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The End of Competition?

Competition policy in Australia is currently at a pivotal point. Almost by accident, the coincidence of a recent High Court decision, a statutory review of Trade Practices legislation (the Dawson Review), and ongoing debate about who should lead the Australian Competition and Consumer Commission have resulted in heightened uncertainty about how competition regulation will operate in future.This is occurring at an important time, as lower global and domestic economic growth creates increased pressures on Australian businesses, especially in the export-dependent rural sector. Mergers and company failures are leading to increasingly concentrated markets, with potential impacts on competition. How these issues are resolved will shape the future of competition policy in Australia for many years.

Not surprisingly, the recent High Court decision in the Boral Case has generated a considerable volume of newspaper column centimetres over the past month.[1] The decision, handed down by the High Court on February 7th, involved a case prosecuted by the Australian Competition and Consumer Commission against Boral Besser Masonry (BBM). In bringing the case before the Courts, the ACCC alleged that Boral had contravened Section 46 of the Australian Trade Practices Act, which prohibits large companies from misusing market power to reduce competition.

The issue being tested in this case, and indeed more generally in the review of the Trade Practices Act, is a very significant one for farmers in Australia. As a consequence of the necessary removal of most forms of statutory control over the marketing of agricultural products over the past two decades, and also as a consequence of the opening up of the Australian economy through competition and tariff reforms, many of the markets that Australian farmers deliver their produce into or source farm inputs from are becoming increasingly concentrated.

[1] High Court of Australia (2003)Boral Besser Masonry vs ACCC. HCA 5, 7th February, 2003.

Numerous examples exist, where just one or two dominant companies control very large shares of relevant markets, and company failures and/or mergers are increasing this trend. While these deregulated markets have generally delivered significant efficiency benefits, ensuring they remain fair and competitive is a key challenge facing policy makers charged with the current re-evaluation of competition policy in Australia.

The Boral Case

Section 46 of the Trade Practices Act states that "A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:

1. eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market
2. preventing the entry of a person into that or any other market
3. deterring or preventing a person from engaging in competitive conduct in that or any other market."

The ACCC launched a prosecution against Boral, alleging that it had breached this section of the Trade Practices Act in responding to extra competition in the market for concrete masonry products in Melbourne.

As detailed in the High Court proceedings, the case arose as a result of the entry of a small regional manufacturer, C&M bricks, into the Melbourne market for masonry products. In 1994, C&M established a new manufacturing facility on the outskirts of Melbourne, using new, highly efficient technology. In response, the ACCC alleged that Boral reduced its prices below the cost of production in order to drive the new competitor out of the market. In the process, the ACCC alleged that Boral's actions also forced two other competitors out of the market.

The ACCC brought the case to the Federal Court in 1998. Initially, a hearing before a single judge of that Court found that no breach of the Trade Practices Act had occurred, however this decision was overturned when it was appealed to the full-bench of the Federal Court. The Full Bench found that Boral had a substantial degree of power in the market, and had taken unfair advantage of this to remove competitors.

Boral then appealed that decision to the High Court. In rejecting the findings of the full bench of the Federal Court, the majority of the High Court judges made a number of important observations about the meaning of the relevant section of the Trade Practices Act.

Market Power

The first concerned the extent to which a market participant can be considered to hold "market power". It is clear from the judgements provided that in order to hold market power, a corporation not only needs to control a significant market share, but it also needs to be able to act without constraint, and recover short-term losses arising from any aggressive pricing policies.

As Justice McHugh explained:

> In my opinion, BBM did not have a substantial degree of power in the relevant market - the sale of concrete masonry products - because it was not able to raise prices to supra-competitive levels without its rivals taking away customers. Nor was it in a position to recover the losses it made by pricing below relevant cost when and if the price-cutting finished. Accordingly, irrespective of the purpose of its pricing, it did not have a substantial degree of market power of which it could take advantage.[2]

Justices Gleeson and Callinan made similar comments in their joint judgement:

> The essence of power is absence of constraint. Market power in a supplier is absence of constraint from the conduct of competitors or customers. ….. Matters of degree are involved, but when a question of the degree of market power enjoyed by a supplier arises, the statute directs attention to the extent to which the conduct of the firm is constrained by the conduct of its competitors or its customers.[3]

Much was made throughout the Court proceedings of available contract data which showed that both prior to and during the period over which the alleged conduct occurred, the building industry was suffering a slump, resulting in intense competition. The other major participant in the market (Pioneer) also seemed to have adopted very aggressive tendering policies during this period, and often initiated and won contests with BBM to secure contracts for the supply of masonry bricks for major public works.

It was also observed by several of the Judges that during the period in question, Boral's share of the market remained relatively static, suggesting that Boral did not have market power to the extent it could extract a significant advantage over its competitors.

A further point noted on the question of the extent of Boral's market power is the fact that the end result of the alleged activities undertaken by Boral was not the removal of the new rival, C&M. By the end of 1996, Boral's main competitors in the market had changed, with C&M effectively replacing Rocla and Budget, but Boral still held only the same market share as it had in April 1994, when the alleged activities commenced.

As explained by Justices Gleeson and Callinan:

> In its Statement of Claim, the ACCC identified C & M as the primary target of BBM's exclusionary purpose. Let it be assumed that BBM hoped that C & M would be eliminated as a competitor. The fact is that C & M was not eliminated. How does an unsuccessful attempt to exclude a competitor establish market power? If BBM's primary objective was as alleged by the ACCC, and the objective failed, the failure indicates an absence, rather than a presence, of market power.[4]

This interpretation of the appropriate test for the potential existence of market power relies heavily on the ability of an investigation to uncover details of transactions that occur in a particular market, rather than setting any arbitrary market-share thresholds. It is also effectively a test that is applicable 'after the event' rather than one that may be appropriate to use as a preventative curb in markets with dominant corporations and smaller participants.

Effects of Competition

A second important element of the Boral decision was the explanation by the Judges of the High Court of the intent of the Trade Practices Act. Most of the majority judgements incorporated an explanation of the nature of competition, highlighting that the intent of the legislation was to promote competition, not to protect competitors:

> The 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.[5]

In a similar vein in their joint judgement, Justices Gaudron, Gummow and Hayne quoted with approval the judgement handed down in an earlier case, which stated:

> …the purpose of s 46 (of the Trade Practices Act) is not 'the economic well-being of competitors', but the protection of the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end.[6]

In reaching these findings, it was also apparent that the Judges rejected any reliance on matters such as whether or not Boral were selling product below their cost of production, something which has been considered by some commentators to be an indicator of 'predatory pricing'. The Courts appear to have concluded that selling at prices below the cost of production wold only be a breach of the Act if it reduced competition to the extent that Boral was able to extract abnormally high profits in the future. As this was never likely to be the case in te relevant market given the low barriers to entry that were judged to exist, then the relatinship between Boral's cost of production and the prices it charged were deemed irrelevnt.

Market Information

In reading the decisions of the High Court judges, one aspect that stands out is the extent to which the decisions made were on the basis of available evidence of pricing behaviour in the marketplace.

[2] High Court of Australia. (2003) op.cit. McHugh at 199.

[3] ibid. Gleeson and Callinan at 121

[4] ibid. Gleeson and Callinan at 145.

[5] ibid. Gleeson and Callinan at 87

[6] ibid. Gaudron, Gummow and Hayne at 164

All the judges appear to have carefully examined evidence tabled about tender prices and contracts awarded over a three to four year period, which included both initial bid prices by the various competitors, and also the final bid prices negotiated with the winning tenderers. Justices Gleeson and Callinan devoted around thirty paragraphs of their judgement to a detailed recitation of the results of major tenders, and this information was also given considerable prominence in other judgements.

As referred to previously, the purpose of the close examination of the pricing information was not to determine whether Boral was tendering product below its cost of production – which has been considered by some to be evidence of predatory pricing – but rather to determine the extent to which Boral was free to act in the market without fear of other competitors reducing Boral's long-term profitability. A secondary consideration was to determine whether there was any evidence of Boral acting in collusion with its major competitor – Pioneer – on which issue the Courts found no evidence of such behaviour.

USA Precedents

A final point worthy of note in relation to the High Court judgements is the extent to which many of the Judges referred to precedents set in US Courts in support of their decisions. At each stage of the trial, the judges involved have relied significantly on decisions reached under US anti-trust and competition law.

This seems to be the case partly because the issues under consideration relate to broad economic concepts as much as they do to strict interpretations of the intent of legislation, but also because the USA has a long history of competition and anti-trust law, and presumably a greater volume of precedents to select from.

Reliance on US precedents requires careful consideration, for two reasons. The first is the sheer size of US markets, which seems to result in markets that are not dominated by just one or two major corporations, as is the case in the much more limited Australian markets. The second reason for caution is that the US has a range of supplementary legislative arrangements in addition to its main anti-trust laws, and these supplementary legislative arrangements tend to operate to prevent anti-competitive behaviour in chronically 'concentrated' markets. There is no similar supplementary legislation in operation in Australia, except perhaps in price surveillance and authorisation systems for State-owned monopoly service providers, such as bulk water suppliers, electricity and gas transmission utilities, and telecommunications.

A Future Competition Framework

The decision of the High Court in the recent Boral case provides some greater clarity in relation to the interpretation of existing Australian competition laws – specifically the Commonwealth Trade Practices Act. The decision is timely in that it highlights a number of issues associated with this legislation, but it is important to recognise that the decision is simply an interpretation of existing laws, which the Commonwealth is at liberty to modify in the future, if it sees fit. Whether or not those laws need additional modification has been the subject of a review process carried out by the Dawson Inquiry, the findings of which are now with the Treasurer and awaiting public release.

Clearly emerging from the High Court decision is the significance that needs to be placed on market information in reaching decisions on these matters. By market information is meant the prices and volumes of transactions occurring in the marketplace, as well as any secondary considerations such as payment terms, promotional contributions or volume discounts.

A dilemma in concentrated markets such as those existing in Australia is that the more concentrated a market becomes, the less likely it is that there will be open and transparent access to market information, in the absence of regulatory intervention. Yet at the same time it is generally acknowledged that the key to efficient markets is open and transparent access to information by all market participants.

There are several approaches that have been used to attempt to overcome this dilemma. The first of these is special inquiries into specific markets by regulatory agencies such as the ACCC in Australia or the Office of Fair Trading in the UK. For example, both these agencies have recently conducted inquiries into the retail grocery industries in their respective countries.[7]

The problem that quickly emerges with such inquiries is the difficulty they encounter in obtaining access to relevant market information. The recent ACCC inquiry was one that was of necessity a voluntary inquiry for participants, as the limited mandatory information disclosure powers the ACCC has under Section 155 of the Trade Practices Act were not invoked. As a result, only 19 of 50 suppliers to retail grocery chains participated, and some of these provided comments only, rather than detailed financial information.

The ACCC was unable, not surprisingly, to determine whether or not the financial information it obtained was biased in any particular direction. It was also unable to detect whether or not any specific breaches of the Trade Practices Act had occurred.

A similar conclusion was reached by the UK's Competition Commission inquiry, however it did highlight a number of areas of concern, specifically the lack of transparency in the dealings between supermarkets and their farmer suppliers, and the pricing policies of supermarket chains on a geographic basis. As a result of the findings in the UK inquiry, the Director General of Fair Trading released a Code of Practice to address relations between Supermarkets and their suppliers. This code contains legally enforeable requirements for Supermarkets to provide suppliers with details of standard terms of trade available to all suppliers, and to detail the terms of trade negotiated with particular suppliers.

[7] ACCC (2002) Report to the Senate on prices paid in the Australian Grocery Industry; Competition Commissioner (2000) "Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom. CM 4842. Oct. 2000

It is interesting to note that both the ACCC and the UK Competition Commission inquiry commented on the particular difficulty of obtaining relevant and timely market information for farm produce supplied to supermarket retailers.

A second approach to information disclosure that has been used is that established under several pieces of USA legislation. The Perishable Agricultural Commodities Act and the Packers and Stockyards Act both regulate their relevant rural industry sectors to the extent of imposing mandatory record retention and disclosure requirements on industry participants, as well as imposing standard payment and security terms throughout the marketing chain.

The focus in this instance is the regulation of market information, rather than regulation of specific behaviour in these markets. The USA Government is able to enforce the mandatory information disclosure provisions in specific declared markets, and after 'sanitising' this information to protect commercial interests, releases it publicly.

Regulation of corporate behaviour in these markets is governed by the more general anti-trust and competition law that operates in the USA, with the mandatory information disclosure arrangements acting as both an anti-competition preventative measure, as well as generating information necessary to successfully prosecute competition breaches, should they still occur.

A related issue that emerges from the High Court decision and which will require further consideration is the fact that the High Court placed a great deal of significance on the actual impact of behaviour by participants in the marketplace, as opposed to the potential impact of behaviour, or the intent of behaviour.

In effect, the High Court has said that the crime of 'attempted murder' may not have a place in competition law, and that a dead corporate body may be required before a breach of the general intent of the Trade Practices Act will be found.

This presents particular difficulties for markets where a high degree of concentration exists, such as those that occur in many instances in Australia. This is because a large, well-resourced and dominant market participant would now seem to have added freedom to adopt pricing policies that will be detrimental to any new market entrant.

Admittedly, the High Court decision did very carefully examine the extent to which Boral could act without consideration of other competitors in the market, and found that sufficient competition existed to restrain Boral's actions. Nevertheless, the decision would appear to give additional latitude to the behaviour of corporations in a dominant position in markets.

As a result, in the absence of changes to the Trade Practices Act, new market entrants are likely to be subject to increased competitive pressure, and may only appear likely to gain some regulatory protection from unfair practices if they were at the point of being driven out of the market – obviously too late to enable them to continue to provide competition.

A further difficulty arises with the approach taken by the High Court in markets such as the fresh produce market, where written contracts are almost unheard of, and where there is no public price-discovery process. For example, fruit and vegetable growers consigning produce to Sydney markets simply receive a remittance based on their agents report of the price they were able to trade that produce for. Several investigations have failed to shed any light on the margins that are extracted by the various participants in the system.

Adopting the approach taken by the High Court in the Boral case, with its very strong reliance on documented market transaction information, would prove to be a pointless exercise in such markets because there is simply no real documentation available.

This suggests that while the approach taken by the High Court in interpreting the Trade Practices Act may be sound from an economic perspective, and may be an accurate interpretation of the law as it currently stands, the adoption of this approach by Government is likely to have some significant limitations when it comes to policing and prosecuting anti-competitive behaviour.

Enhancing the principles adopted in the Boral case with supplementary arrangements – such as mandatory industry codes of practice that regulate information retention and disclosure – will provide a more robust competition framework better suited to the realities of Australia's generally concentrated markets.

COMMENTS CONTAINED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE AT TIME OF PUBLICATION.

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