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Australia

Predatory pricing in Australia: ACCC v. Boral Ltd

Predation has always proved one of the more tricky and complex areas of competition law. A recent decision by the full Federal Court of Australia in *Australian Competition and Consumer Commission v. Boral Ltd*[1] has added to this by concluding that, under Australian law, it is not necessary to show that the conduct alleged to be predatory was intended to be profitable in the long run.

Predation is regarded by many lawyers and economists as rare. Judge Easterbrook has called it a "unicorn"—a much talked about animal never actually observed.[2] Empirical analysis confirms this conclusion by providing scant evidence and examples of predatory pricing.[3] Many economists are also sceptical about its prevalence, although recent game theoretic models have suggested that, under conditions of uncertainty and imperfect information, predatory behaviour can be a rational and profitable strategy.

Notwithstanding this, a number of legal definitions of predation exist, such as the cost-based approach of Areeda-Turner, but there is no clear view which is the most appropriate. One element of the test for predation is that the short-term losses arising from the predatory pricing below some measure of unit costs are intended or incurred with the object of increasing longer-term profits by pricing above competitive levels after a rival has been eliminated. This is perhaps most succinctly expressed in the definition of predatory behaviour adopted by the U.K. Office of Fair Trading in *Thamesway Ltd*:[4]

> "the acceptance of losses in a particular market which are deliberately incurred in order to eliminate a specific competitor, so that supra-normal profits can be earned in the future, either in the same market or in another market."

That this, or a similar test, is part of Australian trade practices law was squarely rejected in *ACCC v. Boral* handed down in early 2001. The court held unanimously that the likelihood that a firm would recoup lost profits was not required under section 46 of the Australian Trade Practices Act 1974 (Cth) which deals with "misuse of market power", the equivalent of Article 82 of the Treaty of Amsterdam.

The facts of the case were as follows. Boral Ltd is a manufacturer and supplier of concrete masonry products (CMP). The Australian Competition and Consumer Commission (ACCC), which is charged with enforcing Australian competition laws, took action in the Federal Court against Boral and a subsidiary, Boral Masonry Ltd (hereinafter simply "Boral"). It alleged that Boral had substantial power in the Melbourne CMP market, and misused its market power by pricing below avoidable cost in breach of section 46. Section 46 prohibits a corporation with a "substantial degree of power in a market" from "taking advantage of that power" for an anti-competitive purpose such as "eliminating or substantially damaging a competitor", "preventing entry" or "deterring or preventing a person from engaging in competitive conduct". At the time, the building industry was in recession, there was considerable excess capacity, and price wars were common.

The trial judge found that Boral operated in a wider market than CMP, did not have substantial market power, nor had it taken advantage of any alleged market power. He held that:

> "there must be a causal connection between the market power and the impugned conduct; that is, the conduct must be made possible only by the absence of competitive conditions; and if the conduct has a business rationale, this is a factor pointing against taking advantage of market power. Selling below avoidable cost, even for a prolonged period, can be a rational business decision."

Following the U.S. position (such as in *Brooke Group v. Brown and Williamson Tobacco*),[5] the court concluded that predatory pricing in breach of section 46 required both selling below cost and a reasonable likelihood of recouping these losses by charging above competitive prices subsequently.

On appeal, the Full Federal Court of Australia reversed the decision. It found that Boral had a "substantial" degree of market power which it had "used" for anti-competitive purposes. The ACCC argued that Boral's conduct amounted to "taking advantage" of its substantial market power even if there was a business rationale. It argued that the trial judge should not have held that predatory pricing in breach of section 46 required both pricing below cost and the reasonable likelihood and ability of recouping the resultant loss by imposing supra-competitive prices later. The Court held that a firm's conduct, even if "rational" or "commercial", is not a defence to a breach of section 46.

The major reason for the Court's conclusion was a change in the test for market power in Australian trade practices law. Originally, section 46 only applied to a firm that was dominant, as is the case under Article 82 of the Treaty of Amsterdam in E.C. law. In 1986, the section 46 threshold was lowered from dominance to that of a "substantial degree of power in a market". As a result, more than one firm can have a substantial degree of power in a market. It was argued by Merkel J. that, if the test for predatory pricing was both selling below cost plus a reasonable likelihood of recouping those profits by subsequent supra-competitive pricing, then this "would necessarily limit predatory pricing under section 46 to a firm that is a monopolist or dominant in a market … [T]he test would render nugatory the lowering of the section 46 threshold." He continued that, while this outcome:

> "may not sit comfortably with the principles that have provided the underpinning for the European and U.S. case law on predatory pricing … the departure from those principles in the Australian context does not arise as a result of their rejection by the Court. Rather, it results from the 1986 amendments which, as stated in the Second Reading Speech, lowered the section 46 threshold to 'ensure that small businesses are given a measure of protection from the predatory actions of powerful competitors'."

Finkelstein J. agreed with this conclusion stating that, if the joint conditions were required, then:

> "it will be almost impossible to maintain a successful predatory pricing prosecution against a firm other than a monopolist … It is also necessary to bear in mind the reason why the U.S. courts have sought to give a precise meaning to the notion of predatory pricing. It was an attempt to provide a standard that could be applied rationally to all circumstances, a 'bright line test' that would not depend upon the alleged predator's intent, which was regarded as an unsatisfactory criterion upon which to found liability … It must also be remembered that in the

> U.S. antitrust legislation is concerned with constraining the behaviour of a monopolist. That is not the focus of section 46. Our section is aimed at regulating a firm with a substantial degree of market power."

This and previous decisions of the Australian courts seem to give predatory practices a wide ambit. The Australian courts have held that pricing below marginal or average avoidable costs is only one factor to be taken into account, and predation does not necessarily require that such a pricing strategy be proven.[6] The critical question appears to be intent, with *Boral* placing emphasis on the strategic aspects of predation (the elimination of a rival) rather than price–cost comparisons and profitability as Professor Corones foreshadowed.[7] This suggests that Australian business will have to be more careful than their U.S. counterparts when competing "vigorously". However, it is not apparent that *Boral* is that different from the position under E.C. law. In *Tetra Pak II*,[8] the Court stated that it was not necessary to establish that the predator was able to raise prices, only that the predation was likely to eliminate a rival. Finally, it is not self-evident that dominance does require that there is a high likelihood of profit/loss recoupment, as *Tetra Pak II* shows. Notwithstanding this, if the Court was correct in concluding that market power thresholds lower than dominance also (expressly) imply changes in other tests for market power abuse, then the attempt by the E.C. Commission to develop notions of "joint dominance" and regulatory attempts to set lower thresholds, such as "significant market power", run the risk of fundamentally altering key aspects of E.C. competition law.

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1 [2001] FCA 30.
2 "Predatory Strategies and Counterstrategies" (1981) 48 *University of Chicago Law Review* 263.
3 D.J. Boudreaux and A.N. Kleit, "Predation: Here? There? Anywhere?", www.antitrust.org/economics/vertical/predation.htm; J.R. Lott, *Are Predatory Commitments Credible* (University of Chicago Press, 1999).
4 Office of Fair Trading, August 1993, para. 8.4.
5 (1993) 509 U.S. 940.
6 *Eastern Express Pty Ltd v. General Newspapers Pty Ltd* (1991) A.P.T.R. ***.
7 *Competition Law in Australia* (2nd ed., 1999), p. 356.
8 [1992] O.J. L284/41.

People's Republic of China

The legal features of Chinese capital markets in the light of the Zhengzhou Baiwen case

The Zhengzhou Baiwen case highlights the problems associated with the listing on capital markets of former state-owned enterprises (SOEs). By using false financial statements, Zhengzhou Baiwen created the false impression that it was a model of reform for SOEs and was the star of the Chinese department store sector. Using the same false accounting methods, Zhengzhou Baiwen floated on the Shanghai Stock Exchange. Only two years later, Zhengzhou Baiwen had gone from being the best performing listed company in the department store sector to the worst performing listed company on the Chinese capital markets. On March 3, 2000, Zhengzhou Baiwen became the first listed company to be sued for bankruptcy in China. The alternative to bankruptcy is a reorganisation scheme, and whether Zhengzhou Baiwen should go bankrupt or whether it should undergo a reorganisation is a matter of controversy in China. Although on February 22, 2001, the provisional general meeting ratified the reorganisation scheme, there are still three enforcement issues with regard to the reorganisation scheme which remain unanswered. The aim of this article is to outline the legal features of the Chinese capital markets based on an analysis of the issues raised by the Zhengzhou Baiwen case, rather than to examine the detailed issues of the reorganisation scheme itself.

The facts of the Zhengzhou Baiwen case

Before it floated on the Shanghai Stock Exchange, Zhengzhou Baiwen was a state-owned wholesale company specialising in stationery and household wares. In April 1996, it floated as a limited stock corporation and thus became the first listed company in Zhengzhou city (the capital of Henan province) and the first listed department store in Henan province. According to the data disclosed in its prospectus and annual financial statements, during the ten years from 1986 to 1996 its sales increased by a factor of 45 and its profits by a factor of 36. By the end of 1997, its annual sales were 7,673 million yuan (US$960 million) and its earnings per share (EPS) were 0.448 yuan. In 1997, only one year after its flotation, Zhengzhou Baiwen was the largest company in the department store sector, and was among the top 100 listed companies in the domestic securities markets.

Zhengzhou Baiwen thus became a star performer in Chinese stock markets. In July 1997, Zhengzhou municipal government held an assembly to designate Zhengzhou Baiwen as a "Red Flag" (*i.e.* a model) for the reform of SOEs and the establishment of the modern enterprise system. Some government departments of Henan province also designated Zhengzhou Baiwen as a reform model for the department store sector. The directors of Zhengzhou Baiwen were awarded

