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PREDATORY PRICING

THE APPLICATION OF THE DOCTRINE IN AUSTRALIA AND NEW ZEALAND

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ABSTRACT

This paper examines the doctrine of predatory pricing. Chapter 1 introduces the topic and outlines the framework of this paper.

Chapter 2 analyses the development of the doctrine in the United States and examines the economic tests established to determine the existence of predatory pricing.

Chapters 3 and 4 analyse whether Australia and New Zealand have adopted any of the American tests, or any elements of those tests as determinative of the existence of predatory pricing.

Chapter 5 concludes that Australia and New Zealand have proved unwilling to adopt any defined criteria in order to prove the existence of predatory pricing behaviour, preferring instead a total rule of reason approach based on an analysis of purpose. This approach has rendered the success of such predatory pricing claims in Australasian jurisdictions inherently unlikely.

Word length

The text of this paper (excluding contents page, footnotes and bibliography) comprises approximately 15,000 words.

CHAPTER 1

INTRODUCTION

1 This paper examines the doctrine of predatory pricing from its origins in the United States, through to the application of the concept in Australia and New Zealand.

2 One of the fundamental problems in examining the doctrine of predatory pricing and its application in any jurisdiction is that there is no generally accepted definition of the doctrine, nor is it generally accepted that the phenomenon actually exists.

3 In essence, predatory pricing can be described as an extreme form of price discrimination which can be distinguished from legitimate price discrimination in that the reduction in price is undertaken for an anti-competitive purpose. The greatest difficulty in establishing an appropriate test for predatory pricing is that the conduct itself, price reduction, is the quintessence of competition.

4 The development of the doctrine in the United States has been based upon attempts to provide quasi-scientific economic tests to indicate when such price reductions could be assumed to be anti-competitive. Those tests fall into two main categories: the cost based tests and more recently, the recoupment tests.

5 Chapter 2 of this paper examines the development of the American cost based and recoupment tests, the application of those tests by the American courts, and the criticisms levelled at those tests which centre on the artificial nature of such economic-legal hybrids.

6 Chapters 3 and 4 of this paper analyse whether Australia and New Zealand recognise the doctrine of predatory pricing as developed in the United States, and whether either common-law jurisdiction has adopted any of the American tests, or any elements of those tests, as determinative, or even indicative, of the existence of predatory pricing.

7 The analysis demonstrates that whilst the Australian and New Zealand lower courts have been prepared to utilise relevant elements of the American tests in order to assist in an assessment of whether predation has occurred, they have not been willing to incorporate the doctrine of predatory pricing as having any independent existence outside of the relevant statutory prohibitions on use of dominance for anti-competitive purposes.

8 Moreover, both Australian and New Zealand appellate tribunals have exhibited extreme reluctance to incorporate any elements of the tests posited in the United States as conclusive or even preliminary indicators of predatory behaviour.

9 Instead, both the Australian and New Zealand appellate courts have repeatedly emphasised the paramount nature of the actual elements of the relevant statutory provisions, and in particular the requirement for a proscribed purpose, over any other potentially relevant test.

10 Chapter 5 of this paper concludes that whilst Australian and New Zealand judicial reluctance to be fettered by precedents which have evolved from a different statutory and constitutional setting; or by quasi-scientific tests which purport to, but do not actually, offer objective proof of predation, is understandable; their alternative total rule of reason approach based purely on an analysis of purpose has its own limitations.

11 In failing to provide any effective analytical framework for assessing the elements necessary to prove predation, and in potentially foreclosing an examination of other factors which may be useful to an assessment of predation, including the significance of economic data, the success of such claims in Australasian jurisdictions is rendered inherently unlikely.

CHAPTER 2

THE UNITED STATES APPROACH

INTRODUCTION

1 The doctrine of predatory pricing is credited with having first evolved in the United States in the 1970s, mainly as a result of the efforts of renowned American economists Areeda and Turner.

> *A firm which drives out or excludes rivals by selling at unremunerative prices is not competing on the merits, but engaging in behaviour that may properly be called predatory.*[1]

2 The development of the doctrine in the United States has been based upon attempts to provide quasi-scientific economic tests to indicate when such price reductions could be assumed to be anti-competitive. Those tests fall into two main categories: the cost based tests and more recently, the recoupment test.

THE UNITED STATES TESTS FOR PREDATION

Cost-based Tests

3 Cost-based tests developed principally as an attempt to introduce some "objectivity" or scientific validity into the investigation of predatory pricing, in the sense that the offence could be proved conclusively by the presentation of costs based data. The cost-based tests are essentially an adaptation of the microeconomic models developed by economists to establish the relationship between cost and price for a particular firm. The focus of the cost-based tests is to determine the pricing level at which predatory intent would be presumed. Essentially, all cost based tests for predation assume that level will be found where price is below some measure of cost. However, much debate has centred over how to determine the appropriate measure of cost.

4 An examination of the most widely used of the cost-based tests, the Areeda & Turner test, its application by the United States courts, and the criticisms levelled at that test, is set out below. The application of the cost-based tests to an analysis

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[1] P Areeda & D Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 1975 Harvard Law Review, p697.

of predatory pricing by the Australian and New Zealand courts and competition law authorities is considered in Chapters 3 and 4 respectively below.

Areeda and Turner Test

5 The most well known of the cost-based tests, and the one that has been most frequently applied by American courts, is that proposed by American economists Areeda and Turner in 1975.[2] Areeda and Turner considered that historically the treatment of predatory pricing in the cases and the literature had suffered from a failure to delineate the doctrine clearly, and accordingly, sought to establish a clear trademark test for determining the existence of predatory pricing.

6 Areeda and Turner analysed a number of possible cost based tests for determining predatory pricing and concluded that short run marginal cost provided the definitive benchmark by which to establish predation.

7 Areeda and Turner noted that when a monopolist sells at a price at or above average cost - that is, total revenues just cover total losses, but could earn greater shortrun profits at a higher price, the firm is likely to be charging the lower price in order to preserve or enhance its market share by deterring rivals. However, they concluded that as long as price was not below average total cost, or marginal cost, such pricing behaviour would only exclude less-efficient rivals and should not be deemed predatory. Areeda Turner concede that such pricing behaviour would also exclude equally efficient rivals, but regard that as an acceptable trade off to avoid over-regulation.

8 As only prices below short run marginal cost would exclude more efficient rivals, Areeda and Turner concluded that prices below that benchmark should be automatically assumed to be predatory and any price above that should be deemed non-predatory. The so-called "brightline" test. Recognising that marginal cost is often difficult to ascertain, average variable cost was considered a sufficient surrogate for marginal cost.

9 The Areeda and Turner rule is by their own admission under inclusive, as from a cost-based assessment, pricing below cost is an irrational economic strategy for a profit maximising firm, and therefore would rarely occur.

> *A demonstrated willingness to indulge in predatory pricing is unlikely to inhibit firms with resources comparable to those of the predator. Repeated*

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[2] N 1, above.

> *predation in the same market, moreover, is not only costly but is likely to be easily detectable and thus the occasion for severe antitrust sanctions. The prospects of an adequate future payoff, therefore, will seldom be sufficient to motivate predation.*[3] *Proven cases of predatory pricing have been extremely rare.*[4]

10 Advocates of cost-based tests consider that as their tests offer objective proof of predation, the satisfaction of the test should be conclusive evidence of predatory conduct, and any further inquiry is unnecessary:

> *The monopolist who sets or cuts prices below short-run profit-maximising levels necessarily contemplates that the low price will have an "exclusionary" effect.*

11 However, the most obvious criticism of the claimed objectivity of cost-based tests is that they are wholly dependent on the variables chosen,[5] as well as the assumptions on which they are based.[6]

> *Different results can be achieved depending upon whether a static or long run model is examined, or whether costs such as depreciation are included. There are real difficulties in classifying a cost as fixed or variable. Should the test embrace only a single product in a multiple product firm? As more and more factors are introduced any test is rendered meaningless.*

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3 It has also been argued that predatory pricing to drive out rivals is unlikely because the alternatives of acquiring rivals by merger or forming a price cartel are less costly. *See* McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J. L. & Econ. 137, 138-43 (1958); Telser, Cutthroat Competition and the *Long Purse*, 9 J. L. & Econ. 259 (1966). In the early years of the Sherman Act predatory pricing was used to coerce rivals into merger with the predator or into joining a price cartel. See, e.g., *Standard Oil Co.* v. *United States*, 221 U.S. 1 (1910); *United States* v. *E.I. du Pont de Nemours & Co.*, 188 F. 127, 140 (Cir. Ct. Del. 1911). When these alternatives are also illegal and either more visible or more difficult to effect, however, the argument that they will supplant predatory pricing is unpersuasive.

4 See Koller, *The Myth of Predatory Pricing - An Empirical Study*, 4 Anti-Trust L. & Econ. Rev. 105 (Summer 1971).

5 Wear, M *Predatory Pricing and the Port Nelson Saga* (1995) Victoria University Press, Wellington 15.

6 Contrary to these claims of objectivity, implicit in competition policy is a very particular view of political and social reality. As Curran notes: "The large modern state is a product of our prevailing liberal theory of free markets, private property and individual action and of laws such as the antitrust laws that legitimate these institutions and facilitate their operation in furtherance of the 'common good'": W J Curran. "On democracy and economics" (1988) 33 *Antitrust Bulletin* 753 at 755.

12 Moreover, cost based tests have been criticised by lawyers and economists as offering an artificial economic-legal hybrid. Economists argue that cost-based tests ignore the fundamental questions of the interaction between supply and demand; whilst lawyers argue that quantitative economic models fail to provide any appropriate legal standards.

13 Moreover, it is also argued that successful predatory behaviour can occur without prices falling below any measure of cost and consequently, cost based tests are of little value in determining such behaviour. Cost-based tests fail to catch "strategic" pricing behaviour by dominant firms, such as charging permanently or temporarily charging above cost but less than profit maximising prices to deter entry, that may be harmful to consumer welfare in the long run.[7] For example, in a situation of optimal capacity or limit pricing, the output at which the firm can operate most cost-efficiently is also the output which maximises profits. In this way, the optimally adapted firm can engage in successful predatory pricing without incurring losses. It is contended that the Areeda and Turner marginal cost test is only relevant in a situation of excess capacity which only occurs in the rare situation of a recession, when entry is already unlikely.

14 Nevertheless, the US Courts have traditionally adopted a cost based approach to the assessment of predatory pricing, and the Areeda & Turner marginal cost rule has been the test most employed. Taperell, Vermeesch and Harland note that "*despite the academic criticism, the Areeda-Turner test has received qualified acceptance in American Courts*".[8]

The Recoupment Test

15 Whilst the advocates of cost-based tests implicitly recognised that predatory pricing would be irrational unless the predator could recover the losses incurred during the period of predation, cost based tests did not explicitly incorporate the potential for recovery as a necessary element to prove predation.

> *Predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains. Predatory*

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7 Austin, P I *The law of Predatory Pricing since Matsushita*, Conference Paper.

8 Taperell, Vermeesch and Harland, *Trade Practices and Consumer Protection* (3rd ed), Butterworths, Sydney, 1983, para 650. See, for example, *Barry Wright Corp v ITT Grinnell Corp* 724 F 2d 227 (1983), and *US Philips Corp v Windmere Corp* 861 F 2d 695 (Fed Cir 1988). *International Air Industries Inc v American Excelsior Co*, 517F 2d 714 (5th Cir 1975), *California Computer Products Inc v IBM Corp*, 613F 2d 727 (9th Cir 1979), *Hommel Co v Fero Corp*, 659F 2d 340 (3d Cir 1981), and *Northern Telephone Co v American Telephone and Telegraph Co*, 651F 2d 76 (2d Cir 1981).

> *pricing would make little economic sense to a potential predator unless he had (1) greater financial staying power than his rivals, and (2) a very substantial prospect that the losses he incurs in the predatory campaign will be exceeded by the profits to be earned after his rivals have been destroyed.*[9]

The Chicago School View

16 Shortly after the introduction of cost based tests came the recoupment theory, developed by the Chicago School of antitrust.[10] An examination of the Chicago School view, its application by the United States courts, and the criticisms levelled at that test, is set out below. The application of the Chicago School view to an analysis of predatory pricing by the Australian and New Zealand courts and competition law authorities is considered in Chapters 3 and 4 respectively below.

17 The view of the Chicago School is that below cost pricing is so patently economically irrational that predatory pricing should not constitute an antitrust infringement without clear evidence of the possibility of recoupment of the losses sustained.

> *Any realistic theory of predation recognises that the predator as well as his victims will incur losses during the fighting, but such a theory supposes it may be a rational calculation for the predator to view the losses as an investment in future monopoly profits (where rivals are to be killed) or in future undisturbed profits (where rivals are to be disciplined). The future flow of profits, appropriately discounted, must then exceed the present size of the losses.*[11]

18 The Chicago School argument is that predation is an investment in future monopoly profits. Accordingly, the success of any predatory pricing scheme is

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9 The predator must be large enough in the relevant market to be able to expand output in order to absorb the excess demand created by this reduction in price.

10 This term is used to describe economic theories made prominent by academics at the University of Chicago, notably George Stigler, Robert Bork (who was originally at Yale University), Richard Posner and Frank Easterbrook. Members of this school maintain that the free market will most effectively achieve the most efficient allocation of resources and that allocative efficiency should be the sole goal of competition law. Bork maintains that: "The law must be drawn to serve as a mesh that stops output-restricting behaviour and permits efficiency creating activity ... The whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare": Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, New York, 1978), pp.70, 91.

11 Bork, *The Antitrust Paradox*, p 145. This passage was cited with approval by the United States Supreme Court in *Matsushita*: 106 S Ct 1348 (1986) at 1357; cf, F M Fisher, "*Matsushita*: Myth v Analysis in the Economics of Predation" (1988) 64 *Chicago-Kent Law Review* 969.

dependent upon future gains (appropriately discounted) exceeding present losses.[12] It is the unviability of this recoupment which leads the Chicago School to regard predatory pricing as extremely rare. The Chicago School argues that, assuming the predatory firm has a larger market share than the victim, predation will actually be more costly to the predator. Moreover, the predator's loss of market share when prices are raised post predation, and the new entry that is likely to occur when prices are raised, will further reduce the potential to recoup. Accordingly, unless the predator has considerable financial resources, or is able to inflict very disproportionate losses, predation will be irrational.[13]

19 The Chicago view also rejects the notion that predation in one market can be financed by cross subsidisation from another market, as assuming profit maximisation is occurring in all markets, no further price increase could occur. Moreover, even if the predator has the resources available to finance predation, those funds could likely be used more profitably in alternative endeavours.

20 Moreover, The Chicago School argues that the counterstrategies available to the victim also serve to lessen the potential for successful predation. For example, the victim could offer long-term contracts at the competitive price, or acquire capital market finance to fund a defensive campaign.

21 The recoupment test for predatory pricing does not abandon the necessity for examining the relationship between price and cost. However, that test is subjugated to the preliminary and fundamental question of whether recoupment is feasible. According to Easterbrook:

> *Areeda and Turner do not explain why predation ever is profitable; indeed, although they specify certain "preconditions" to profitable predation (quick exit and barriers to entry that protect the ensuing monopoly), their proposed rule does not incorporate these preconditions.*

22 As with the cost based tests, advocates of the recoupment test consider that as their test offers objective proof of the ability to predate. Accordingly, if recoupment is impossible, then any inquiry, including an inquiry as to purpose, is irrelevant. As Easterbrook J stated in *Rose Acre Farms*: "*Unless recoupment lies in store even the most vicious intent is harmless to the competitive system*".

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12 While the majority of predatory pricing cases have proceeded under the monopolisation offence of s2 of the *Sherman Act*, some cases have proceeded under the "attempt to monopolise" limb of s2.

13 Bork, *The Antitrust Paradox*, p 147.

23 To support their claims of the rarity of such schemes, Bork and Posner both rely on studies by McGee which question whether Standard Oil was ever engaged in predatory pricing to drive out competing refineries.[14] If predatory pricing is a profitable venture the funds will be found regardless of the firm's dominance of other markets.[15]

24 Critics of The Chicago School recoupment approach comment that while the recoupment approach has the appeal of simplicity over artificial cost-based tests, and the evidentiary problems associated with purpose tests. However, as with cost based tests, the seeming reliance on a pure economic test, in fact, obscures the policy decision to prefer assumptions based on a particular economic theory.

25 Critics of the Chicago view, such as Posner, also argue that whilst the difficulty of recoupment makes predatory pricing schemes rare, such pricing is not inevitably irrational (Posner). The Chicago School view is based on the assumption that firms prefer short-term profit-maximisation over longer-term growth. However, this assumption ignores the fact that firms will take into account how their behaviour will affect the behaviour and expectations of existing and potential competitors. In fact, there are two clear methods by which predatory strategies can be profitable. First, a firm can develop a reputation for market toughness.

26 Posner argues that a firm may:

> *develop a reputation (for willingness to use predatory pricing) that may enable the firm to exclude other potential competitors without any additional below cost selling ... the costs incurred ... in one market may generate greater deterrence benefits in other markets.*

27 Similarly, although predatory pricing may not be profitable in the context of a single entrant, it may be so in the long run by the effect it has on other existing and potential rivals.

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[14] J S McGee, "Predatory Price Cutting: The Standard Oil (NJ) Case" (1958) 1 J Law & Economics 137: see *Standard Oil Co v United States* 21 US 1 (1911); cf, R Koller, "The Myth of Predatory Pricing: An Empirical Study" (1971) 4 *Antitrust Law & Economic Review* 105.

[15] B Johns, "Identifying Predatory Conduct: The Role of Economic Evidence", paper presented at the *Trade Practices and Consumer Law Conference*, Terrigal, October 1990. The issue here is essentially one of leverage: the use of monopoly power in one market to gain a competitive advantage in another: cf, *US v Griffith* 334 US 100 (1948). But there are problems with this approach and certainly the mere accessibility of finance from monopoly profits is not sufficient to establish leverage; cf, the approach, however, in *Victorian Egg Marketing Board v Parkwood Eggs Pty Ltd* (1978) ATPR 40-081.

> *The original handful of predatory episodes may be costly to the predator, but that firm makes up its losses and more by intimidating other competitors in the many markets in which no predation has occurred (Posner).*

28 The second strategic approach would involve a multimarket predator adopting low prices in one market, so deterring entry into that or any other market as potential rivals assume that the predator must be more efficient.

29 Nevertheless, recent decisions of the United States Supreme Court US cases have adopted the recoupment test in preference to cost-based tests. In *Matsushita Electric Industrial Co Ltd v Zenith Radio Corp*[16] the United States Supreme Court appears to endorse completely the Chicago approach.

30 In *Matsushita* two United States television manufacturers alleged that 21 Japanese television manufacturers had conspired to charge high prices for televisions in Japan and to use the profits from these sales to subsidise low prices in the United States, with the objective of monopolising the United States market.

31 The Supreme Court questioned the frequency of such schemes because:

> "*conspirators must have a reasonable expectation of recovery, in the form of later monopoly profits, more than the losses suffered*".[17]

32 The Supreme Court regarded the success of such schemes as:

> "*inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralising the competition*".[18]

33 The Court concluded that predatory pricing would be an irrational activity as there were no real barriers to entry in the market and, therefore, no likelihood of recoupment.

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16 106 S Ct 1348 (1986). This decision together with *Cargill Inc v Monfort of Colorado Inc* 479 US 104 (1986) which adopted the approach in *Matsushita*, were the first US Supreme Court predatory pricing cases since *Utah Pie Co v Continental Baking Co* 386 US 685 (1967). The *Matsushita* decision has been applied by the Court of Appeals in *Indiana Grocery Inc v Super Value Stores Inc* 864 F 2d 1409 (7th Cir 1989) and *AA Poultry Farms Inc v Rose Acre Farms Inc* 57 ATRR 260 (7th Cir 1989).

17 106 S Ct 1348 (1986) at 1357, citing Bork, *The Antitrust Paradox*, p 145.

18 Ibid. The Court cites Areeda and Turner together with Chicago School members Bork, Easterbrook, Koller and McGee on the rarity of such conduct.

34 Moreover, the Court also rejected the claim that the Japanese were using their supra-competitive profits in the Japanese market to sustain the substantial losses in the United States, [19] without any examination of the evidence pertaining to purpose - which seems to be a complete acceptance of the Chicago School view that predatory behaviour by cross-subsidisation between markets is unlikely to occur.

The Relevance of Purpose

35 It is clear from the above analysis that in America evidence of purpose has received little emphasis in the establishment of whether predatory pricing has occurred under both the cost-based and recoupment tests. The emphasis in the development of the predatory pricing doctrine has been in attempts to establish quasi-scientific standards to determine conclusively the existence of predatory pricing, with little focus on purpose.

36 The assumption has been that, as all competitive conduct is ultimately intended to exclude competitors, proof of subjective intent does not assist in distinguishing predatory conduct. For example, Easterbrook J, in *AA Poultry Farms Inc v Rose Acre Farms Inc*, stated:

> *Intent does not help to separate competition from attempted monopolisation ... intent is not a basis of liability (or a ground for inferring the existence of such a basis) in a predatory pricing case.* [20]

37 This can be contrasted with the prominence of the inquiry as to purpose over a cost-based or recoupment analysis in both Australia and New Zealand, which is discussed further in Chapters 3 and 4 below.

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[19] 106 S Ct 1348 (1986) at 1359.

[20] Ibid, at 263.

CHAPTER 3

THE AUSTRALIAN APPROACH

INTRODUCTION

1 Like New Zealand, Australia has never, either by statute, or at common law, explicitly or implicitly adopted the American doctrine of predatory pricing.

2 There have been a number of Australian cases in which the doctrine of predatory pricing has been specifically pleaded or considered. These cases demonstrate clear judicial reluctance to incorporate any of the American tests, or even any particular element of those tests, into an assessment of whether predatory pricing has occurred; preferring instead to concentrate solely on the wording of the Trade Practices Act 1974 itself. A similar attitude on the part of the Trade Practices Commission, the agency responsible for enforcing the Trade Practices Act is demonstrated by its investigation into the collapse of Compass Airlines, which can be contrasted with the divergence of approach between the New Zealand courts and the New Zealand Commerce Commission examined in Chapter 4 of this paper. The courts' and the Commission's decisions are analysed in detail below.

The Trade Practices Act 1974

3 Australia's prohibitions on anti-competitive behaviour are contained in the Trade Practices Act 1974. The provision of the Act which is relevant to an assessment of predatory pricing is section 46 which prohibits use of market power for proscribed anti-competitive purposes.

AUSTRALIAN PREDATORY PRICING CASES

4 The Australian decisions to date considering allegations of predatory pricing in terms of section 46 of the Trade Practices Act are examined below.

The Tytel case

5 In one of the earliest decisions on predatory pricing under section 46, the *Tytel*[21] case, the Australian Telecommunications Commission (ATC) introduced a new telephone into the Australian market. The price for the telephone did not include the surcharge usually imposed by the ATC to eliminate its competitive advantage

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[21] *Tytel Pty Ltd v Australian Telecommunications Commission* (1978) ATPR 40-081; (1978) 33 FLR 294; (1978) 4TPC 124.

due to its being exempt from customs duty. The surcharge was later included in the price, but the product was still relatively cheaper than its competitor. Jackson J did not consider the latter price which reflected ATC's costs and included the surcharge to be predatory. However, he was less certain about the introductory price and said that the evidence was:

> *... open to the interpretation that the respondent used its power in the market to set a low price for the Versatel for its introduction to the market for premium telephones, and did so for the purpose of substantially damaging the ... applicants in terms of section 46(1)(a), or for the purpose of deterring them from engaging in competitive conduct in that market in terms of section 46(1)(h), or for the purpose of deterring them from engaging in competitive conduct in that market in terms of section 46(1)(c).*

6 The Tytel case clearly rejected the Areeda & Turner view that prices must be below average variable cost to be predatory and endorsed the view posited by critics of cost-based tests that successful strategic predatory pricing can occur notwithstanding the fact that the predator's prices are not below its own costs; although it was not made clear whether they would need to undercut the competitor's price.

The Victorian Egg Marketing Board Case

7 Similarly, in the *Victorian Egg Marketing Board*[22] case, the only case in which a claim of predatory pricing under section 46 succeeded, the necessity for price to fall below the Areeda & Turner brightline test of average variable cost before an allegation of predatory pricing could be sustained was rejected.

> *I leave open the question whether in the ordinary course a monopolist can engage in predatory price-cutting only if the price is below some particular cost, and not where the price set, although it may deter competitors, is one which merely does not maximise the monopolist's profit. It may be that where one can infer the requisite purpose from other evidence, price-cutting may be predatory in the sense referred to and a 'taking advantage' of power derived from the substantial control of a market, notwithstanding that it is not below marginal or average variable cost and does not result in loss being incurred.*[23]

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22 *ictorian Egg Marketing Board v Parkwood Eggs Pty Ltd* (1978) ATPR 40-081.

23 Ibid.

8 However, the court was prepared to focus on whether elements of the American tests could be useful indicators of predation and concluded that the Areeda & Turner test could be helpful in this regard.

> *where a corporation with the requisite market power is, in the absence of countervailing evidence that its pricing was not aimed at destroying actual or potential competition, selling at below average variable cost there may be grounds for inferring that it is taking advantage of its power for a proscribed purpose.*

9 In addition, the court applied United States authority[24] to the effect that predatory pricing is indicated by the use of temporary price reductions.

10 On the facts in this case Bowen CJ concluded that the Victorian Egg Marketing Board did have predatory purpose in temporarily pricing in the Australian Capital Territories (ACT) market at a price well below that which it charged in Victoria (its usual market), and which its competitor in the ACT, Parkwood, was not able to meet without making a loss, notwithstanding that it had not been established that the predator's prices were not below any measure of cost.

11 However, the *Tytel* and *Victorian Egg Marketing Board* decisions must be contrasted with the more recent precedents under section 46, which evince, in common with the American courts, a clear Australian judicial reluctance to regard price reductions as raising any inference of anti-competitive purpose in the absence of compelling evidence of predatory intent. That more recent Australian attitude is exemplified by the decisions in the *CSBP & Farmers* and *Eastern Express* cases, which are analysed below.

The CSBP Case

12 In the *CSBP*[25] case it was made clear that a price reduction by a market dominant firm, even if timed to coincide with and undercut a price reduction by a competitor, would not raise any inference of predatory conduct. On the facts in this case, CSBP reduced its price per tonne for urea to undercut the sale prices simultaneously announced by a competitor.

13 In that case, Fisher J went on to state that if an "unreasonably low" price had been charged, with the intent of keeping a competitor out, that could be an indicator of predatory intent. However, it was not made clear whether an unreasonably low

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[24] *US v Corn Products Refining Co.* (1966) 234 F. 964 at pp. 1012-1013.
[25] *Trade Practices Commission v CSBP Farmers Ltd* (1980) ATPR 40-151.

price signified a price below some measure of cost. In this case liability was avoided as there was no evidence of below cost pricing; and in Fisher J's view, the price reduction represented legitimate business behaviour - that is, there was no prima facie evidence of any proscribed purpose.

> *it cannot be that an adjustment [by a corporation with a substantial degree of market power] of its price which only reflects, e.g., a change in cost of materials is a contravention of the Act if the adjustment injures another ... I would see this as predatory behaviour if it be proved that the defendant charged an unreasonably low price with the intent to keep [a competitor out of the market].*

14 The CSBP case appears to adopt the American presumption, which was later reiterated by Wilcox J in the Eastern Express case that if prices are not below cost, the plaintiff must prove predatory intent.

The Eastern Express Case

15 In the *Eastern Express*[26] case it was alleged that General Newspapers had engaged in predatory pricing in reducing the price for display advertising in its newspaper, for the purpose of eliminating or damaging Eastern Express. General Newspapers conceded that its price cuts would adversely affect Eastern Express; however it claimed that these price cuts were necessary to defend its publication.

16 Following the widely accepted American view,[27] Wilcox J rejected the notion that price reductions by a firm having market power would give rise to a presumption of proscribed purpose.

> *Traders commonly fix prices with the intention of diverting to themselves custom which would otherwise flow to their competitors. In doing so, they realise that, if they are successful, the result will be to damage - in extreme cases, even to eliminate - those competitors. But such conduct is the very stuff of competition, the result which Pt IV seeks to achieve. It would be surprising if Parliament intended to proscribe competitive conduct when undertaken by a company with sufficient resources to compete effectively. Something more must be required ...*[28]

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26 *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1991) ATPR 41-128.

27 See for example *Olympia Equipment Leasing Co. v Western Union Telegraph Co.*, 797 F. 2d 370 (7th Cit 1986).

28 At 52, 897.

17 In Wilcox J's view, the means for distinguishing between legitimate price reductions and anti-competitive predatory pricing would be provided by an examination as to purpose:[29]

> *...the outward manifestation of a decision to engage in predatory pricing is a lowering of prices, an action which, on its face, is procompetitive. The factor which turns mere price cutting into predatory pricing is the purpose for which it is undertaken ...*

18 Whilst the American tests for predation largely ignore the issue of purpose; Wilcox J nevertheless considered that elements of those tests could be synthesised to provide guidance as to the existence of predatory purpose and concluded that failure to meet a cost standard would be one element necessary to the finding of a proscribed purpose.

> *I think that the principles evolved in America provide useful guidance upon the problem of applying the concept of predatory pricing to s 46. If they make one thing clear, it is that a charge of predatory pricing must be related to the costs incurred by the price cutter.*[30]

19 Wilcox J then went on to consider United States authorities in more detail in an attempt to determine whether a set of conclusive indicators of predatory pricing could be derived. His Honour then adopted the following factors as appropriate indicators of predation, although he did not express a final view as to whether they should be regarded as conclusive:[31]

- below cost pricing is a necessary prerequisite, and the most appropriate cost measure is average variable cost.
- the essence of predatory pricing is its "sporadic" temporary element.
- the critical question is the purpose behind below cost pricing and the determination of purpose should employ a two stage inquiry. If prices are below average total cost but above average variable cost, the plaintiff bears the burden of proving predatory purpose; if prices are below average variable cost, the defendant must prove a lack of predatory purpose.

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29 At 52, 895.
30 Above n10, 900.
31 At pp 52,898-52,900.

20 Notably, Wilcox J did not require the potential for recoupment as a necessary element of a predatory pricing claim. Wilcox J's approach in synthesising relevant elements of the American tests into a framework for indicating predatory conduct, but not including the necessity for recoupment within that set, was mirrored by McGechan J in the High Court of New Zealand in the *Port Nelson* case, which is discussed in Chapter 4 of this paper.

21 However on appeal, the Full Federal Court expressed a clear reluctance to define and apply any particular set of rules on this issue. This reluctance likely stems from the continued debate over what constitutes predatory pricing and how to detect it.[32]

22 The Full Federal Court commented that the United States contexts in which predatory pricing occurred varied widely and often were not analogous to Australian trade practices law. Whilst it was not apparent that Wilcox J had intended directly to incorporate the United States doctrine of predatory pricing into Australian law, Lockhart and Gummow JJ nevertheless specifically warned against the direct application of American predatory pricing decisions to section 46 cases.

> *It would be ... an error to translate into the operation of s46 the United States decisions dealing with predatory pricing at the expense of an independent examination of the Australian legislation as it applies to each case.*
>
> *... No preordained and fixed categories as to the level of pricing or economic theory or practice of costing necessarily control the drawing of that inference in any particular case.*

23 The Full Federal Court clearly rejected adopting any specific set of criteria to provide indicators of the existence of predatory pricing in terms of section 46, preferring instead a total rule of reason approach based purely on an analysis of the dominant firm's purpose. The Full Federal Court's approach was expressly approved by the New Zealand Court of Appeal in the *Port Nelson* case, which is discussed in Chapter 4 of this paper.

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[32] See Trade Practices Commission, "Misuse of Market Power Background Paper" (TPC, Canberra, 1990), paras 55-64 and Report of the Trade Practices Commission, *The Failure of Compass Airlines* (TPC, Canberra, 1992). See also Predatory Pricing Enforcement Guidelines adopted by Canada's Director of Investigation and Research (1992) 62 *Antitrust and Trade Regulations Report* Special Supplement.

24 The observation which can be made is that in failing to provide any analytical framework for assessing the elements necessary to prove predatory pricing, the Australian Full Federal Court has failed to establish any transparent test by which a plaintiff can attempt to distinguish predatory conduct from competitive behaviour; thus rendering allegations of predatory pricing less likely to succeed.

25 However, as the Full Federal Court's ideological position appears to concur with that underlying American authorities, that is, that predatory pricing is inherently irrational and unlikely to occur, the active discouragement of predatory pricing claims may have been intentional.

> *... The Court should be vigilant to ensure that its jurisdiction is not invoked to interfere with normal and legitimate competitive pricing activities in the relevant market under the guise that such activities are predatory.*[33]

THE APPROACH OF THE AUSTRALIAN TRADE PRACTICES COMMISSION

26 A similar ideological view on the part of the Australian Trade Practices Commission is evident from its investigation into the collapse of Compass Airlines, which is analysed below.

27 From this decision it is clear that the Trade Practices Commission evinces a similar reluctance to the Australian courts to define particular criteria as conclusive indicators of predatory intent. Although, in contrast to decisions by the Australian judicial tribunals, but in common with the New Zealand Commerce Commission, the Trade Practices Commission does appear to favour the Chicago school recoupment approach to the assessment of predation, it in fact failed to apply that theory in its reasoning in this decision.

The Trade Practices Commission's Inquiry into the Collapse of Compass Airlines

28 In 1992 the Trade Practices Commission carried out an investigation into the collapse of Compass Airlines.

29 Compass Airlines had been a new entrant into the Australian domestic passenger aviation market. Following Compass' entry and its strategy of significant fare

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[33] (1992) 106 ALR 297, 324, 326.

discounting, the two incumbent carriers retaliated by offering substantial discounts, particularly in the form of travel bonuses and frequent flier programmes.

30 The Trade Practices Commission considered whether cost based tests could be relevant indicators of predatory intent and, whilst it did not regard such tests as conclusive, it accepted that: [34]

> *pricing below average variable cost is difficult to justify on commercial grounds and may therefore be indicative of predatory intent.*

31 The Commission went on to apply this cost test and concluded that, as prices were not below average variable cost, they were not predatory, notwithstanding that:

> *all three airlines were failing to cover their overheads and were recording losses overall in 1991. This indicates that the level of price competition on Compass' routes was not sustainable in the medium term for any of them.*

32 The reason for the Commission's failure to clarify why these below cost prices were not predatory, or to conduct any inquiry as to purpose, appears to because the Commission supports the Chicago school recoupment approach to an assessment of predation. On the facts here the Commission concluded that since Compass' failure there had been no significant increase in fares, and therefore, as recoupment had not occurred the price reductions had not been predatory.

33 However, the Commission's assessment seems to have been a misapplication of the recoupment test. The relevant consideration is whether there is an ability to recoup, and it is clear that the Commission had earlier concluded that the high barriers to entry to the domestic passenger aviation market did make recoupment feasible.

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[34] At the same time the TPC also recognised that in certain circumstances (such as the need to avoid redundancies, or to clear excess stocks of perishable goods and services), even pricing below average variable cost could be justified and consistent with competitive behavior.

CHAPTER 4

THE NEW ZEALAND APPROACH

INTRODUCTION

1 In common with Australia, New Zealand has never, either by statute, at common law, explicitly adopted the American doctrine of predatory pricing.[35]

2 Historically, and in contrast to the United States and Australia, there have been very few New Zealand cases in which the doctrine has been specifically pleaded or considered. Nevertheless, a notable recent decision reiterates New Zealand appellate judicial reluctance to incorporate any of the American tests, or even any particular elements of those tests, into an assessment of whether predatory pricing has occurred; preferring instead to concentrate solely on the wording of the Commerce Act 1986 itself.

3 Conversely, recent decisions by the Commerce Commission, the agency responsible for enforcing the Commerce Act, illustrate that the Commission clearly favours the Chicago School recoupment test as the most appropriate means to establish predation; and considers that American authority can provide useful precedent on the elements necessary to prove the existence of predatory pricing. The courts' and the Commission's decisions are analysed in detail below.

The Commerce Act 1986

4 New Zealand's prohibitions on anti-competitive behaviour are contained in the Commerce Act 1986. The provisions of the Act which are relevant to an assessment of predatory pricing are sections 36 and 27.

5 Section 36 of the Act mirrors section 46 of the Australian Trade Practices Act 1974 and specifically prohibits the use of a dominant position in a market for the purpose of preventing or deterring competition or restricting the entry of any person, or eliminating any person; from any market.

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[35] This can be contrasted with the US essential facilities doctrine which was expressly adopted by the High Court of New Zealand in *the Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Limited* [1987] 2 NZLR 647. However, the New Zealand courts are now also more reluctant to apply that doctrine. See for example, *Fisher & Paykel v Commerce Commission* (1990) 3 NZBLC at 101,678.

6 Section 27 of the Act prohibits a person from entering into, or giving effect to, a contract, arrangement or understanding which contains a provision which has the purpose or effect (or likely effect) of substantially lessening competition in a market.

New Zealand predatory pricing cases

7 There has only been one judicial decision to date considering an allegation of predatory pricing in terms of the Commerce Act, the recent *Port Nelson* case. This case is examined below.

The Port Nelson Case

8 In the *Port Nelson* case, Port Nelson was the dominant provider of all port facilities at Nelson port. Port Nelson refused to allow a new entrant, Tasman Bay Marine Pilots Ltd ("TBMPL") to use its own pilots when hiring Port Nelson's tugboats, but required TBMPL to use Port Nelson's pilots, the so-called "tug tie".

9 In addition, the port company introduced a minimum charge and discount. The Commerce Commission brought proceedings against Port Nelson alleging that the tug tie and the discount structure breached sections 36 and 27 of the Commerce Act. The Commission's central allegation in relation to predatory conduct was that Port Nelson's discount structure amounted to below cost predatory pricing for the purposes of eliminating TBMPL as a competitor, and was an anti-competitive use of dominance for a proscribed purpose in breach of section 36 of the Act.

10 Notably, the Commission did not specifically allege that this predatory pricing structure breached section 27 of the Act (which does not relate to use of market power), as the Commission supports the Chicago School view that predatory pricing is only feasible for a firm having market power. This issue is discussed further below in the context of the Commission's investigation into Internet pricing and the collapse of Kiwi Airlines.

11 The High Court and the Court of Appeal analysed Port Nelson's conduct under section 36 to determine whether its new pricing structure reflected an anti-competitive use of dominance. In considering this issue, rather than conducting any analysis of Port Nelson's pricing structure and behaviour in terms of any of the elements of the American tests for predatory pricing, both the inferior and superior

courts chose instead simply to apply the precedent for use of dominance laid down by the Privy Council in the *Telecom v Clear* local access case.[36]

12 That test is that a dominant firm will only incur liability under section 36 for its unilateral conduct if it acts in a way which a person not in a dominant position, but otherwise in the same circumstances, would have acted. If there is an anti-competitive use of dominance, a proscribed purpose can generally be presumed, but not the converse.[37]

13 However, the *Telecom v Clear* local access case was not a decision on predatory pricing, but rather related to the maximum price, that is, its opportunity cost; that a vertically integrated natural monopoly can charge for access to, in this case, its telecommunications network. The only direct relevance of the local access case to a decision on predatory pricing, is that it is clear that monopolistic pricing practices are not *per se* prohibited under section 36 of the Commerce Act. Apart from that aspect, the *Telecom v Clear* case provides little useful guidance on the application of section 36 to a claim of predatory pricing.

14 In applying the *Telecom v Clear* test both the High Court and the Court of Appeal quickly concluded that introducing the minimum charge and discount did not amount to a use of Port Nelson's dominance, as it was not acting in a way in which it would not have acted had it not been dominant.

15 However, neither tribunal provided any clear indication of the circumstances, if any, in which price reductions by a market dominant firm would amount to a use of dominance or evidence anti-competitive purpose in terms of section 36. Moreover, as the *Telecom v Clear* test has subjugated the inquiry as to purpose to that of use of dominance; a test which appears almost impossible to satisfy, it seems likely that even compelling evidence of predatory purpose will not be sufficient to attract liability for predatory pricing under section 36.

16 Nor did either tribunal consider the more pertinent question of whether Port Nelson was acting in a way in which it *could* not have acted had it not been dominant, for example by financing the discount through cross-subsidisation; which appears to be an implicit acceptance of the Bork view that such leveraging is

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[36] *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1955] 1 NZLR 385.

[37] If a dominant firm engages in collusion, it may infringe the restrictive trade practices prohibitions in Part II of the Commerce Act.

unlikely to occur. However, McGechan J suggested that a tying arrangement could be one indicator of anti-competitive predatory behaviour.

17 The lack of effective analysis of Port Nelson's pricing strategy under section 36 may well be a manifestation of the New Zealand courts' ideological position, shared with that of American and Australian judicial tribunals, that predatory pricing by a market dominant firm is inherently economically irrational and unlikely to occur; accompanied by a marked reluctance to regard low prices as potentially damaging to consumer welfare.

18 For example, in the High Court, McGechan J reflected the prevailing attitude of the American courts, and also that expressed by Wilcox J in the *Eastern Express* case, that no presumption of predation would be raised by a dominant firm lowering its prices.

> *... there seems no reason why a monopolist should not be able to give discounts, in accordance with normal practice, like any other trader. Indeed, it is to the benefit of consumers, and encourages efficiency on the part of the monopolist, to do so. In particular, in relation to bulk discounts within the monopoly lines, or discounts for prompt payment, it is difficult to see how such ever could be harmful.*

19 As both courts concluded that Port Nelson's pricing structure did not amount to a use of its dominance in terms of section 36, both courts then turned to analyse whether predatory behaviour could be said to have occurred in terms of section 27 of the Commerce Act. In analysing predatory pricing under section 27, which does not require market dominance, both courts seemingly rejected the Chicago school view preferred by the Commerce Commission that predatory pricing is only possible for a firm having market power. However, as illustrated below, it is clear from their analysis of the elements required to prove an allegation of predatory conduct in breach of section 27, that market power is an implicit element of the offence.

20 McGechan J in the High Court considered the relationship between price and cost, and adopted the traditional American view that for prices to breach section 27, the defendant's overall pricing structure must be below cost.

> *... it is not breach of s27 simply to price competitively. A firm which through efficiency, or willingness to contain profit margins, undercuts rivals or potential entrants may have the elimination of competition as one of its purpose. ... Such efficiencies and profit containment nevertheless are regarded as in the public interest. Such scenarios*

> *are competition in action; to be promoted by the Act, not prevented by it. If less efficient or more rapacious competitors are killed off, so be it.*
>
> *For breach of s27 to occur, pricing must go rather further. Pricing must be below cost. (We leave aside the theoretical complication of pricing at cost.)*

21 McGechan J then went on to conduct a minute examination of various cost thresholds and made considerable reference to the Areeda & Turner test of average variable cost, but ultimately did not chose any particular measure of costs as the appropriate test for New Zealand.

22 Having established that Port Nelson's overall prices would be below any relevant measure of cost, McGechan J then went on to consider the other elements necessary to establish a breach of section 27.

23 As it was clear that the discount had not had the effect of substantially lessening competition, McGechan J had to establish whether there was an anti-competitive purpose. In analysing whether such a purpose existed, he read into the section an additional requirement of predation, that is an intent to create an aggressive deterrent reputation.

> *The section will be met if the activity has the features of pricing below cost, with associated substantial purpose of eliminating or deterring present competition, and the creation of a deterrent aggressive reputation.*[38]

24 This additional predatory requirement implies that market power is a prerequisite for the existence of predatory pricing, as only a firm having market power would be in a position to create such an aggressive deterrent reputation. This is clearly the view adopted by the Commerce Commission in its investigation into Internet pricing, which is discussed below.

25 McGechan J considered that the above elements would be sufficient to establish predatory pricing in terms of section 27, and clearly rejected the Chicago school notion that recoupment is a necessary element of the offence.

> *... conduct that does lessen competition will contravene [the section] even in the absence of evidence of the ability ultimately to recoup the loss - though that may generally be presumed from a decision to indulge in anti-competitive conduct ...*

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[38] Above, at p.538.

26 McGechan J's conclusion that below cost pricing accompanied by anti-competitive purpose and the creation of a deterrent aggressive reputation is sufficient to establish predatory pricing, appears to be a clear endorsement of the Posner view that predatory strategies can be rational without necessarily incorporating a clear ability to recoup.

27 Nevertheless, whilst incorporating many elements of US analysis of predatory pricing into his assessment of whether a breach of section 27 had occurred, His Honour was at pains to point out that this did not mean that the doctrine of predatory pricing existed in New Zealand.

> *It will be noticed this discussion has not referred to "predatory pricing". That is deliberate. Nor does the legislation. The statutory question is whether the provision concerned has the purpose (or effect or likely effect) of substantially lessening competition. If it does, the section is met. If it does not, then whether or not the activity amounts to "predatory pricing" - a term of uncertain scope - the section is not met.*

28 Despite McGechan J's apparent disavowal of the existence of the doctrine of predatory pricing in New Zealand, the Court of Appeal were clearly critical of the emphasis he had placed on using the criteria applied in the United States to support his findings and warned against the incorporation of US-based case law into the wording of the Commerce Act.

> *Like the Full Court of the Federal Court in Australia (Eastern Express Pty Ltd v General Newspapers Pty Ltd (1992) ATPR 41-167, 40,307) we are reluctant automatically to read into the statutory wording concepts evolved in the differently based United States case law.*

29 In particular, whilst upholding the High Court's decision, the Court of Appeal refused to accept that below cost charging was a prerequisite for a breach of section 27; or even that it would raise any inference of predatory conduct.[39]

> *It is not a contravention of s27 to offer or sell goods or services at less than cost. The section requires proof of the substantial lessening of competition - not merely aggressive competitive conduct. ... The mere fact that a participant operates in the market at a loss ... will not necessarily lessen competition.*

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[39] *Port Nelson v Commerce Commission* (1996) CA, 169/95, 247

(b)elow cost pricing will not frequently give rise to competition law concerns. The reduction of prices generally will reflect competition at work...

30 Accordingly, the criteria posited by McGechan J in the High Court of below cost pricing accompanied by anti-competitive purpose and the creation of a deterrent aggressive reputation, can no longer be relied upon as conclusive indicators of predatory pricing.

31 Moreover, it appears that the New Zealand courts are likely to remain reluctant to enunciate any clear criteria as indicative of such predatory conduct. However, in failing to provide any clear analytical framework for assessing the relevance of pricing behaviour - the Court failed to establish any clear test by which predatory conduct can be distinguished from competitive behaviour

THE APPROACH OF THE NEW ZEALAND COMMERCE COMMISSION DECISIONS

32 In contrast to the New Zealand judicial approach, the Commerce Commission has made it clear in two recent decisions that it continues strongly to favour the Chicago recoupment approach to an assessment of predatory pricing, and will have regard to and apply the United States tests, notwithstanding the explicit rejection of both of these approaches by the Court of Appeal.

Commerce Commission Investigation of Internet Pricing

33 In May 1997 the Commerce Commission published its report on its investigation into allegations of predatory pricing against Telecom New Zealand Limited in respect of its internet access business.

34 In this case independent providers of internet services (ISPs) alleged that Telecom was engaging in predatory pricing by reducing its internet access price. The new prices were substantially below Telecom's previous prices, and those charged at the time by the ISPs. The ISPs alleged this meant that Telecom must be pricing its Internet access services below cost, particularly as Telecom's 0800 number access price to Telecom customers of $4.95 per hour was clearly less than the price of approximately $6.00 per hour offered by Telecom to ISPs for access to the same service.

35 In assessing whether predatory behaviour had occurred under section 36 of the Act, the Commission followed the precedent laid down in the *Port Nelson* decision that price reductions by a dominant firm do not amount to use of dominance in terms of section 36. Once again, no view was expressed as to what other

behavioural elements would also need to be present to lead to the conclusion that predatory pricing in terms of section 36 had occurred.

36 Despite the explicit rejection of the recoupment approach by both the High Court and the Court of Appeal in Port Nelson, the Commission nevertheless applied this approach. It concluded that the low entry barriers to the internet market, and the fact that credible competition already existed in the internet market - CLEAR was an established participant in the market and Telstra had signalled its intention to enter after Telecom had reduced its prices, rendered recoupment ultimately unfeasible.

37 The Commission did also consider the issue of whether Telecom would be able to create an aggressive deterrent reputation by its conduct, seemingly accepting the Posner view as approved by McGechan J in the Port Nelson case, that a predatory pricing strategy can also be rational if it succeeds in discouraging entry to the relevant markets. However, the Commission's view appears to be that unless such strategic behaviour is also accompanied by an ultimate ability to recoup, then the test for predatory pricing is not satisfied.

38 Further, the Commission concluded that as there was a legitimate business reason for Telecom to price in that manner, namely to increase subscriber numbers to enable it ultimately to generate higher profits from the provision of value added services, no predatory purpose could be inferred.[40] This aspect of the decision may be limited to industries where an economy of scope can be gained from the joint provision of two services. For example, media such as television, radio and newspapers are provided below cost in order to increase circulation. This in turn attracts a larger advertising revenue which makes the newspaper or magazine profitable overall. As advertising revenues are a function of circulation, the profit of a newspaper or a magazine is maximised not by raising the price and restricting the size of the readership, but rather by lowering the price so as to increase its circulation and advertising revenue.[41]

39 Given its conclusion that recoupment was not feasible, the Commission did not carry out any analysis of whether Telecom's prices were below any measure of cost. However, whilst it is clear that the Commission considers that prices below marginal cost are a necessary prerequisite to an allegation of predatory pricing (see

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[40] The Economist had also predicted that competition in Internet provision would drive many internet service providers in this direction. The Economist, *Internet Service Providers: Making a Business of the Bit Buffet*, 8th March 1997, pp. 79-80.

[41] Areeda and Hovenkamp, paragraph 729.7a.

the discussion of the Commission's investigation into the collapse of Kiwi Airlines below), it does not endorse the view that below cost pricing is sufficient to raise any presumption of predatory conduct, at least in an emerging market. In this regard, the Commission once again expressly approved United States authority, recognising that new entrants into a market often make losses for substantial periods before they become established, as noted in the *Rose Acre* farms case.[42]

> *Trying to infer (or refute) predatory conduct from the relation between price and cost is difficult business. Often a price below cost reflects only the sacrifice necessary to establish a presence in a competitive market (for example, new magazines lose money for years as they try to increase circulation and attract advertising revenue, without creating the tiniest risk of monopoly).*

40 The Commission's investigation into internet pricing clearly evidences the Commission's endorsement of the Chicago school approach to an assessment of predatory pricing, and a clear preference for utilising the factors posited in American case law as indicators of whether predation can be assumed or not. The Commission's recent investigation into the collapse of Kiwi Airlines, which is examined below, further consolidates this approach.

The Commerce Commission's Investigation into the Collapse of Kiwi Airlines

41 In August 1997 the Commerce Commission published its report into the investigation of alleged predatory behaviour by Air New Zealand in substantially lowering some of its prices for Trans-Tasman flights to match the fares charged by the new entrant, Kiwi Airlines.

42 On the evidence produced by Kiwi Airlines, the Commission concluded that it was not established that Air New Zealand had dominance in any relevant market, which, in the Commission's view, automatically precluded any finding of predatory pricing. This again evidences the Commission's endorsement of the Chicago school approach; as only firms having dominance would have the required ability to recoup. Notwithstanding, the Commission went on to assess the allegations against Air New Zealand on the assumption that dominance could be proved.[43]

43 Once again, in applying the Privy Council test for use of dominance, the Commission was compelled to conclude that Air New Zealand's behaviour did

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[42] *A A Poultry Farms Inc v Rose Acre Farms Inc* 881 F.2d 1396 (7th Cir. 1989) at 1400.

[43] Above, n x, para 28.

not amount to use of dominance. On this occasion the Commission made it plain that it considered the Privy Council test in the *Telecom v Clear* case inappropriate to an assessment of whether predatory pricing has occurred in terms of section 36.

although helpful, the Privy Council test for predatory prices is not very exacting.

44 Accordingly, whilst recognising that the United States' tests for predatory pricing have not been adopted by New Zealand Courts, the Commission nevertheless described them as providing "instructive benefit" and, as with its investigation into internet pricing, went on to apply the criteria for establishing predatory pricing from what it considered to be the most appropriate American authorities. In this instance, the Commerce Commission adopted Judge Easterbrook's test in the *Rose Acre Farms* case to analyse Air New Zealand's actions.

45 In examining the first limb of the test the Commission adopts the Chicago school view, as accepted by the American courts, and as applied by McGechan J in the *Port Nelson* case, that an assessment of predatory pricing must be based on the costs and revenues associated with a full product line. That is, the predator's "overall price structure" must be predatory.

46 On the facts in this case, the Commission considered that Air NZ would be likely to establish a strong case that its $299 dollar seats were not being sold below incremental variable cost (which would be extremely low as most of the costs of running the individual flights would be recovered from the seats which continued to be sold at the higher price). Despite the Court of Appeal's statements in the Port Nelson decision to the contrary, the Commission was clearly of the view that if prices were not being sold below a reasonable measure of cost,[44] a predatory pricing allegation could not be supported.

47 In applying the second limb of the *Rose Acre Farms* test, that is, whether predatory intent existed, the Commission concluded that the anecdotal evidence suggested aggressive competition was Air New Zealand's motivator, rather than predatory intent. This was demonstrated by the fact that each of Air New Zealand, Kiwi Airlines and Qantas had played a role in initiating price reductions.[45] The Commission adopted a similar view to that expressed by Wilcox J in the *Eastern Express* case, and McGechan J in *Port Nelson* that price reductions by monopolists

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[44] Above, n x, para 36. However, Air New Zealand was not actually required to substantiate that prices were above incremental, or any other measure of cost.

[45] Para 38.

would not be seen as inherently anti-competitive. Although, notably, the Commission preferred to cite American authority on this proposition, rather than the domestic tribunal. [46]

> *a firm with lawful monopoly power has no general duty to help its competitors, whether by holding a price umbrella over their heads or by otherwise pulling its competitive punches.*

48 Moreover, in contrast to the view of McGechan J in the *Eastern Express* case, the Commission implied that even an express purpose to eliminate a competitor accompanied by an intention to recoup lost profits would not amount to predatory intent, in the absence of an actual ability to recoup.[47] On the facts in this case the Commission had concluded that Air New Zealand was not dominant in any of the relevant markets and so section 36 of the Commerce Act could not apply. However, it is unclear whether the Commission's reasoning would be extended to a monopolist, given that such a purpose would appear to fall clearly within the proscribed purposes contained within section 36.

49 The Commission did not address the issue of whether Air New Zealand might have been attempting to create a deterrent aggressive reputation; presumably because the Commission had already concluded that whilst barriers to entry in the domestic aviation market are high, such barriers in the relevant Trans-Tasman markets are low, which would have precluded Air New Zealand from being able to establish such a reputation with the ultimate aim of recoupment.[48]

> *The regulatory and other barriers to entry are low, and there is significant competition, both actual (particularly Qantas) and potential, to provide constraints to any existing player.*[49]

50 In respect of the third limb, whether recoupment in fact occurs, the Commission concluded that as Air New Zealand maintained Trans-Tasman fares at less than those prevailing prior to Kiwi Airline's entry, this tended to indicate that Air

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[46] *Olympia Equipment Leasing Co. v Western Union Telegraph Co.*, 797 F. 2d 370 (7th Cit 1986), per Posner J.

[47] Para 50.

[48] Para 15.

[49] Page 80, paras 8-13.

New Zealand was not reaping monopoly profits, nor was it reaping "high price later" returns.[50]

51 Given that the Commission had not carried out any examination into the relationship between price and cost, it is unclear how it reached the conclusion that Air New Zealand was not reaping monopoly profits in its overall pricing structure. Although, given the Commission's assessments of the barriers to entry, it presumably was of the view that recoupment was ultimately impossible.

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[50] Above, n x, para 39.

CHAPTER 5

CONCLUSIONS

1 It is clear that both the Australian and New Zealand courts share the same antipathy towards explicitly incorporating the American doctrine of predatory pricing into the common law framework existing in those jurisdictions.

2 The Australian and New Zealand lower courts have been prepared to utilise relevant elements of the American tests in order to assist in an assessment of whether predatory pricing has occurred in breach of the relevant statutory provisions, However, this approach has been openly criticised by the appellate tribunal in each jurisdiction.

3 Both the Australian and New Zealand appeal courts have proved extremely unwilling to accept any of the elements posited in the United States as conclusive, or even preliminary indicators of predatory behaviour. Neither has either tribunal been prepared to define any alternative criteria which could be used to assist in an analysis of whether predatory pricing has occurred.

4 Instead, both the Australian and New Zealand appellate courts have repeatedly emphasised the paramount nature of the actual elements of the relevant statutory provisions , and in particular the requirement for a proscribed purpose, over any other potentially relevant test.

5 Whilst a reluctance to be fettered by precedents which have evolved from a different statutory and constitutional setting; or by quasi-scientific tests which purport to, but do not actually, offer objective proof of predation, is understandable; nevertheless the total rule of reason approach based purely on an analysis of purpose which has been adopted in Australia and New Zealand clearly has its limitations. The relevant statutory provisions provide little illumination as to what constitutes a predatory purpose. Moreover, mere reliance on the relevant firm's subjective intent may fail adequately to analyse purpose within the wider context of the intention to undertake a longer term predatory strategy.

6 In the circumstances, the Australian and New Zealand courts narrow focus on a literal interpretation of the proscribed purposes in the statute may foreclose an examination of other factors which may be useful to an assessment of predation, including in particular, an examination via cost-based analysis, of the economic basis of the behaviour in question.

7 In failing to provide any effective analytical framework for assessing the elements necessary to prove predation, and in diminishing the significance of economic data, the success of such claims in Australasian jurisdictions is rendered inherently unlikely.

8 Ultimately, this may be an intentional manifestation of the underlying ideological position prevailing in those jurisdictions, which reflects the philosophical attitude prevalent in the United States, that predatory pricing by a market dominant firm is inherently economically irrational and unlikely to occur; accompanied by a marked reluctance to regard low prices as potentially damaging to consumer welfare.

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