was the customer who determined the price that BBM would have to meet in order to win the bid.

Despite the lack of indirect evidence of a proscribed purpose derived from the conduct of BBM, the overall objective of driving competitors out of the market is clearly made out by the direct evidence of purpose. In addition, BBM did drop its prices over the relevant period to match its competitors and in one instance priced below its competitors, and two competitors did leave the market during the relevant period. It is therefore likely that the Court will find that one of the purposes of BBM's pricing was to drive at least one competitor out of the market. Indeed, three of the seven justices of the High Court in *Boral* quoted with approval Heerey J's original finding that the requisite purpose existed,[52] and the other four were not required to make any finding on this point given their overall finding that there was no predatory pricing conduct. BBM's pricing would

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[51] Detailed by Heerey J at first instance (n 16) and repeated by Beaumont J in his Full Federal Court judgment (n 17).
[52] *Boral* above n 12 per Gleeson CJ and Callinan J at 625, Kirby J at pp 695-699.

therefore most likely be found to have been motivated to some (substantial) extent by a proscribed purpose, and the purpose element of the Predatory Pricing Provisions is therefore likely to be satisfied.

The outcome in *Boral* decided on the Predatory Pricing Provisions

If the Birdsville Amendment was applied to the facts in *Boral*, the alleged infringer, BBM, would no doubt be found to have had substantial market share and priced its products for a proscribed purpose, which are two of the four elements required for an infringement. As has been mentioned, the inclusion of the substantial market power in the Prospective Predatory Pricing Provision will likely mean that no breach will be found on the application of this provision to the facts in *Boral*.

A re-determination of the decision in *Boral* on the Birdsville Amendment would likely turn on the "relevant cost" figure, which would be based on avoidable cost to BBM as modified by a whole of business approach considering the benefits to the wider Boral group derived from the operation of BBM. The relevant cost threshold under the Birdsville Amendment would therefore be significantly lower than the threshold of avoidable cost used by Heerey J. This may mean that the period over which the below cost pricing occurred may be significantly reduced from the period of April 1994 through October 1996 found by Heerey J, and actually be so short that it would not be found to be a "sustained period". In that case no infringement of section 46 as amended by the Birdsville Amendment would be found.

The lack of detail in the *Boral* judgments of what is the "relevant cost" below which the predatory pricing threshold will be reached makes it difficult to be definitive on these two elements, being the determination of the "relevant cost" threshold and whether BBM priced below that threshold for a "sustained period". However, there is a significant possibility that the High Courts' decision would be reversed if it were re-determined on the New Amendments.

The difference in *Boral* between the direct evidence of purpose and the indirect evidence of the purpose through the conduct of BBM highlights just how inaccurate a tool purpose

is for discrimination between good and bad corporate behaviour. All competitors have a purpose of triumphing over their opposition, and it is likely to be bad luck or poor scrutiny of publications and internal communications that provides evidence of purpose on which to found a prosecution for a breach of section 46, not a significant difference between the actual purpose of competitors.

When we look to see whether BBM's conduct has contravened the goals of section 46, we observe that after the alleged infringing behaviour, two smaller competitors had left the market. However, with the three large competitive players remaining, C&M, Pioneer and BBM, and some smaller competitors also remaining, competition in the market would still have been strong. Even in terms of the object of fair trading, BBM was not the price leader driving the market down. Indeed, there is evidence that BBM attempted to lead the price up on many occasions. BBM was therefore not acting unfairly during the relevant period.

As the High Court stated, the market conditions of oversupply and the large number of suppliers were responsible for driving prices down in the CMP market. BBM's conduct generally was to increase capacity and focus on service, marketing and efficiency in conjunction with price matching on some occasions, hoping to outlast its competitors. These actions are not contrary to the objectives of section 46 given the overall health of competition in the market before and after the alleged predatory conduct.

The prospective Predatory Pricing Provision is therefore more effective than the Birdsville Amendment as its outcome when applied to the facts in *Boral* matches the object of section 46 and the Birdsville Amendment's outcome does not.

PROBLEMS WITH THE CURRENT SECTION 46

Section 46 has been faulted on many grounds,[53] including that substantial market power (or substantial market share) must be proven as at the time of the alleged predatory conduct, rather than after the conduct has been completed (as was the case in the target market in the *GlaxoSmithKline* case). If an organisation without substantial market power has sufficient resources other than market power to utilise to engage in predatory conduct, such as financial, structural (contractual, geographical or other advantages), or other resources, then they can acquire substantial market power or share as a result of the predatory conduct which they did not have at the time of that conduct, but still escape the censure of section 46. This has been called the 'hole in the section 46 net'[54] and remains a problem with the section despite the New Amendments.

The government senators' report contained in the References Committee Report noted that section 45 had a far more successful record of prosecutions than section 46, and put the relative failure of section 46 down to three issues with the section: '*formidable difficulties of proof, the expense and complexity of such proceedings, and the high hurdles which the section, as currently drafted, raises*'[55]. These three criticisms echo the views of many commentators and are considered below.

Difficulties of Proof

Proving purpose as part of a breach of section 46(1) involves an assessment of the state of mind of a corporation, which can be conceptually and practically difficult, even when so-called "objective" criteria are specified. As was seen in *Melway*, even the full Federal Court can misapply the purpose element of section 46, and it will be even more difficult to apply for lower courts.

[53] Anthony Niblett, Joshua S Ganz and Stephen P King, *Structural and behavioural market power under the Trade Practices Act: An application to predatory pricing*, (2004) 32 ABLR 83.
[54] This phrase has been coined by a number of writers, including Geoff Edwards, *The hole in the section 46 net*, *The Boral case, recoupment analysis, the problem of predation and what to do about it*, (2003) 31 ABLR 151; See also McHugh J in *Boral* at [269].
[55] References Committee Report, p 82 (Government Senator's Report) p 83; See also *Boral* ibid per McHugh J at [269].

In a competitive marketplace, competitors are often damaged by legitimate competitive behaviour, and in some instances, are forced out of the market. Given the aggressive nature of a truly competitive market, legitimate competitive behaviour from large participants in a market is often difficult to distinguish as indirect evidence of purpose from a misuse of market power, making indirect evidence of purpose inconclusive. Direct evidence of purpose is therefore an important element of section 46.

However, finding direct evidence of a proscribed purpose has proven to be far easier than some commentators have led us to believe. Direct evidence of purpose was found in both *Boral* and *Melway*.[56] Competitive "banter" in informal communications within a corporation is common, and may be used as direct evidence to prove the purpose element.

Expense and Complexity

Any determination of misuse of market power will by its very nature likely require a detailed analysis of the market in which the alleged misuse has occurred, which is a complex exercise. This complexity may be reduced if an effects test is implemented in place of the current purpose test, as proving the effect of particular conduct can be conceptually easier than proving purpose, however, not necessarily any less complex or expensive. Therefore the introduction of an effects test may not have a significant impact on the cost or complexity of proving a contravention.

The market share threshold of the Birdsville Amendment is an easier threshold to assess than the substantial market power threshold. Substantial market share would consequently be less complex and expensive to prove than substantial market power. This is the only good reason for the introduction of the market share threshold in the Birdsville Amendment. However, market share is only an approximate for market power, and its use in section 46 may lead to unfortunate instances of proven contravention in the absence of any actual market power on the part of the infringer.

[56] See the Dawson Committee Report supra, pp 77- 79.

High Hurdles

The interpretation of the substantial market power element of section 46 by the High Court has been criticised by some commentators as misinterpreting the intention of Parliament's 1986 amendment which lowered the section 46 threshold from "a position to substantially control a market" to "a substantial degree of power in a market".[57] These critics contend that the Courts have effectively kept the standard of market power at the higher threshold of "a position to substantially control a market" which in their view is a nearly unreachable threshold.

However, of the Three Decisions, the majority of the High Court in both *Rural Press* and *Melway* decided that the respective alleged infringers had both reached the threshold of substantial market power. In addition, after *Boral* and with the benefit of the High Court's reasoning in all Three Decisions, the majority of the Full Federal Court in *Safeway*[58] found that Safeway Stores Pty Limited, a participant with a 16-20% market share, had breached section 46 and did have substantial market power. The High Court refused Safeway Stores Pty Limited's application for special leave to appeal the Full Federal Court judgment in that case.

It is difficult to reconcile the decisions in *Rural Press, Melway* and *Safeway* with the criticism levelled at the Court over their interpretation of a substantial degree of power in a market. Instead, it seems that the concept of substantial market power has been the subject of misplaced criticism which should have been directed at other problems with section 46 such as the definition of market power and the take advantage element as detailed above.

The Birdsville Amendment

The Birdsville Amendment was reportedly conceived by Senator Barnaby Joyce while he was passing through the Western Queensland town of Birdsville, from which the amendment derives its name. The Birdsville Amendment was added to the *Trade*

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[57] See Frank Zumbo, *The High Court's Rural Press decision: The end of s 46 as a deterrent against abuses of market power?* (2004) 12 TPLJ 126.
[58] *ACCC v Australian Safeway Stores Pty Limited and Another* (2003) 198 ALR 657.

Practices Legislation Amendment Bill (No 1) 2007 on 13 September 2007, well after the tabling of the References Committee Report on the bill. The bill with amendments was subsequently passed on 20 September 2007 and was assented to on 24 September 2007, less than two weeks after the Birdsville Amendment was first tabled. The Birdsville Amendment has consequently not been subject to the same scrutiny as the rest of the *TP Amendment Act*.

In addition to the 'hole in the section 46 net' issue which the Birdsville Amendment shares with the rest of section 46, the Birdsville Amendment suffers from some unique problems due to its particular drafting.

(a) Undefined Terms

The new undefined terms in the Birdsville Amendment are likely to create confusion for businesses, at least until some jurisprudence develops, which may create a chilling effect on many previously legitimate competitive practices such as clearout sales and price matching with competitors where those prices are at or near cost.

"*substantial market share*"

Considerations such as barriers to entry and other structural factors are not required in any determination of market share, and indeed there may be quite a number of participants with substantial market share in any given market, but each participant may have no real market *power* due to the presence of the others. Businesses with as little as 10% market share for example may come within the auspices of the term, and as a result, the Birdsville Amendment may actually penalise the small businesses that it is designed to protect.

The substantial market share test has been enacted as a result of misplaced criticism of the substantial market power threshold, and has the capacity to bring corporations without substantial market power within the scope of the Birdsville Amendment's predatory pricing provision, potentially combining with the purpose test to prosecute infringements by corporations without the capacity to act in a predatory manner and in the absence of any actual anti-competitive conduct.

"sustained period"

The Birdsville Amendment requires below cost pricing to be conducted over a "sustained period" in order to attract censure, however, there is no definition of "sustained period" in the amendments. Presumably this element has been included to enable participants to conduct sales and clearances without attracting the censure of the section, however, foreign cases that have considered the length of time required for below cost pricing to be predatory have found predatory conduct which has occurred over less than a month[59], and the uncertainty in the meaning of this phrase may have a chilling effect on such activities before judicial interpretation gives this phrase more certainty, to the detriment of consumers in the intervening period.

"relevant cost"

Another undefined term in the Birdsville Amendment is "relevant cost". There are many measures of cost which may be appropriate to the definition of predatory pricing depending on market conditions and the cost structure of the competitor. The References Committee argued in its report that variable cost was 'generally favoured … as the appropriate yardstick' and that its use would provide 'greater certainty'[60]. However, certainty is of no assistance to competitors where variable cost is not the appropriate measure.

AVC is one measure that has been commonly used as a threshold in predatory pricing cases, but is by no means the only measure for cost that has been used around the world as a measure below which predation occurs[61].

In some industries, such as telecommunications, the AVC is vanishingly small compared to the fixed costs of setting up the infrastructure upon which the services are delivered. In those industries, a more appropriate measure may be long-run average incremental

[59] See the UK Competition Appeal Tribunal case of *Aberdeen Journals Limited v Office of Fair Trading* [2003] CAT 11, where the conduct occurred from 1 March to 29 March 2000.
[60] Committee Report p 17.
[61] For example, as discussed, in *AKZO v Commission* above n 24.

cost[62], which is the sum of the variable and product specific fixed costs divided by the number of units produced.

Other cost measures that have been considered are marginal cost, which is the increase in total cost attributable to producing the last unit actually produced, and average avoidable cost, which is the total cost avoided by not producing a number of units divided by the number of units not produced.

There may also be valid commercial reasons for selling below AVC or any other specific measure, which depend on the circumstances of the case, such as if the market price falls below AVC, as was held to be the case in *Boral*, or where the product in question is a discontinued or older line. By making the standard 'relevant cost' the amendment sidesteps the issue, and leaves it up to the Courts to decide which yardstick for cost is the most appropriate.

Given the lack of any coherent consensus on the issue and the numerous potential factual circumstances and different cost structures, there may be no way to define the concept of "relevant cost" further. However, as there are a finite number of different cost pricing methodologies, and given the importance of this calculation to a prosecution for predatory pricing, a declaratory provision detailing a list of the various possible methods of calculating cost price and their definitions may be of assistance to the courts, and may help corporations by giving some degree of certainty to the legality of their pricing structures.

(b) Removal of the 'take advantage' element/'business rationale' defence

The 'business rationale' defence has developed through a line of High Court cases on section 46, and provides that conduct which has a reasonable business rationale that does not require substantial market power will not take advantage of a corporation's market power but will instead comprise lawful, vigorous, competitive behaviour[63]. However, as the take-advantage element of section 46(1) has not been replicated in the Birdsville

[62] As suggested in the European Competition Commission's *Notice on the Application of the Competition Rules to Access Agreements*, OJ [1998] C 265/2, [1998] 5 CMLR 821.
[63] Above no 12 at p 625.

Amendment, the business rationale defence to a claim of predatory pricing has been effectively removed by the amendment.

(c) Purpose instead of '*take advantage*':

As there is no take advantage element in the Birdsville Amendment, the judicially defined business rationale defence will not be available as a defence to a claim of predatory pricing brought under the amendment. The purpose element will therefore become more important as the mechanism for discriminating between 'good' and 'bad' below cost pricing behaviour under the Birdsville Amendment. The Prospective Predatory Pricing Provision by contrast includes the 'take advantage' element, and does not suffer from this issue.

According to the Treasurer Mr Costello, the purpose element of the Birdsville Amendment will act as a safeguard against misapplication of the Birdsville Amendment[64]. Using purpose as a safeguard in the Birdsville Amendment is problematic for the following reasons:

(i) The proscribed purposes of the Birdsville Amendment include the relatively benign purposes of substantially damaging a competitor, and deterring a person from engaging in competitive conduct.

(ii) Almost all competitive conduct will have as a purpose the desire to take market share from the competition, which will in turn cause damage to competitors, and may cause substantial damage depending on the success of the conduct. Indeed, the lifeblood of competitive markets is the desire to triumph over the opposition. It will be difficult for any business to rebut an allegation that *one* of their substantial purposes in reducing their prices is to harm their competition.

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[64] Comments of Peter Costello, Treasurer, as reported in the Australian Financial Review, Friday 14 September 2007, page 11.

(iii) The TPA allows that conduct may have many purposes, any one of which can be considered a purpose if it is a substantial purpose[65]. Conduct that has a legitimate purpose, even a dominant legitimate purpose, will still contravene the section if it also has a substantial purpose proscribed by the section.

(iv) The TPA also allows proof of purpose by inference "from the conduct of the corporation, or of any other person or from other relevant circumstances"[66], and need not be the actual subjective purpose of the decision makers of the corporation. Given the variety of sources of such proof, and the aggressive culture a genuinely competitive market fosters, finding a purpose of substantially damaging the competition or deterring competitors from competitive behaviour will not be difficult to achieve in many instances.

(v) Smoking gun communications containing direct evidence of purpose are not difficult to come by in many businesses (see *Boral*), depending on the foolishness of employees who may record what would otherwise be common but unwritten motivations.

As some of the proscribed purposes of section 46 reflect desirable competitive behaviour, purpose is a very blunt tool with which to discriminate 'good' competitive behaviour from 'bad'. It may be a simple matter of luck whether or not evidence of such a purpose is discovered by an investigating authority and used against a corporation.

Until the Birdsville Amendment is itself amended, reducing the likelihood of a successful prosecution for predatory pricing may be the achieved by a change in office culture as much as a changes in pricing strategy. Prudent advice to potential discounters would include a warning about mentioning competitors in a negative way in internal or external communications, and scrutinising the business practices and behaviour of employees. A paper trail of reasonable and proper purposes for pricing activities which do not refer to

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[65] Section 4F(1)(b) *TPA Act*.
[66] Section 46(7).

competitors should be kept to lay out with great clarity the purpose of all discount pricing activities. In this way, any negative inference of a proscribed purpose can be to some extent rebutted by actual evidence of purpose.

IS CONSIDERATION OF RECOUPMENT NECESSARY IN A PREDATORY PRICING PROVISION?

A capacity for recoupment is a good indication that the level of competition in the market has been weakened by pricing conduct, which in turn may indicate that the conduct was predatory. Indeed, the US Supreme Court's rationale for the requirement of recoupment in *Brook Group* was that it was a necessary prerequisite of harm to consumers[67]. In essence, recoupment is an approximate measure of the anti-competitive effect of predatory behaviour. Should the alleged infringer increase its market power as a result of below cost pricing conduct, then competition in the market will have been reduced, thereby allowing recoupment of the losses incurred from below cost pricing. By requiring a reasonable prospect of recoupment, the US courts have in essence added an effects test to their provision as it applies to predatory pricing. In addition to the US, 15 other foreign jurisdictions require recoupment as a perquisite for a finding of predatory pricing[68].

In Australia, the High Court stated in *Boral* that the capacity for recoupment may be of factual importance but is not determinative[69]. However, all the judges considered it an important element in that case, and some commentators have even suggested that recoupment is an essential but not sufficient element of predatory pricing[70]. Despite such pronouncements, the importance of recoupment to the analysis of predatory pricing was not recognised in the *TP Amendment Act*.

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[67] *Brook Group* supra at 224.
[68] ICN Report supra n 16, at p 17.
[69] *Boral* n.12 at p 422 per Gleeson CJ and Callinan J.
[70] Geoff Edwards, *The hole in the section 46 net*, *The Boral case, recoupment analysis, the problem of predation and what to do about it*, (2003) 31 ABLR 151 at 163.

The basis for criticism in Australia of the requirement for recoupment is that this element does not cover all the motivations for predatory pricing behaviour, such as sending a signal to potential market entrants that their entry will be met with below cost pricing[71]. This criticism has some validity, and for this reason, an effects test is a better measure of the anti-competitive effects of a pricing strategy than a requirement for recoupment, as any anti-competitive effect can be caught by an effects test, even if it is not possible to quantify the anti-competitive effect as an amount of profit in dollar terms. With the addition of an effects test to a provision aimed at predatory pricing, the requirement for recoupment therefore becomes unnecessary.

AN EFFECTS TEST FOR PREDATORY PRICING

As a result of the difficulties associated with the purpose element of section 46, some commentators have called for an effects test to replace or add to the purpose element (such as currently exists in section 50 of the *TPA*), whereby a demonstrated or likely anti-competitive effect of the conduct must be proved instead of or as an alternative to purpose.[72] However, an amendment to incorporate an effects test was rejected by the Dawson Committee and many other Australian reports into the effectiveness of section 46,[73] on the basis that one of the unintended consequences of such a test would be a chilling effect on competition.

The Dawson Report[74] raised the problem that if an effects test were implemented in section 46:

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[71] See for example Kathryn McMahon *Competition Law, Adjudication and the High Court*, [2006] MULR 35.

[72] See for example Mitchell Landrigan, *Great(er) Expectations*, 26(1) UNSWLJ 276; Garth Campbell, *The Big Chill from Birdsville* (2007) Vol 45 No. 10 LSJ 64

[73] See for example the Trade Practices Consultative Committee, *Small Business and the Trade Practices* Act, AGPS, Canberra, December 1979 (Blunt Committee Review); House Representatives Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies and Acquisitions: Profiting from Competition?*, AGPS Canberra, 1989 (Griffiths Committee Review); and Report by the Senate Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls,* AGPS, Canberra, December 1991 (Cooney Committee Review); Report of the Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, August 1993, p.70.

[74] *Review of the Competition Provisions of the Trade Practices Act* – Trade Practices Act Review Committee, January 2003.

> 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.

The example given by the Dawson Committee was if a new outlet was opened in a new location or geographic market by a large competitor. This behaviour may have the effect of driving smaller competitors from that location, and was argued to be an example of normal competitive behaviour unwittingly caught in the section 46 net once an effects test was included.

In a similar vein, in 1993, the Hilmer Independent Committee of Inquiry into section 46 stated that an effects test:

> …would not, in the Committee's view, constitute an improvement on the current test. It does not address the central issue of how to distinguish between socially detrimental and socially beneficial conduct.[75]

These arguments have also been echoed in other reports.[76]

Since the publication of these various reports, the High Court has handed down its decisions in *Melway* and *Boral*, which developed the 'business rationale' defence under the take advantage element of section 46 and has to some extent resolved the issue put forward by the Dawson Committee (and also earlier reports that considered and rejected the introduction of an effects test into section 46). The business rationale defence which has been incorporated into the take advantage element by the High Court alleviates the need for the purpose element to be the sole or main arbiter of the appropriateness of the conduct. Indeed, many overseas jurisdictions accept a business rationale defence to a claim of predatory pricing[77].

A different criticism of an effects test in section 46 was put forward by the Cooney Committee Review, which reasoned:

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[75] ibid at p 70.
[76] For example, Joint Select Committee on the Retailing Sector, *Fair Market or Market Failure? Review of Australia's Retailing Sector*, AGPS, Canberra, August 1999 (Blunt Committee Review 1999), at p 100.
[77] For example, Brazil, Bulgaria, Canada, Chile, Denmark, European Commission, France, Germany, Hungary, Ireland, Italy, Jamaica, Japan, Korea, and Mexico, according to the ICN Report supra n 16 at p 26.

> To prohibit the taking advantage of market power where this has or is likely to have the effect of, for example, preventing a person from engaging in competitive conduct would unduly widen the operation of the prohibition. It would force corporations to evaluate the potential effect of their every action on their competitors and potential competitors.[78]

Were an effects test to be added to section 46 as a whole, this criticism may have some validity, however, an effects test introduced as a part of a predatory pricing provision only would not be problematic in this way. In general, large companies are aware of the prices their competitors are charging as these prices have a direct and immediate impact on their own businesses. To consider a competitor's prices when setting your own prices is the norm rather than a significant extra burden on a company.

As has been discussed above, the purpose test is not a good way to distinguish between good and bad competitive conduct. The take advantage element, which now incorporates a de facto business judgment rule, is a more effective way to discriminate between legitimate and illegitimate competitive behaviour than is a purpose test. *Boral* showed that the danger in relying on a purpose test is that the conduct complained of may have the purpose but not the effect of substantially lessening competition, and will still be caught. The result of replacing the current purpose test with an effects test will be that by contrast, some conduct that has the effect but not the purpose of substantially lessening competition may be caught. The take advantage element will be the mechanism by which majority of such conduct will be excluded, based on the existence of an objectively assessed business rationale. The only conduct caught by such a provision that could be considered questionable would then be below cost pricing conduct that has no legitimate business rationale, and has the effect of substantially lessening competition in a market, but where the purpose of substantially lessening competition has not been proven. Requiring large competitors to have regard to their pricing and avoid such behaviour does not seem to be an unreasonable requirement given the care and scrutiny with which competitive pricing is usually undertaken. To avoid injustice in this area, purpose could become an element to consider when determining damages for a breach of such a provision.

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[78] ibid at p 96.

As discussed above, an effects test is an element of the US, European, and Canadian predatory pricing provisions, and indeed, according to the ICN Report in the majority of overseas jurisdictions. In Europe for example, predatory pricing below AVC requires a demonstrated anti-competitive effect combined with a relatively high threshold of "market dominance", but is subject to an appropriately drafted 'business rationale' style defence[79]. In their July 2005 report, the European Competition Commission stated that the reasons for the adoption of an effects based approach to article 82 were:

1. An effects based approach focuses on consumer welfare.
2. A company cannot circumvent the effects based approach by characterising their actions in different ways; and
3. An effects based approach will not capture pro-competitive strategies.[80]

These jurisdictions have similar free market economies to that of Australia, and all three of the reasons above are equally applicable to an Australian provision. The Australian criticism of the effects test is hard to reconcile with the fact that the majority of overseas jurisdictions with similar competitive market economies rely on such a test.

Intent may be an appropriate additional consideration for a criminal offence of predatory pricing. In 10 of the 35 overseas jurisdictions which have a criminal as well as a civil predatory pricing provision[81], intent is one of the criteria which distinguishes the criminal provision from the civil provision, intent indicating a more severe breach requiring criminal sanction. However, the criminal predatory pricing provisions are very rarely used in those jurisdictions, and certainly not in the last 10 years.

In summary, the criticisms that have been levelled at an effects test in the past in Australia lose their force if the test is combined with an appropriately drafted business rationale defence. For the reasons outlined above, the replacement of the purpose test with an effects test would be a positive amendment to section 46(1AA). Indeed, many of

[79] Article 82(c) of the European Commission Treaty.
[80] Report by the EAGCP, *An Economic Approach to Article 82*, July 2000, pp 2-3.
[81] Brazil, Canada, Denmark, France, Ireland, Israel, Japan, Korea, Peru, and Taiwan. See ICN Unilateral Conduct Working Group *Report on Predatory Pricing*, n 16 above at pp 6-7.

the same arguments apply to the replacement of the purpose test with an effects test in section 46 generally.

RECOMMENDATIONS

In order to ensure a proper balance between the objectives of the protection of competitors (fair trading), the protection of consumers, and the protection of competition, in the operation of section 46, the following recommendations should be implemented:

1. Include "financial power" as a consideration in the determination of market power under section 46:

Partly in response to *Boral*, the 2004 Senate Economics References Committee Report into section 46 recommended that section 46 be amended to include "financial power" as a consideration in the determination of market power[82]. Financial power was defined by the Committee to be access to financial, technical and business resources. This recommendation is of paramount importance to any new predatory pricing provision, as the clearest application of financial power as a misuse of market power is one of predatory pricing. If the References Committee Report's recommendation were to be accepted by Parliament, it would combine with the Cross-market Amendment to extend the reach of section 46 beyond the market in which the alleged infringer's market power resides to capture more anti-competitive behaviour.

The government and some commentators have raised concerns about the scope of such an amendment.[83] However, as a consideration only, it is up to the courts as to what weight they put on the financial power used and whether it amounts to substantial market power in a market. In *Rural Press*, given the small size of the Riverland market compared to the financial and organisational power of Rural Press (which included many papers across many markets), it is likely that the financial and organisational power that Rural Press threatened to use (effectively the entirety of its resources) would be held to be substantial

[82] Senate Economics References Committee Report, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, pp 19-23.
[83] Australian Government Response to the Senate Inquiry Into the Effectiveness of the *Trade Practices Act* 1974 in Protecting Small Business, p 7.

market power in the Riverland market. The threat to distribute papers for free in the Riverland market is an egregious use of financial and organisational power to maintain a monopoly which would satisfy the 'take advantage' element, and given the obvious purpose of the threat, it is likely that the High Court decision in *Rural Press* would be reversed if financial power was included in the considerations for market power.

2. Substantial market power should be the result of conduct in section 46:

The 'hole in the section 46 net'[84] detailed above can be dealt with by considering substantial market power as the end result of predatory conduct, rather than a pre-condition under a predatory pricing provision as is currently the case although the recommendation above will go some way to alleviating this issue. This recommendation 2 should apply to the whole of section 46.

3. Return to a threshold of substantial market power in a predatory pricing provision:

The threshold of substantial share of a market in the Birdsville Amendment should be replaced with the substantial market power threshold. This will more narrowly target corporations who have the power to actually benefit from predatory strategies, and bring the provision more in line with the European model. The substantial market power threshold has a history of jurisprudence that can also be relied upon to increase certainty of the application of such a provision for businesses.

4. Implement an effects test in place of the purpose test in a predatory pricing provision:

Due to the difficulty in capturing predatory pricing under a general misuse of market power provision, a separate subsection of section 46 that specifically deals with predatory pricing such as the Birdsville Amendment should be retained.

[84] This phrase has been coined by a number of writers, including Geoff Edwards, *The hole in the section 46 net*, *The Boral case, recoupment analysis, the problem of predation and what to do about it*, (2003) 31 ABLR 151; See also McHugh J in *Boral* at [269].

Replacing the purpose test with an effects test in the Birdsville Amendment would not have the consequences that were foreshadowed by the Dawson or other committees for section 46. These and previous committees did not properly consider this aspect of the 'take advantage' element of section 46, or the introduction of a new predatory pricing provision, which is understandable given more recent judicial developments. The introduction of an effects test in conjunction with a properly defined business rationale defence to the Birdsville Amendment will instead increase the economic efficiency of the provision, and in turn increase consumer welfare.

5. Retain the "relevant cost" and "sustained period" terms in a new predatory pricing provision:

Due to their conceptual utility, and despite their current lack of definition, the elements of "relevant cost" and "sustained period" should be kept and in time jurisprudence will make out these concepts in more detail. These terms assist in narrowing the scope of any new predatory pricing provision so as to exclude legitimately competitive behaviour.

Predatory pricing cases in Canada, Europe and the US have all considered these terms as elements of an infringement, and can be considered by the Australian courts should they require guidance.[85] However, a declaratory provision detailing and defining different measures that can be used for "relevant cost" may be of assistance to businesses and should also be considered.

6. Properly define the 'business rationale' defence as a part of the take advantage element in section 46:

A properly defined business rationale defence should be incorporated into section 46 as a whole, which may require the court to weigh any proposed business rationale for the conduct in question against the anti-competitive effects of the conduct, and remove the use of the counterfactual from the reasoning which underlies the consideration of the

[85] See for example *Culhane v. ATP Aero Training Products Inc.*, 2004 FC 535 (Canada); *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH* (1978) E.C.R 1139 (European).

defence. This is especially important in conjunction with an effects test, as legitimate competitive behaviour may otherwise be caught by the new provision.

It is pleasing to see that the newly elected Labor government has indicated that recommendations 3, 5 and 6 above are likely to be adopted[86].

CONCLUSION

Low prices are generally speaking the goal of any free market economic system, and drafting a provision that penalises corporations for pricing their products at too low a price will always be a difficult task. The question of what is "unfair" when it comes to low pricing has proven difficult to determine, and an inaccurately drafted provision will have harmful consequences for the wider economy. Jurisdictions around the world have had difficulty with this issue, and have attempted to resolve this difficulty in a variety of ways.

Most jurisdictions have drafted very general provisions, leaving the difficult task of drawing a line between "unfair" and "legitimate" pricing to the Courts. However, in Australia this approach has not resulted in an effective predatory pricing provision, but instead in a significant amount of dissatisfaction and criticism from business groups and commentators. Generally drafted provisions lack certainty and do not give courts sufficient guidance on the application of the provision.

Looking to foreign provisions and cases for inspiration, it is apparent that overseas laws on predatory pricing differ markedly from our own. We are alone in our reliance on purpose as the sole discriminating factor in predatory pricing cases. Indeed, most foreign jurisdictions rely on some form of anti-competitive effects test, including the United States, with a smaller role played by a purpose test[87]. The prevalence of the use of effects tests for predatory pricing provisions around the world flies in the face of arguments against the incorporation of such a test in Australia. Those arguments lose their force if

[86] See *Rudd Government Acts to Strengthen Laws to Promote Fair Competition* above at n 6.
[87] One notable exception being *Canada* which has the an effects test, and a purpose test in the alternative.

an anti-competitive effects test is coupled with a properly constructed business rationale defence.

Section 46 of the *TPA* has been amended many times with the goal of more effectively targeting predatory pricing, and the recent Birdsville Amendment was a bold attempt at accurately defining predatory pricing conduct in order to proscribe it. However, amongst other issues, the Birdsville Amendment suffers an over reliance on purpose as the discriminating factor, leading to the possibility of unintentionally capturing legitimate competitive pricing within the ambit of the prohibition. As a result, the Birdsville Amendment must itself be amended to avoid a chilling effect on competition in the Australian economy. The Federal Government has indicated that they plan to make some further amendments to this provision, however, even after these amendments are made, many issues will remain. The recommendations detailed in this paper address these issues, and if these recommendations are adopted, for the first time in Australia we will have a truly effective predatory pricing provision.

27 June 2008

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