The 1991 Irish Competition Act: Lessons from US anti-trust

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ABSTRACT

The 1991 Irish Competition Act may have profound effects on how business is conducted in Ireland. Two of the most important sections of the act are Section 4, which prohibits anti-competitive behavior, and Section 5, which deals with the abuse of a dominant position in the marketplace. The economic implications of both sections are addressed by examining how similar legislation has been interpreted by the courts in other jurisdictions, by US anti-trust laws in particular. The principles underpinning the act reflect those of EC competition policy, enshrined in Articles 85 and 86 of the Treaty of Rome and of US antitrust laws, namely, the Sherman and Clayton Acts. They are explicitly designed to control the abuses of monopoly power and in so doing protect competition. While the Irish Competition Act understands the need for competition policy, it appears on a first reading to have adopted a Chicagoan approach that tends to misunderstand the real world conduct of firms. Under the guise of a general law, the act may inadvertantly further the interests of a limited group rather than the general welfare. In so doing, it proffers an apology for rent-seeking behavior.

FULL TEXT

INTRODUCTION

The 1991 Competition Act which came into force on October 1st 1991 is a new piece of legislation which may have profound effects on how business is conducted in this country. Two of the most important sections of the Act are Section 4, which prohibits anti-competitive behaviour and Section 5 which deals with the abuse of a dominant position in the market place. This paper shall address the economic implications of both Sections 4 and 5 by examining how similar legislation has been interpreted by the Courts in other jurisdictions, in particular, by US anti-trust laws.

Section 4 of the Irish Act prohibits "all agreements, decisions and concerted practices between undertakings or associations of undertakings which have as their object or effect the prevention, restriction or distortion of competition in trade in any goods or services". This is the rather broad definition of anti-competitive behaviour within the Act, but Section 4(1) goes on to list particular restraints of trade, including price fixing and exclusionary practices. The provision goes beyond the EC legislation in that it applies to services which means that the professional classes as businesses will need to be as aware of the Act. However, some exemptions are allowed. Under S4 (2) & (3), the Authority may grant a Licence which would "permit the doing of acts which would otherwise be prohibited and void under subsection 1". The Competition Authority may also issue 'block exemption' licences for agreements which conform to conditions set out in the licence. The section also provides that the Authority may issue a Certificate that behaviour is not anti-competitive.

Section 5 prohibits any abuse of a dominant position in trade in the State or in a substantial part of the State for any goods or services. It does not define "dominant position" or "abuse" of such a position, but it does give examples "without prejudice to the generality of subsection 1" of what would amount to abuse. I shall refer to this throughout the paper.

Section 6 provides that any person aggrieved by actions prohibited under Section 4 or 5 has a right of action in the High Court and may be granted (a) an injunction or declaration and/or (b) damages, including exemplary damages.

ANTI-COMPETITIVE BEHAVIOUR

The principles underpinning this Act reflect those of EC competition policy, enshrine in Articles 85 and 86 of the Treaty of Rome and of US antitrust laws, namely, the Sherman and Clayton Acts. They are explicitly designed to control the abuses of monopoly power and in so doing protect competition. It is generally agreed that the main goal of antitrust and competition policy is to improve consumer welfare. The philosophy is contained within the 1991 Irish Competition Act and alluded to in phrases like "allowing consumers a fair share of the resulting benefit" (S4(2)(c)).

PRICE FIXING

The issue of price fixing is dealt with in S4(1)(a) of the Irish Act which prohibits all agreements, decisions and concerted practices which 'directly or indirectly fix purchase or selling prices or any other trading conditions'.

(i) HORIZONTAL PRICE FIXING

The issue of price fixing arose in US v Trenton Potteries (1927), an application of the 1890 Sherman Act. This Act was the first piece of legislation designed to protect economic competition. It stated that contracts or conspiracies in restraint of trade were illegal, as were actions which monopolise or attempt to monopolise trade. The Court found that combining to fix price was unreasonable in itself and that any price set by group agreement, rather than by competition, involved restraint. In the Trenton case, the Court held that it was not necessary to show that the association had fixed unreasonable prices--as long as it had the power to do so. However in US v Socony (1940), the Court went further. The Socony defence was that the price stabilisation scheme established a reasonable price. However, this was not an adequate defence--the Court declared that a combination to fix prices was illegal per se, even if the participants lacked the power to fix prices. This reduced the emphasis placed on the rule of reason in horizontal price fixing cases. So, for example, a professional business of (say) lawyers in a particular city which decides to fix fees for administrative reasons rather than as a concerted effort to deter entry into the area's legal services market may have no defence under US anti-trust.

The control of price fixing is an important element of competition policy both for US and Irish legislators; the importance is clearly evident in Section 4 of the Irish Act. It is well established that explicit agreements by competing or independent firms to fix prices are a primary concern of the Sherman Act. In the earliest cases it became clear that Sherman condemned every restraint of trade with no exceptions. Therefore, all price fixing arrangements were considered unlawful, without regard to whether or not they could be deemed reasonable. This changed with the Robinson-Patman Act which prohibited price discrimination where it might 'injure, destroy or prevent competition'. Section 4 of the Irish Act states a similar view. The problem is in defining price discrimination. Does every price difference amount to price discrimination? We should note that charging the same price to two customers may not be price discrimination under the Sherman Act even though the costs of one seller are higher than those of another.

(ii) VERTICAL PRICE FIXING

Vertical restraints of trade involve cooperation between the manufacturer of a good and its chain of distributors. The earliest US cases on vertical restraints were concerned with manufacturers' control of retailers' prices. This is the phenomenon of resale price maintenance or RPM, and the landmark case in the US is Miles Medical Co v John Park & Sons Co (1911), wherein the Court ruled that a manufacturer who sells his products to a wholesaler is not entitled to restrict their resale through interference with the pricing decisions of the wholesaler. This decision was confirmed by the Court in California Retail Liquor Dealers Association v Midcal Inc (1980), but there is still disquiet within the literature on the efficacy of this antitrust rule. Unless RPM results in higher prices, restricts output or results in oligopoly co-ordination, the anti trust legality, it is argued, should be measured by the rule of reason on a case by case basis.

Price discrimination implies that a vendor charges different prices to different purchasers. In the Irish Act, price discrimination is dealt with in S4(1)(a) and (d). The Act does not state whether it is concerned with horizontal or vertical price fixing, or whether implicit as well as explicit price fixing is prohibited. Horizontal price arrangements are illegal across virtually all jurisdictions and, under EC Article 85, implicit or spontaneous price collusion is prohibited. One could infer that in effect the same applies in Ireland. The absence of a direct reference to vertical price fixing frustrates the treatment of resale price maintenance [RPM] where the manufacturer imposes a price floor on the dealers. A presumption that RPM is not prohibited may ensure the continued absence of both intrabrand and inter-brand price competition in Ireland.

Section 5 does not refer directly to price fixing, instead referring to "unfair" prices or trading conditions. Subsection 2 (a) states that an abuse of a dominant position may consist in "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions". The definition of an unfair price will be a problem for the Authority during the initial years particularly in the absence of a bench-mark price, McNutt & Doherty (1992). A similar problem with respect to the definiton of a 'predator price' has only in the past decade been resolved in US anti-trust by reference to the Areeda-Turner rules. In this respect a predator price is defined as a price below the short run average variable cost. In the recent bread war in Ireland, the establishment of a fair price for the humble loaf of bread became an issue. Is it, for example, 35p for a 800g loaf? If so, it suggests that the supermarkets in charging 37p for example are not charging an unfair price. But, if 55p is the break-even price for the average bakery, a 37p loaf could represent below-cost selling. Thus, the situation could occur where a price that is deemed to be fair is also held to be below-cost selling. It is not clear whether below cost selling is prohibited under Section 5.

In the first instance consumers do benefit from the 35p loaf and provided the price is the result of economies of scale, it would be lawful. If however the price recurs in cycles as a short run predator tactic to increase sales it should be prohibited. In particular if below cost selling is interpreted as predatory pricing with the explicit purpose of disadvantaging rivals then it should be prohibited. EC Article 86 does not proscribe below cost selling specifically, although it does prohibit 'unfair' pricing. The characteristic of an unfair price may be close to an 'unreasonable' price in US anti-trust. It is more than likely that the first test case under Section 5 (2) (a) will abandon the case by case analysis of price in favour of a more robust definition. Collusive pricing behaviour or conscious parallelism which is endemic to local monopoly markets escapes direct proscription in the Irish Act.

MONOPOLISATION

The Irish Act replaces the concept of monopoly with that of "abuse of a dominant position". Section 5(1) states that "Any abuse by one or more undertakings of a dominant position in trade for any goods or services in the State or in a substantial part of the State is prohibited". While defining neither dominant position nor abuse, it does give instances of such abuse.

In the landmark US case on monopolisation, Standard Oil of New Jersey v US (1911), Judge White interpreted s1 of Sherman as condemning 'every undue or unreasonable restraint of trade'. The Court held that monopoly alone was not a violation of Sherman, but when this was combined with an intent to exclude, it amounted to a violation. Judge Hand in US v Aluminium Co. of America (1945) shifted the emphasis and the foundation of US anti-monopoly law. Rather than looking at the defendants' abusive market practices [none were shown], the court emphasised market structures and the firm's apparent market power. This was a major departure from Standard Oil and Judge Hand's ruling could be read as making monopoly power unlawful per se, even if it is a natural monopoly. The Court recognised conspiracy to monopolise as a separate offence in American Tobacco Co v US (1946). Conspiracy to monopolise differs from single firm monopolisation by not requiring proof of monopoly power and by showing a specific intent. This appears to be the direction within the Irish Act which (i) requires abuse to occur and (ii) does not offer a definition of a dominant position.

PROTECTING COMPETITION

The Clayton Act 1914 was an amendment to the 1890 Sherman Act and dealt with three specific categories of anti-competitive behaviour--price discrimination, exclusive or tying contracts and mergers. All three were held to be unlawful where "the effect may be substantially to lessen competition or tend to create a monopoly". Under the Sherman Act, it was necessary to prove that anti-competitive behaviour was unreasonable and prohibitive. This was interpreted by the rule of reason established by Standard Oil Co of New Jersey v US (1911). Under the Sherman Act, therefore, the monopoly would have to be in place before it could be prohibited. Therefore the Sherman Act could not be called protection since it did not prevent monopolies. It would appear from an initial reading that the Irish Act is in line with the principles of Sherman which concentrates on restraints of trade rather than on monopolisation.

If charged with price discrimination under US anti-trust law, the seller may escape in either of two ways (i) "cost justification" where the difference reflects the differences in the seller's costs of supplying, regardless of the impact upon other sellers. It has been applied narrowly as with US v Borden Co(1962). And secondly (ii) by showing that the lower price was charged 'in good faith to meet an equally low price of a competitor' and this defence is complete and overrides any showing of competitive injury as in Standard Oil Co v FTC (1951). Price discrimination is dealt with under the amended Section 2 of the Clayton Act. It is unlawful to price discriminate where the effect may be to substantially lesson or injure competition. For the economist, however, the seller who estimates that $P_i/P_j=MC_i/MC_j$ does not discriminate in price. A difference in price which allows for a difference in cost is not discriminating. However, the phenomenon of 'postage stamp pricing', selling at uniform price regardless of cost, is deemed to be discriminatory. Price structure was defined in FTC v Morton Salt Co (1948). Morton claimed that bulk order discounts were non-discriminatory and were available to everybody.

However, the courts ruled that these discounts were, in effect, only available to the largest retailers, thus small retailers would be disadvantaged.

Can this line of argument in future Irish cases be substantiated by economic theory, if the market in question--the retail food market--is size differentiated? This depends on whether or not the smaller retailer feels discriminated against; prima facie there is no way that a distributor can distinguish between a small and large retailer unless distribution arrangements reveal so. If such arrangements are institutionalised then the smaller retailer may be discriminated against. The issue is not one of disadvantage in paying a higher price for stock if the smaller convenience stores can charge higher prices which cover their higher costs, but rather whether an inbuilt bias exists against the smaller retailer at the point of distribution. Irish mitigating circumstances as regards price discrimination may include (i) discrimination is justified by cost differences [applicable really in a retailer-consumer interface] and (ii) discrimination is justified by a seller meeting competition in good faith. Under Section 3 of Clayton, tying contracts are not explicitly defined, but they have become the main targets of the Act. The issue centres on the leverage effect of a seller through a tying contract. It is suggested that this power can be used to exclude competitors in markets for tied products. Anti-trust laws suggest that the effect of an exclusive dealership was akin to that of a tying contract.

An arrangement similar to a tying arrangement exists in the market for lottery games in Ireland, with retailers prohibited from stocking more than one brand of lottery game. This restrains the rival firm for example, from gaining from the apparent absence of barriers to entry. However in economic theory, the economies of scale in advertising, created by an exclusive dealership ensures a monopoly position. An important issue is how the Irish Act interprets a restrictive agreement which in itself is dependent on the size of the market. In estimating the industry elasticity in order to determine the market structure, one should also take cognisance of firm specific market share both before and after the agreement. This would be of direct interest in the retail food sector and in the retail banking sector in Ireland.

In particular it could easily apply to the local grocer or the large firm both of whom exercise a degree of market power. The application of the Irish Act in this regard may require essentially a structural test rather than an abuse test. Also there is a test of presumptive illegality, the government need only prove the defendant's monopoly position to establish a prima facie case and then the burden of proof would shift to the defendant to show that it had not abused its position. Hence it would penalise vigorous competition by firms that acquire substantial market positions. In US anti-trust it would appear that the monopolist has a choice either to respond to the threat of entry by pricing at competitive levels and violate Sherman Section 2 or it disregards potential entrants by charging a monopoly price and invoke the Hand opinion and be deemed to have acted unreasonably and therefore illegally.

There is no de minimis provision in the Irish Act which would exempt firms of a certain size with no intent to restrain competition. One could assert that the Competition Authority may not have to show abusive market power. Sheer size may offend against the Irish Act in allowing for a firm to gain monopoly profits and power. Indeed this may be relevant to the Irish situation where firms are not defined as dominant, rather as abusing a dominant position. However as economists are aware it is the role played by the industry elasticity which clearly defines the extent of market power, that is, the ability to increase price without sustaining a loss in sales.

Without any definition of a dominant position, Section 5 indicates some abuses of such a position which will be prohibited in law. The categories of restraint of trade have been reduced from five in Section 4 to four in Section 5. Legal reasoning apart, the economic alarm bells sound when one identifies the absent category as that which referred to market division. It is not unusual for large firms, with dominant market share, to engage in market sharing. Airline companies have been found in breach of EC rules in this regard. While evidence of duopoly behaviour is difficult to obtain, the removal of this behaviour from the exclusionary practice under Section 5 weakens the implementation of the Act and may be conducive to such behaviour. The particular attention given to market division in the Act [S4(1)(c)] under the context of sharing markets, may not be consumer orientated; indeed its absence from Section 5 could support this point. A lesson from US anti-trust would have suggested the amalgamation of the subsections on tying arrangements and exclusionary practice rather than a dilution of this anti-competitive practice.

CONCLUDING COMMENTS

The debate over the interpretation of competition in current US anti-trust has been settled in favour of a Chicagoan interpretation which suggests that the competitive process would be ill-served if anti-trust was used to block aggressive competition. This allows the firm to achieve its dominant position on efficiency grounds rather than by foreclosure of potential entrants; the conclusion in this line of argument is that concentration and competition are not antithetical. Where the extent of competition is unknown a judge would require information on the elasticity of the industry demand curve. For example with different elasticities, a 2 firm and a 10 firm structure challenge the traditional economic theory. In other words a 10 firm structure with an industry elasticity of 0.5 is more monopolistic (measured as the divergence between price and LMC) than a 2 firm structure. In the Chamberlin model, the degree of industry demand elasticity influences profit. One would not have considered an industry which exhibits an oligopoly structure to have long run profit=0. A monopoly may have the power to influence elasticity over time; smaller firms acting collectively could do likewise. It could thus be argued that a monopoly structure defined by the rule P>LMC and by a small number of firms might initially be observed but the structure might not resemble a monopoly in the long run.

Section 4 s1(b) and s1(c) identify exclusionary restraints on trade, where s1(b) refers specifically to market exclusion. Market exclusion is introduced as a structural economic arrangement with no allowance for the conduct of firms in engaging in either pre-emptive advertising or product proliferation. Section 4 s1(c) refers to market division which is the quintessential textbook example of duopoly behaviour. As s1(d) refers to price discrimination one has to be cautious in the interpretation of price discrimination in the Irish Act. One would suspect that not all price discrimination is prohibited although it will be interesting to note the Authority's interpretation of the many examples of price discrimination which pervade our life from professional fees to coupons for purchase to multi-part pricing in supermarkets. Finally s1(e) refers to tying arrangements which in the evolution of US anti-trust have been connected to exclusionary practices.

Since the granting of licences to firms does enable them to escape proscription under the Irish Act, it is not necessary to allow continued immunity from anti-competitive activity at a time when increasingly more goods and services available to Irish consumers are either distributed or produced by firms who would rationally enter into market sharing arrangements with rival firms. The existence of a high degree of concentration is a necessary predicate for the exercise of market power. Indeed the pattern of price movements in some products is consistent with the exercise of that power which would make one curious to look further and evaluate additional information and evidence. Leaving aside the legal reason, the removal of 'control production' from Section 5 and the reference only to 'limiting production' is rather unhelpful from an economist's perspective in searching for duopolistic practices; in addition it appears contradictory to the spirit of anti-competitive legislation.

Limiting production could be excused by reference to the exigencies of market demand but control of production is very much within the remit of an abuse of a dominant position. What must not be overlooked is the significance of market power which can impact on the market. Whether an abuse of dominant position occurred or whether a restraint is reasonable or whether a price is unfair are economic issues, which may, over the next few years take second place to issues of [substantive] law, of interpretation of statute and adherence to precedent. Inferences must be drawn from the undisputed material facts of the case otherwise the role of economics will be denigrated. In addition, legislators should be aware that firms are wont to engage in co-operative action rather than compete. While this Act understands the need for competition policy it appears on a first reading to have adopted a Chicagoan approach which tends to misunderstand the real world conduct of firms. Under the guise of a general law, the Irish Competition Act may inadvertently further the interests of a limited group rather than the general welfare. In so doing it proffers an apology for rent-seeking behaviour.

CITATIONS

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