Trade Practices - Pricing - Market Power - Reduction of Competition

ACCC v Boral, unreported, Federal Court, Heerey J, 22 September 1999.

An aggressive pricing policy isn't the same as predatory pricing, according to the Federal Court (*ACCC v Boral*, 22 September 1999). Predatory pricing, in its strict legal sense, involves a business with a substantial degree of market power selling its products below cost with the expectation of driving its competitors out of the market and later recouping its losses with above market prices.

A company that engages in a price war will only be guilty of predatory pricing if:

- it has a substantial degree of market power; and
- it has used that market power,

for an anti-competitive purpose, such as to drive competitors out of the market.

A key message from the *Boral* case is that if below cost pricing is a rational commercial response to particular market circumstances, i.e. something that any business could pursue whether it has a substantial degree of market power or not, it will not constitute predatory pricing.

Background

Concrete products manufacturer BBM engaged in an aggressive pricing policy in the depressed Melbourne construction market of 1994-1996.

The ACCC took proceedings against BBM under section 46 of the *Trade Practices Act*. Section 46 bars a company from using its "*substantial degree of power*" in a market to reduce competition in any market. The ACCC alleged that BBM had a substantial degree of power in the market for concrete masonry products in metropolitan Melbourne and had taken advantage of that power by selling its products at less than the "*avoidable cost*" of production. This, said the ACCC, amounted to predatory pricing for the purposes of section 46.

(The avoidable cost of production of an item is the cost that will be avoided by not producing it. If the cost of an item is made up of the raw material costs and the company's fixed costs, for example, the avoidable cost will be the raw material costs.)

What the Court said

Heerey J dismissed the ACCC's case on the ground that BBM did not have a substantial degree of power in the marketplace. His Honour found that the relevant market was the broader market for paving and wall construction materials, which contained a number of strong competitors. He also noted that there were low barriers to entry in this market. On this basis, the ACCC failed the threshold test necessary to demonstrate a contravention of section 46.

However, Heerey J went on to state that even if it had had the requisite degree of market power, BBM's below cost pricing strategy was rational because it avoided it having to exit the market and realise its lost investment. This was more important for BBM (and indeed other industry participants) than the prospect of temporary (or even sustained) low prices which in the longer run might enable it to stay in the market. His Honour did not move from this position even though he accepted the ACCC's argument that BBM had hoped, if not intended, that its pricing strategy would force its competitors to exit the market.

In these regards, Heerey J made the following important comments:

> *"... [i] selling below cost plus [ii] recoupment of supra-competitive pricing [that is, charging monopoly prices or higher prices than a competitive market would permit] equals predatory pricing. Absent the second element, or at least the hope or expectation thereof, there is no more than ruthless competitive conduct, something which the TPA does not forbid, but rather promotes.*
>
> *Selling below avoidable cost, even for a prolonged period, can be a rational business decision. Such conduct is not of necessity consistent only with taking advantage of market power for the purpose of predatory pricing ..."*

The ACCC argued that BBM had deep pockets and had used those deep pockets to drive down prices (thereby taking advantage of a substantial degree of market power). Heerey J rejected this argument as well:

> *"I do not agree that financial strength necessarily equates to taking advantage of such power."*

Implications

This decision provides important guidelines for companies that are contemplating whether to engage in

price-cutting. Heerey J recognised that the law is not intended to interfere with competitive business decisions that damage other market participants. In this regard, he stated:

> *"s46 exists to protect competition and consumers, not competitors, ... neither price cutting (to whatever level) nor ruthless competition, nor conduct designed to injure competitors is necessarily unlawful.*
>
> *... if a firm does not have a substantial degree of market power it does not matter how low are its prices or how competitor-hostile its purposes. Prices may later return to a profitable level, but the firm will not be able to give less and charge more."*

Also worth noting are:

- His Honour's apparent adoption of the concept of "*avoidable price*" as one key to predatory pricing.
- His view that the use of deep pockets will not turn aggressive pricing into anti-competitive behaviour.
- The emphasis placed by his Honour on the company's own internal statements of purpose for the price war.

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