The relevance of economic efficiency to s 46

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1 Introduction

1 My topic is the relevance of economic efficiency to the new language in s46; and I wish to put two propositions.

a. The first is that there is a long history of recognising that one aspect of competition in the context of competition law is a notion of socially useful competition.

b. The second proposition is that this notion of socially useful competition is particularly relevant to monopolisation cases of the kinds that will appear under our new s 46.

2 My first proposition

2 From the beginnings of our current competition statute, the Tribunal and the courts have recognised that analysing competition cannot be divorced from considerations of economic efficiency.

3 In the literature of economics, the link stems from the famous 1940 paper by J M Clark on the topic of what he termed 'workable competition'.[1] Clark was attempting to develop a concept of competition which would be a useful guide to assessing competition in real-world market conditions. The initial contribution of J M Clark led to the development of a literature on workable competition (sometimes called 'effective competition').

4 Those who are familiar with this literature will recognise references to workable or effective competition in the exposition of the meaning of competition by the Tribunal in Re QCMA and Defiance Holdings.[2] The Tribunal refers to 'effective competition' and to a 'socially useful competitive process' but it deliberately avoids providing a neat definition of competition:

> Since we give such importance to the relevance of competitive considerations in proceedings for authorization, we add a few comments on how the Tribunal views competition. However, "competition" is such a very rich concept (containing within it numbers of ideas) that we should not wish to attempt any final definition which might, in some market settings, prove misleading or which might, in respect of some future application, be unduly restrictive. Instead we explore some of the connotations of the term.[3]

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1 J M Clark, "Toward a Concept of Workable Competition," *American Economic Review*, Vol 30 (1940) pp 241-256.

2 *Re QCMA and Defiance Holdings* (1976) ATPR 40-012.

3 *Re QCMA and Defiance Holdings* (1976) ATPR 40-012 p 17,245.

5 In her academic writing, Maureen Brunt explores the various ideas that the concept of competition connotes; She quotes the High Court in *Queensland Wire* referring to competition as a process that operates to 'protect the interest of consumers' and continues:

> What we have been discussing is a concept of competition which is profound and goes to the heart of its role as the engine of efficiency and progress. Yet competition is a very rich concept and there are shades and differences of meaning in customary usage – even by an economist. Putting aside the textbook concept of theoretical perfect competition one might distinguish the following meanings or connotations:
>
> - an absence of market power, as just discussed;
> - rivalry, a striving to gain at each other's expense;
> - workable, or useful, competition; and
> - "soft competition", the preservation of individual competitors.
>
> The last concept has been decisively rejected by courts and administrative bodies on both sides of the Tasman. But the other three are all related – the first as a concept which stresses the structural dimension of competition; the second as a concept which highlights market conduct; and the third as a concept which emphasises competition as an instrument of economic performance. …
>
> The phrase "workable competition" is not susceptible to precise, universally accepted definition but usually carries two connotations: first, that the concept of competition must be of a process that is practically achievable in commercial reality and second, that is must be a reliable mechanism for achieving good economic performance – in short, efficiency and progressiveness constrained by market forces.[4]

6 The system of classification was adopted by the Competition Tribunal in *Chime Communications No. 2*, the Competition Tribunal stated:

> What, then, do we draw from the various models for studying a market to determine its competitiveness and for assessing how the market may behave in the future? In the Tribunal's view a market is sufficiently competitive if the market experiences at least a reasonable degree of rivalry between firms each of which suffers some constraint in their use of market power from competitors (actual and potential) and from customers. The criteria for such competition are structural (a sufficient number of sellers, few inhibitions on entry and expansion), conduct-based (eg no collusion between firms, no exclusionary or predatory tactics) and performance-based (eg firms should be efficient, prices should reflect costs and be responsive to changing market forces).[5]

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4 Maureen Brunt, "'Market Definition" Issues in Australian and New Zealand Trade practices Litigation', pp 185-237 of Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law*, Kluwer Law International (2003) at 201-202.

5 *Application by Chime Communications Pty Ltd (No 2)* [2009] ACompT 2 at para 48.

7 *Chime No. 2* refers to the exposition of workable competition in the textbook by Scherer and Ross.[6] The Tribunal states:

> Much of the literature on workable competition was analysed by S H Sosnick in his paper 'A Critique of Concepts of Workable Competition' (1958) 72 Quarterly Journal of Economics 380. Sosnick suggests a large number of characteristics that will determine whether a market is workably competitive. Scherer and Ross (at 53 - 54) have divided them into structural, conduct and performance categories as follows:
>
> Structural criteria:
>
> - The number of traders should be at least as large as scale economies permit.
> - There should be no artificial inhibitions on mobility and entry.
> - There should be moderate and price-sensitive quality differentials in the products offered.
>
> Conduct criteria:
>
> - Some uncertainty should exist in the minds of rivals as to whether price initiatives will be followed.
> - Firms should strive to attain their goals independently, without collusion.
> - There should be no unfair, exclusionary, predatory, or coercive tactics.
> - Inefficient suppliers and customers should not be shielded permanently.
> - Sales promotion should be informative, or at least not be misleading.
> - There should be no persistent, harmful price discrimination.
>
> Performance criteria:
>
> - Firms' production and distribution operations should be efficient and not wasteful of resources.
> - Output levels and product quality (that is, variety, durability, safety, reliability, and so forth) should be responsive to consumer demands.
> - Profits should be at levels just sufficient to reward investment, efficiency, and innovation.
> - Prices should encourage rational choice, guide markets toward equilibrium, and not intensify cyclical instability.
> - Opportunities for introducing technically superior new products and processes should be exploited.
> - Promotional expenses should not be excessive.
> - Success should accrue to sellers who best serve consumer wants.

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6 F M Scherer and David Ross, *Industrial Market Structure and Economic Performance*, 3rd edition (1990) Houghton Mifflin Company.

> The point we draw from Sosnick's work, as is made evident by Scherer and Ross, is that determining whether competition is "workable" involves an analysis of empirical data regarding the structure and dynamics of a market and its participants.[7]

3 Application to s 46

8 My second proposition is that a notion of socially-useful competition is particularly relevant to monopolisation cases of the kinds which will appear under our new s 46.

9 I find one aspect of George Hay's paper particularly interesting. This is that the US courts have analysed the effects of conduct on competition in slightly different ways depending on the context and, in particular, the application has varied depending on whether they have been analysing mergers, agreements or monopolisation.

10 When speaking of the monopolisation provision of the Sherman Act, George stated:

> All of the conduct potentially covered by Section 2 is about efforts by a large firm to injure its smaller competitors. But some ways of injuring your competitor are allowed and some are prohibited. … It is all in where you draw the line.

11 There are two ways to make money:

a. Being more efficient than your competitor. Sometimes this is termed 'competing on the merits' in US cases or when Justice Heerey was writing decisions under our s 46. Being more efficient means competing on the basis of a better mousetrap or a lower-cost mousetrap.

b. Stitching things up.

12 Any monopolisation provision has to allow competition based on a better or lower-cost mousetrap and proscribe stitching things up.

13 Some of the decisions under our old s 46 have recognised precisely this distinction. I shall refer to two of them. The first is that of Justice Toohey in Queensland Wire:

14 He quotes the textbook on competition law by Donald and Heydon and then states:

> These distinctions have been drawn because Pt IV of the Act, which is designed to promote and preserve competition, must confront the problem caused by a competitor who is so successful as to eliminate rivals and thus defeat the legislative aim of promoting competition. If success is due to no more than

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7 *Application by Chime Communications Pty Ltd (No 2)* [2009] ACompT 2, para 36.

> superior skill and efficiency, little criticism can be made of the conduct involved. Not so, if there has been unfair business practice. And so constraints have been placed on competition. The nature of those constraints has been influenced by this distinction between predatory conduct and conventional business practice.

15 My second quotation is from Justice McHugh (speaking of the old s 46) in *Boral*:

> Section 46 would be a vehicle for anti-competitive conduct if the most efficient firm in the market had substantial market power and by reason of its efficiency could not take market share from its rivals without contravening the section. This makes little sense from the perspective of achieving an efficient economy with efficient resource allocation or for the benefit of consumers who can be provided with quality goods or services at lower prices. In a competitive market, the more efficient firms can produce more (because their average costs are lower) and obtain a greater share of the market with the result that they substantially damage their less efficient competitors. Such firms can expand their production until their marginal cost equals the market price. No one would suggest that an efficient firm with market power breaches the section because it increases its output to the level of its marginal cost. Yet the firm has market power, has substantially damaged its competitors …[8]

16 In my opinion, exactly the same reasoning must apply to consideration of the test under the new s 46. One can only make sense of the substantial lessening of competition test if one has in mind a notion of socially useful competition. One should not condemn as lessening competition, conduct which involves competing on the basis of a better mousetrap or a lower-cost mousetrap. One should only condemn as lessening competition conduct which produces profits by stitching things up.

8 *Boral* High Court per Mc Hugh, para 280.

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