

## Chapter 4

### Predatory pricing, geographic price discrimination and the Trade Practices Act

#### Predatory pricing and the TPA

4.1 Section 46(1) of the *Trade Practices Act* is a general prohibition against the abuse of market power. It precludes a corporation that has 'a substantial degree of power in a market' from taking advantage of that power for the purpose of substantially damaging or eliminating a competitor(s), preventing the entry of a person into the market or deterring or preventing a person from engaging in competitive conduct in that (or any other) market.

4.2 Section 46(1AA) of the Act deals specifically with predatory pricing. It states that a corporation that has 'a substantial share of a market' must not supply goods or services for a *sustained period* at a price that is less than the relevant cost to the corporation of these goods or services, for the purpose of eliminating or substantially damaging a competitor or deterring or preventing a person from engaging in competitive conduct in that (or any other) market.

#### Price discrimination and the TPA

4.3 The TPA formerly included an explicit 'price discrimination' provision. Section 49(1) stated:

A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to

- (a) the prices charged for the goods;
- (b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of goods;
- (c) the provision of services in respect of the goods;
- (d) the making of payments for services provided in respect of the goods if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods.

4.4 Section 49(2) listed two defences to 49(1). The first is where there is reasonable allowance for differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the different places to which the goods are supplied to purchasers. The second defence is where the discrimination was constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier.

4.5 As highlighted by the Law Council of Australia, the Swanson Committee (1976), the Blunt Committee (1979) and the Hilmer Committee (1995) all considered the operation and utility of the Section 49 amendment and recommended its repeal.

4.6 Section 49 was finally repealed in 1995 on the recommendation of the Hilmer Review. The Review found that:

The Committee does not consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is potentially to the detriment of the welfare of the community as a whole. Sectoral assistance policy of this sort is generally most efficiently implemented by more open and direct assistance, including budgetary and taxation measures of various kinds. In any event, it seems clear that small businesses have not achieved any significant benefit from the presence of s49.<sup>1</sup>

4.7 The Review concluded that 'to the extent that section 49 has had any effect it seems to have diminished price competition'. It also noted that price discrimination 'generally enhances economic efficiency, except in cases which may be dealt with by s.45 (anti-competitive agreements) or s.46 (misuse of market power)'.<sup>2</sup>

4.8 In 2003, the Dawson Review found that the effect of price discrimination on competition should be considered on a case-by-case basis. In this context, it noted that section 46 is the most appropriate means to tackle anti-competitive price discrimination. Further, the Review considered that there are reasons for differences in wholesale prices in the grocery industry which do not involve anti-competitive practices.<sup>3</sup>

### **Section 46 is inadequate and ineffective**

4.9 The Southern Sydney Retailers Association argued that section 46 of the TPA is 'totally and completely useless against geographic price discrimination'. The Association's President, Mr Craig Kelly, criticised the section 46(1) threshold of 'a substantial degree of market power' and cited Justice McHugh in the Boral case who noted that conduct that is predatory may not be captured by section 46 simply because the predator does not have substantial market power.<sup>4</sup>

4.10 The National Association of Retail Grocers of Australia (NARGA) claimed that a prohibition of price discrimination 'would be a simple way to address that way

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1 Treasury, *Submission 10*, p. 6.

2 Frederick Hilmer, *Report on National Competition Policy*, 1995.

3 Dawson Review, 2003, pp. 96–97  
<http://tpareview.treasury.gov.au/content/report/downloads/PDF/Chpt4.pdf> (accessed 21 September 2009).

4 Mr Craig Kelly, *Proof Committee Hansard*, 25 September 2009, p. 5.

in which market power can be misused'.<sup>5</sup> The Blacktown Amendment would reduce the potential for predatory behaviour and does not depend on a decision of the ACCC to act.<sup>6</sup>

4.11 NARGA argued that price discrimination legislation will assist to make the Australian marketplace more competitive. In NARGA's opinion, section 46 has not been effective at addressing geographic price discrimination. It argued that it is very difficult to prove that market power has been misused. For example, it would not be possible for a small competitor in the petroleum market to determine whether the price at which fuel is being offered by a large chain retailer nearby is predatory.<sup>7</sup>

### **Section 46 is adequate to proscribe geographic price discrimination**

4.12 Other submitters have argued that section 46(1) of the TPA effectively proscribes predatory pricing and, to the extent that it constitutes predatory pricing, geographic price discrimination.

4.13 Coles argued in its submission that the TPA's provisions on predatory pricing are adequate to proscribe against 'geographic price discrimination'. It noted that the Second Reading Speech of the bill did not describe any types of alleged behaviours in the retail sector that could not be addressed under the existing provisions of section 46.<sup>8</sup> Indeed, Coles argued that the bill's ban on all geographic price discrimination is 'incongruous with the spirit and intent of s46 more generally'.<sup>9</sup>

4.14 Treasury wrote in its submission that the section 46 provisions in the TPA are:

...well targeted to prevent predatory pricing since it takes into account the relevant requirements necessary for a firm to engage in predatory pricing. At the same time it also allows businesses sufficient pricing flexibility to compete effectively and to provide their products at efficient prices.

In contrast, the Bill's single price rule does not distinguish between pro-competitive and anti-competitive behaviour.<sup>10</sup>

4.15 This echoes the finding of the 2003 Dawson Review which found that section 46 of the TPA remained the best means of delineating between competitive and anti-competitive price discrimination.

4.16 The Australian Association of Convenience Stores wrote in its submission:

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5 NARGA, *Submission 6*, p. 3.

6 NARGA, *Submission 6*, p. 5.

7 NARGA, *Submission 6*, p. 4.

8 Coles, *Submission 5*, p. 3.

9 Coles, *Submission 5*, p. 3.

10 Treasury, *Submission 10*, p. 1.

We see no evidence that collusive practices are determined by geographic or indeed any other size implications and affirm that the Trade Practices Act 1974 (Commonwealth) already provides protection for small retail business against corporations that appear to have a substantial degree of power in the market.<sup>11</sup>

4.17 ANRA told the committee that in its opinion, section 46(1) of the TPA is sufficient to deal with the threat of predatory pricing. It noted that this section required proof of anti-competitive intent and that the bill is silent on this matter. ANRA argued that the bill would effectively be an effects based test rather than a determination of the principle of anti-competitive intent.<sup>12</sup> As Dr Brendan Long told the committee:

...it is a mistake to confuse normal market differentials with a deliberate attempt to engage in an anticompetitive practice. The challenge for a regulator is to separate those two elements, which is what the Trade Practices Act does and what the proposed amendment does not do.<sup>13</sup>

4.18 The committee notes that there are alternative approaches to preventing predatory pricing if the existing trade practices legislation is regarded as inadequate. In October 2008, the Senate Economics Committee explained that the Fuelwatch scheme would reduce the scope for predatory pricing:

Another problem for the independents is that the major chains can spread losses at one station over a number of other stations. This makes it easier for them to engage in a predatory pricing strategy of very aggressively cutting prices at a station next to an independent to drive out the independent (or at least discourage it from trying to undercut the price set by the major station) and covering the loss at this station from profits at other stations...This strategy is *less* likely to work under Fuelwatch, as more motorists will switch from the profitable stations of the major company to the one offering the low price, reducing the chain's ability to cross-subsidise its loss. Furthermore, Fuelwatch makes it much more obvious when large retailers are engaging in predatory pricing and would make it easier for an independent victim to gather the evidence to show a court or the ACCC.<sup>14</sup>

### ***The international approach***

4.19 Neither New Zealand, the UK or Canada have any legislation similar to the Blacktown Amendment dealing with price discrimination. An alternative approach to what this bill proposes was, until recently, legislated in Canada. Rather than

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11 Australasian Association of Convenience Stores, *Submission 3*, p. 1. The same argument was put by ANRA, *Submission 9*, p. 3.

12 Dr Brendan Long, *Proof Committee Hansard*, 25 September 2009, p. 14.

13 Dr Brendan Long, *Proof Committee Hansard*, 25 September 2009, p. 17.

14 Senate Standing Committee on Economics, *National Fuelwatch (Empowering Consumers) Bill 2008*, October 2008, p 37.

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prohibiting any variation in price for the same product within a geographic area, provision 50 of Canada's *Competition Act* established nationwide price discrimination offences with key threshold requirements relating to the anti-competitive effect and purpose.

4.20 In March 2009, provision 50 was repealed because price discrimination, predatory pricing and geographic price discrimination were considered not necessarily harmful to economic welfare and could be beneficial to competition. As a result of the amendments, non-dominant businesses are free to offer different prices for the same product in different parts of Canada. Dominant firms will still 'have to be careful not to engage in any practices that could be found to have an anti-competitive purpose and be likely to prevent or lessen competition substantially'.<sup>15</sup> Predatory pricing will now be dealt with under the civil abuse of dominance provisions in the *Competition Act*.<sup>16</sup>

4.21 Treasury noted in its submission to this inquiry that the trend in Australia and overseas has been to repeal provisions similar to those contained in the bill because of the negative consequences of these provisions.<sup>17</sup>

4.22 As the Law Council of Australia stated in its submission:

In New Zealand, the UK and the EU there are no specific legislative provisions dealing with price discrimination and actions for anti-competitive price discrimination are instead pursued under their respective prohibitions on misuse of market power.<sup>18</sup>

4.23 The literature distinguishes between price discrimination as a competitive and legitimate pricing tactic and the constraints of anti-trust (predatory pricing) legislation. Dr Nagle, for example, considers geographic price discrimination to be both a common and acceptable competitive tactic, but cautions:

One must be particularly careful when segmenting by location to counter competition. The Robinson-Patman Act explicitly forbids anyone "to discriminate in price...where the effect of such discrimination may be to substantially lessen competition..." As a rule, you can cut price selectively in one geographical area to meet the price of a competitor. It is risky, however, to undercut the prices of a local competitor while keeping prices higher elsewhere. Unless the local competitor is itself financially strong and the selective price cutting is done only to defend rather than to gain market

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15 Paul Crampton, 'Major changes to the Competition Act (Canada) and the Competition Bureau's Enforcement Policies', *The antitrust source*, June 2009, pp. 3–4. <http://www.abanet.org/antitrust/at-source/09/06/Jun09-Crampton6-29f.pdf> (accessed 16 September 2009).

16 Competition Bureau Canada, 'Proposed changes to the Competition Act', <http://www.cb-bc.gc.ca/eic/site/cb-bc.nsf/eng/00243.html> (accessed 16 September 2009).

17 Treasury, *Submission 10*, p. 1.

18 Law Council of Australia, *Submission 2*, p. 3.

share, the local competitor has a good chance of winning a claim that your local price cutting is anticompetitive.<sup>19</sup>

4.24 The ACCC in giving evidence to the committee also highlighted their concerns that this Bill is unlike any other trade practices legislation in operation in any other similar jurisdiction to Australia. Whilst the United States does have some legislation it was described by the Law Council of Australia as "overly complex and preventing price competition".<sup>20</sup> The ACCC commented that:

Moving to the US experience, the Robinson-Patman Act has been quoted by some as being akin to the proposals in the Blacktown amendments. Commentators that draw that analogy must be reading different text to what I am. I understand that US laws do not prohibit price discrimination per se but rather prohibitions require a finding of a substantial lessening of competition. Defences are also available, allowing businesses to reflect differing costs and to match prices. These are big differences to what is on the table here today. I note also that both judicial and academic commentators in the US encourage a reading down of those provisions, and commentators note that regulators have not been particularly active in the field.<sup>21</sup>

#### ***Costs differences and matching a competitor's price***

4.25 The former section 49(2) of the TPA contained two defences relating to the higher cost of the manufacture, distribution, sale or delivery of goods to different areas and where a company acts in 'good faith' to match a competitor's price. Submitters to this inquiry have highlighted both these factors in defence of geographic price discrimination.

4.26 Treasury has argued that the bill 'seems to be premised' on the assumption that 'a good that looks the same is the same, regardless of where and how it is sold'. It emphasised that location, surroundings, service and convenience are all significant components of any product and must be taken into account when determining price.<sup>22</sup>

4.27 Coles has cited the following factors as to why its retail sites may sell the same product at different prices:

- freight costs vary in transporting products to different sites (a point also highlighted by 7-Eleven Stores);<sup>23</sup>
- rental tenancy agreements can vary from site to site;

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19 Dr Thomas Nagle, *The strategy and tactics of pricing*, Prentice-Hall, New Jersey, 1987, p. 160.

20 Law Council of Australia, *Submission 2*, p. 3.

21 Mr Scott Gregson, ACCC, *Proof Committee Hansard*, 5 October 2009, p. 3.

22 Treasury, *Submission 10*, p. 2.

23 7-Eleven Stores Pty Ltd, *Submission 8*, p. 2.

- products delivered directly to site commonly have different wholesale prices in different regions;
- products may be chosen for promotion in some sites but not others due to its popularity within the demographics of a particular area;
- fresh products may have 'subtle quality distinctions' based on their sourcing origins which is often reflected in minor price variations;
- utility and other rates vary at different sites; and
- staffing levels and wages differ between different sites.<sup>24</sup>

4.28 The July 2008 ACCC report into the competitiveness of retail prices for standard groceries found that grocery prices differ between locations for a number of reasons. The report concluded that price differences for groceries were largest for goods which are more likely to be regionally sourced, such as fresh produce. The minimal competition in some areas partly reflects the small size of the communities:

...which means that there is limited scope for the entry of multiple stores. Higher prices for groceries in these locations may partly reflect a lack of competitive pressure, but also results from higher operating costs relative to turnover.<sup>25</sup>

4.29 Treasury's submission noted the ACCC's publication *Understanding petrol pricing in Australia* which listed various reasons as to why petrol prices, and competition in petrol retailing, might vary among locations. The ACCC concluded:

The influence of these factors can vary considerably between locations, resulting in substantial differences in prices. It is not surprising therefore that there are considerable variations in petrol prices across locations, including differences between city and country prices.<sup>26</sup>

4.30 There will obviously be some cost differences between locations. The ACCC study showed that there are price differences resulting from lack of competition in some locations. What is not clear is the relative size of these effects.

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24 Coles, *Submission 5*, p. 4.

25 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 87.

26 Treasury, *Submission 10*, p. 2.

