Misuse of Market Power: Rationale and Reform

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Misuse of Market Power:
Rationale and Reform

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The prohibition against misuse of market power in section 46(1) of the Competition and Consumer Act 2010 (Cth) (and its identical predecessor in the Trade Practices Act 1974 (Cth)) has been the subject of ongoing debate, and numerous legislative reviews, throughout its 40-year history. A recurring issue considered by these reviews is whether the provision should be amended to incorporate an 'effects-based test', which would allow liability to be established on the basis of the effect of the impugned conduct on the competitive process in the relevant market. In 2015, the Harper Review became the first of these reviews to recommend the adoption of an effects-based test and, in 2016, the government announced its intention to adopt this recommendation. The announcement remains controversial, praised by some as a long overdue 'strengthening' of the law, and criticized by others as protectionism for small businesses which would ultimately harm consumers.

This dissertation addresses the question whether Australia should adopt an effects-based test for misuse of market power. It does so in the context of the wider international debate about the appropriate standard for unilateral anticompetitive conduct, taking into account tests proposed for the characterization of unilateral anticompetitive conduct in other jurisdictions, especially the United States and the European Union. It makes a comparative analysis of several 'profit-focused tests', including the existing Australian 'take advantage' test, and several 'effects-based' tests, including the 'substantial lessening of competition' test proposed by the Harper Review. The respective proposals are evaluated in terms of their likely error costs, administrability and certainty.

This dissertation argues that, despite the apparently intractable debate between advocates of profit-focused tests and advocates of effects-based tests, a common thread can be identified. Upon closer analysis, each of the proposals reveals a central concern, not with the actual effect of the conduct, nor with its profitability for the dominant firm, but with the objective purpose of the conduct. The dissertation concludes that a standard which expressly focuses on whether the impugned conduct had an 'objective anticompetitive purpose' is superior to both the profit-focused and effects-based approaches advocated to date.

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Signed .....

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Chapter 4 contains material from Katharine Kemp, '"Taking Advantage" and Other "Profit-Focused" Tests for Unilateral Anticompetitive Conduct' (2016) 41 *Monash University Law Review* 655, and is reproduced by permission of the editors.

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List of Abbreviations

ACCC	Australian Competition and Consumer Commission
AIPA	*Australian Industries Preservation Act 1908* (Cth)
CCA	*Competition and Consumer Act 2010* (Cth)
EC Guidance Paper	*Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2
Harper Panel	Competition Policy Review Panel
Harper Proposal	Ian Harper et al, *Competition Policy Review: Final Report* (March 2015), Recommendation 30
Sherman Act	15 USC §§ 1-7 (1890)
TFEU	*Treaty on the Functioning of the European Union*, opened for signature 7 February 1992, [2009] OJ C 115/199 (entered into force 1 November 1993)
TPA	*Trade Practices Act 1974* (Cth)
TPC	Trade Practices Commission

CHAPTER 1: INTRODUCTION

I. RECENT DEVELOPMENTS

On 16 March 2016, Australian Prime Minister Malcolm Turnbull made an announcement that caused considerably more excitement than most on the subject of competition law.[1] In a joint press conference with the Treasurer and the Assistant Treasurer, Prime Minister Turnbull stated that: '[T]he Cabinet has agreed that we will move to amend section 46 in line with the recommendations of the Harper Review.'[2] He went on to explain that the proposed amendment would incorporate an 'effects test' for misuse of market power in section 46(1) of the *Competition and Consumer Act 2010* (Cth) ('*CCA*'), an amendment which he viewed as 'a vital economic reform'.[3]

The Prime Minister's announcement took many in the small business community by surprise, even in the midst of their long-running campaign to secure this very amendment.[4] The Former Chairman of the Australian Competition and Consumer Commission ('*ACCC*'), Allan Fels, applauded the government's decision as the adoption of 'an economically sound and sensible principle'.[5] By contrast, the Federal Opposition described the proposal as a 'multi-billion dollar disaster waiting to happen',[6] while the Chief Executive of the Retail Council argued that the government's decision

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[1] Gareth Hutchens, 'Turnbull Government Sides with Small Business, Agrees to Implement Controversial "Effects Test"', *Sydney Morning Herald* (online),16 March 2016 <http://www.smh.com.au/federal-politics/political-news/turnbull-government-sides-with-small-business-agrees-to-implement-controversial-effects-test-20160316-gnk6mx.html>.

[2] 'Joint Press Conference with the Treasurer and Minister for Small Business and Assistant Treasurer', Transcript (16 March 2016) <http://www.malcolmturnbull.com.au/media/joint-press-conference-with-the-treasurer-and-minister-for-small-business-a> ('*Joint Press Conference Transcript*').

[3] Hutchens, above n 1.

[4] Ibid.

[5] Allan Fels, 'Effects Test: The Case For', *The Australian Financial Review* (Sydney),17 March 2016, 39.

[6] Gareth Hutchens, 'Labor Wants to Make it Easier for Small Business to Litigate Large Businesses', *The Sydney Morning Herald* (online), 15 March 2016 < http://www.smh.com.au/small-business/labor-wants-to-make-it-easier-for-small-business-to-litigate-large-businesses-20160314-gnihx3.html >.

was 'simply bad policy and the consumer is the loser'.[7] This debate is likely to continue in Australia for some months (and possibly years) to come, given the protracted process required for the amendment of the relevant legislation.[8] Some predict that the 'effects test' issue will become a 'battleground' in the next federal election.[9]

II. THE MISUSE OF MARKET POWER DEBATE IN AUSTRALIA

The government's March announcement represents the most significant development in a debate that has endured in Australia for several decades. To explain, the prohibition of misuse of market power in section 46(1) of the *CCA* (and its identical predecessor in the *Trade Practices Act 1974* (Cth)) has been the subject of numerous parliamentary and independent reviews throughout its 40-year history.[10] A recurring issue considered by these reviews is whether section 46(1) should be amended to incorporate an 'effects test'.[11]

When section 46(1) was first enacted in 1974, its wording left some ambiguity as to whether it required the corporation in question to act with a certain purpose, or whether it was the effect of its conduct that mattered.[12] But in 1977 the provision was amended to remove that ambiguity: it was the corporation's purpose that determined the legality of its conduct.[13]

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[7] Hutchens, above n 1.

[8] See *Joint Press Conference Transcript*, above n 2. See also Part II below.

[9] Phillip Coorey and Patrick Durkin, 'Effects Tests to Become Election Battleground', *The Australian Financial Review* (Sydney), 17 March 2016, 5.

[10] See Stephen Corones, 'The Characterisation of Conduct under Section 46 of the *Trade Practices Act*' (2002) 30 *Australian Business Law Review* 409; Geoff Edwards, 'The Hole in the Section 46 Net: The Boral Case, Recoupment Analysis, the Problem of Predation and What to Do About It' (2003) 31 *Australian Business Law Review* 151. See further Chap 3 Part III(C)(2) herein.

[11] See Chap 3 Part III(C)(2) herein.

[12] See Trade Practices Act Review Committee, Parliament of Australia, *Report to The Minister for Business and Consumer Affairs* (1976) 39. The provision was originally enacted as *Trade Practices Act 1974* (Cth) s 46(1).

[13] *Trade Practices Amendment Act 1977* (Cth) s 25. See further Chap 3 Part III(C)(1) herein.

The current text of section 46(1) reads as follows:

> A corporation that has a substantial degree of market power in a market shall not take advantage of that power in that or any other market for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
> (b) preventing the entry of a person into that or any other market; or
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

If a corporation with a substantial degree of market power takes advantage of that power for one of the three proscribed purposes, it misuses its market power. The corporation's purpose in engaging in the conduct is highlighted by the provision, but the requirement that the corporation 'takes advantage' of its market power is also critical.[14]

The ACCC, and a number of commentators and small business groups, have argued that the existing 'take advantage' and 'purpose' elements in section 46(1) restrict the reach of the provision, such that it fails to capture or deter significant instances of unilateral anticompetitive conduct.[15] They argue that the prohibition would be more effective in capturing anticompetitive conduct if it focused on the effect, or likely effect, of the impugned conduct on the competitive process in the relevant market.[16]

Since the 1970s, there have been thirteen parliamentary and independent reviews, and one Green Paper, which have considered the effectiveness of section 46(1).[17] Each

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[14] See Chap 3 Part III(D) herein.

[15] See, eg, ACCC, Submission to the Competition Policy Review Panel, *Reinvigorating Australia's Competition Policy*, 25 June 2014, 78–80; Stephen Corones, Submission to the Competition Policy Review Panel, *Competition Policy Review Committee Submission*, 8 October 2014, 7–10; Small Business Development Corporation (WA), Submission to the Competition Policy Review Panel, *Submission to the Competition Policy Review Draft Report*, November 2014, 7–9.

[16] Ibid.

[17] Trade Practices Act Review Committee, Parliament of Australia, *Report to The Minister for Business and Consumer Affairs* (1976) 39 ('*Swanson Report*'); Trade Practices Consultative Committee, Parliament of Australia, *Small business and the Trade Practices Act: Volume 1* (1979) ('*Blunt Report*');

review received submissions that section 46(1) should be amended to include an effects-based test[18] for misuse of market power.[19]

In the main, the arguments raised in submissions to, and commentary concerning, the legislative reviews have been consistent on each side of the debate. Proponents of an effects-based test argue that the absence of such a test is inconsistent with the purpose of the legislation and the purpose of section 46.[20] Given that the objective of section 46(1) is the protection of the competitive process in the long-term interests of consumers,[21] it is only logical that the provision should require some impact on the competitive process from which consumer harm can be inferred.[22] An effects-based test,

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Parliament of Australia, *The Trade Practices Act: Proposals for Change* (1984) ('*1984 Green Paper*'); House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989) ('*Griffiths Report*'); Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Monopolies and Acquisitions: Adequacy of Exisitng Legislative Controls* (1991) ('*Cooney Report*'); Committee of Review of the Application of the Trade Practices Act 1974, Parliament of Australia, *National Competition Policy* (1993) ('*Hilmer Report*'); House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Finding a Balance: Towards Fair Trading in Australia* (1997) ('*Reid Report*'); Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia's Retailing Sector* (1999) ('*Baird Report*'); House of Representatives Standing Committee on Economics, Finance and Public Administration, Parliament of Australia, *Competing Interests: Is There Balance? Review of the Australian Competition and Consumer Commission Annual Report 1999-2000* ('*Hawker Report*'); Senate Legal and Constitutional References Committee, Parliament of Australia, *Inquiry into s 46 and s 50 of the Trade Practices Act 1974* (2002) ('*McKiernan Report*'); Trade Practices Act Review Committee, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act* (2003) ('*Dawson Report*'); Senate Economics References Committee, Parliament of Australia, *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* (2004) ('*Stephens Report*'); Senate Economics References Committee, Parliament of Australia, *The Impacts of Supermarket Price Decisions on the Dairy Industry* (2011) ('*Dairy Report*'); Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) ('*Harper Final Report*').

[18] See the definition of this term in Part III below.

[19] See, eg, *Cooney Report*, above n 17, 82–3; *Hilmer Report*, above n 17, 68; *Dawson Report*, above n 17.

[20] See, eg, ACCC, Submission No 56 to the Trade Practices Act Review Committee, *Submission to the Trade Practices Act Review*, June 2002, 79–80 ('*ACCC Submission 2002*'); Corones, 'Characterisation of Conduct', above n 10, 409–11.

[21] See Chap 3 Part IV herein.

[22] See Corones, 'Characterisation of Conduct', above n 10, 409–11.

it is argued, would also bring section 46 into line with other prohibitions in Part IV of the Act, which incorporate a 'substantial lessening of competition' test.[23]

Proponents of an effects-based test have also raised the difficulties inherent in proving subjective purpose.[24] The Australian courts have acknowledged 'the notoriously difficult task of satisfying the criteria of liability' under section 46(1).[25] According to the ACCC, an effects-based test would overcome difficulties in proving purpose in a range of circumstances, particularly as corporations become more sophisticated about covering their tracks and concealing their intentions.[26] At the time of the Dawson Review in 2002,[27] the ACCC stated that it had not taken action under section 46(1) for about six years and that, on a number of occasions, it did not take such action because it considered that it could not prove the necessary purpose.[28] At the same time, the purpose element has been criticised as over-broad since the proscribed purposes extend to the purpose of 'eliminating or substantially damaging a competitor', a purpose which is well within the normal goals of any warm-blooded, competitive firm.[29]

The existing 'take advantage' test for misuse of market power has also been criticised. Given that the objective of the provision is to protect the competitive process in the interests of consumers,[30] it is argued that the 'take advantage' test is under-inclusive. In particular, the courts have interpreted this element in a way that permits a corporation to preserve or increase its substantial market power, without creating any benefit for consumers, so long as the corporation does not 'use' its market power to achieve that

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[23] Ibid. Eg, a 'substantial lessening of competition' test is incorporated in *CCA* ss 45, 47.

[24] Ibid 413. See, eg, *ACCC Submission 2002*, above n 20, 80–1, 88.

[25] See *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90, 122 [85].

[26] *ACCC Submission 2002*, above n 20, 79, 82–3.

[27] See *Dawson Report*, above n 17.

[28] *ACCC Submission 2002*, above n 20, 81, 88.

[29] See *Harper Final Report*, above n 17, 339.

[30] See Chap 3 Part IV herein.

end.[31] Further, the phrase 'take advantage' is sufficiently open to interpretation that the case law has produced various complex (and sometimes conflicting) statements about how this element may be proved.[32] This impedes both the ability of courts to apply the provision in a consistent manner and the ability of corporations to predict in advance whether a proposed strategy is lawful.

Those who oppose the introduction of an effects-based test claim that such a test would unjustifiably extend the scope of section 46(1), leading to an increased risk of false positive errors,[33] and a consequent dampening of the socially beneficial urge to compete on the part of corporations with market power.[34] Opponents argue that the test would introduce unwarranted and harmful uncertainty for big business.[35] There is also an argument that if section 46(1) were amended to include an effects-based test, a further amendment would be required to permit an efficiency defence (which the provision does not presently allow) to take account of the fact that any anticompetitive effect may be substantially offset by efficiency benefits flowing from the same conduct.[36]

Notwithstanding the persistent proposals for an effects-based test, earlier review committees either deferred consideration of this issue, or refused to recommend such a change on the ground that the existing provision had not been proved defective and a

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[31] See Chap 4 Part VI(E) herein.

[32] See Margaret Brock, 'Section 46 of the *Trade Practices Act* — Has the High Court Made a "U-Turn" on "Taking Advantage"?' (2005) 33 *Australian Business Law Review* 327; Jeffrey M Cross, J Douglas Richards, Maurice E Stucke and Spencer Weber Waller, 'Use of Dominance, Unlawful Conduct, and Causation Under Section 36 of the New Zealand's Commerce Act 1986: A United States Perspective' (2012) 18 *New Zealand Business Law Quarterly* 333, 337–40.

[33] That is, the unwarranted condemnation of conduct that is actually efficient and competitive. See Part V(B) below.

[34] See, eg, Productivity Commission, Submission No 125 to the Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, July 2002, 16–18; Telstra Corporation Ltd, Submission No 117 to the Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, July 2002, 11–15.

[35] Productivity Commission, above n 34, 25–8; Telstra Corporation Ltd, above n 34, 11–15.

[36] Telstra Corporation Ltd, above n 34, 11–15. See also Corones, 'Characterisation of Conduct', above n 10, 419.

substantial amendment would create unacceptable uncertainty for the business community with the likely effect of deterring competitive conduct.[37] Until 2014, only the *1984 Green Paper* recommended the adoption of an effects-based test.[38] By contrast, in 2003, the *Dawson Report* went as far as to say that, given the number of times an effects-based test had been considered and rejected, the effects issue should not be considered by future periodic reviews.[39]

Nonetheless the proposal continued to demand attention. In the course of the 2011 Senate Economics References Committee Review, the Chairman of the ACCC, Rod Sims, stated in respect of section 46:

> [M]y own view is that the biggest issue is whether it should be a purpose or effects test. To me, that is where the rubber hits the ground, and that is, I think, a legitimate issue to debate.[40]

The Committee went on to recommend that the government initiate an independent review of the effectiveness of the *CCA*.[41] In 2013, the new Coalition government promised an independent 'root-and-branch' review of Australian competition law and policy.[42]

In 2014, the Competition Policy Review Panel ('Harper Panel') conducted the first wholesale review of Australian competition policy in over 20 years and, in March 2015, created significant controversy by recommending the adoption of an effects-based test for misuse of market power.[43]

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[37] See Chap 3 Part III(C)(2) herein.

[38] *1984 Green Paper*, above n 17, 8.

[39] *Dawson Report*, above n 17, 82.

[40] *Dairy Report*, above n 17, 107.

[41] Ibid 115.

[42] See Joe Hockey, 'Australia: Open for Business' (Speech delivered at American Australian Association, New York, 15 October 2013).

[43] *Harper Final Report*, above n 17, 335–47

In particular, the Harper Panel recommended that section 46(1) be repealed and replaced by the following provision:

> A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market. [44]

The Harper Panel argued that this amendment would draw the focus away from the over-broad question whether the corporation intended to harm its rivals, and towards the relevant question whether the conduct had the purpose, effect or likely effect, of damaging the competitive *process*.[45] The Harper Panel also pointed out that this wording would create consistency between section 46(1) and other provisions in Part IV of the *CCA* which refer to conduct which has, or a provision of a contract, arrangement or understanding which has, 'the purpose, or has or is likely to have the effect, of substantially lessening competition'.[46]

While the government has now indicated its intention to adopt this recommendation, the actual amendment of section 46(1) is likely to take some time. According to the intergovernmental *Conduct Code Agreement 1995*,[47] the federal government must consult with, and seek the approval of, the States and Territories regarding proposed changes to Part IV of the *CCA*, which includes section 46(1).[48] The *Harper Final Report* recommended that exposure draft legislation be prepared within 12 months of accepting the recommendations in consultation with States and Territories and that

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[44] Ibid 344–5. The Harper Panel also recommended that the new s 46 incorporate legislative guidance on the meaning of this test, and that 'authorisation' should be permitted in respect of conduct which would otherwise be captured by s 46(1), as explained in Chap 5 Part VI.

[45] Ibid 339–1.

[46] Ibid 341. See *CCA* ss 45(2)(a),(b), 47(10), read with ss 4D, 4F.

[47] Council of Australian Governments, *Conduct Code Agreement 1995*, cl 6, 7.

[48] *Harper Final Report*, above n 17, 310.

finalised amendments be put to the States and Territories for their approval within two years.[49]

III. RESEARCH AIMS AND QUESTIONS

The aim of this dissertation is to determine whether the general law against misuse of market power in Australia, namely section 46(1) of the *CCA*, should be amended to include an 'effects-based test'. For these purposes, an 'effects-based test' is defined as a test for the characterisation of unilateral anticompetitive conduct,[50] which focuses on the effect, or likely effect, of the impugned conduct on competition in the relevant market.

This is not a concept with a single meaning, rather it has been given different content by authorities in different places and eras, depending on their understanding of the meaning and value of competition, and their theory as to what kind of proof of impact is sufficient to warrant intervention.[51] However, all of these tests have in common a professed concern with the actual or probable effect of the conduct on the competitive process, as opposed to its effect on any individual competitor.[52] They also seek to determine the objective impact of the firm's conduct, as opposed to the subjective intent or purpose of the firm.[53]

The question whether section 46(1) should be amended to include an effects-based test must be answered within the Australian context, taking into account the objective of the misuse of market power prohibition in Australia.[54] It therefore requires an analysis of how accurately the respective tests can identify unilateral conduct that is harmful to the competitive process and ultimately consumers, and, just as importantly, how reliably the

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[49] Ibid.

[50] See the definition of 'unilateral anticompetitive conduct' in Chap 2 Part VIII herein.

[51] See Chap 5 Parts III–VII herein.

[52] Ibid.

[53] Ibid.

[54] See Chap 3 Part IV herein.

tests can be applied by courts, and by firms seeking to determine in advance whether proposed conduct will contravene the provision.[55] There is no benefit in having a test that perfectly describes harmful unilateral conduct if it can only be accurately applied by a Nobel Prize-winner.

Further questions addressed by this dissertation include:

- What is the underlying rationale for regulating single-firm conduct in the context of competition laws?
- What is the underlying rationale and objective of the current prohibition against misuse of market power in Australia, and particularly the critical 'take advantage' element?
- Is there any substantial deficiency in the existing misuse of market power law having regard to its objective?
- If so, would a legal standard that focuses on the effect of the impugned conduct on the competitive process be more appropriate, having regard to the likely error costs, administrability and certainty of the respective standards?
- Is there an alternative standard which overcomes the disadvantages of relying on either the 'take advantage' test or an effects-based test for unilateral anticompetitive conduct?

These last three questions are addressed, in part, by a comparative analysis of various legal tests adopted and proposed for the characterisation of unilateral anticompetitive conduct both in Australia and in other jurisdictions, including the United States ('US') and the European Union ('EU'). To provide the context for this choice of methodology it is first necessary to outline the broader debate about unilateral conduct standards in the international antitrust community.

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[55] See Part V below.

IV. BACKGROUND TO THE 'UNILATERAL CONDUCT' DEBATE

A. The International Context

Unilateral anticompetitive conduct has been called the 'new frontier' in competition law.[56] The area is not 'new' in the sense that it is being addressed by competition law for the first time. Rather, it has attracted increasing attention in recent decades, particularly as international competition law networks have attempted to reach some consensus on the types of unilateral conduct that should be sanctioned by competition laws.[57] Despite these efforts, economists and lawyers have struggled to arrive at a coherent and defensible theory about the kind of competition mischief a firm can cause while acting alone, as well as the types of unilateral conduct that courts can reliably remedy.[58] The debate on how to characterise unilateral conduct has often been sharpened by ideological and intellectual differences.[59] After all, what is at stake is the ability of firms to exercise economic power at the expense of consumers and society as a whole, or conversely the unnecessary restraint of firms acting efficiently for the benefit of society as a whole.

In recent decades, the main tension internationally has been between the 'economics-based' approach to unilateral anticompetitive conduct in the US and the more 'formalistic' approach to such conduct in the EU.[60] This tension has sometimes been

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[56] Paul Crampton, '"Abuse" of "Dominance" in Canada: Building on the International Experience' (2006) 73 *Antitrust Law Journal* 803, 803.

[57] See, eg, International Competition Network Unilateral Conduct Working Group, 'Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies' (Paper presented at the 6th Annual Conference of the ICN, Moscow, May 2007); Giorgio Monti, 'Unilateral Conduct: The Search for Global Standards' in Ariel Ezrachi (ed), *Research Handbook of International Competition Law* (Edward Elgar, 2013) 345.

[58] See A Neil Campbell and J William Rowley, 'The Internationalization of Unilateral Conduct Laws – Conflict, Comity, Cooperation and/or Convergence?' (2008) 75 *Antitrust Law Journal* 267, 268–75.

[59] See Chap 2 Parts III–VII herein.

[60] See, eg, Philip Marsden, 'Exclusionary Abuses and the Justice of "Competition on the Merits"' in Ioannis Lianos and Ioannis Kokkoris (eds) *The Reform of EC Competition Law: New Challenges* (Kluwer Law International, 2010) 413–6.

more than intellectual, with the US and EU antitrust authorities reaching contrary decisions concerning the same practices in major cases.[61] While comparisons have often been drawn between the approaches of these two jurisdictions, there have also been enduring debates over appropriate antitrust standards for unilateral conduct *within* each of these jurisdictions.

B. The United States

In the US, the general prohibition against unilateral anticompetitive conduct is found in the law against monopolization in section 2 of the *Sherman Act*,[62] which provides that:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.[63]

Trends in the application and enforcement of section 2 changed during the twentieth century. In the 1950s and '60s, under the influence of the Harvard School of anitrust,[64] US antitrust authorities and courts tended to distrust the ability of unassisted market forces to correct market failures; to condemn dominant firm conduct without sufficient investigation; and to protect small businesses, regarding the rivalry of numerous smaller

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[61] See Assistant Attorney General for Antitrust, US Department of Justice, R Hewitt Pate, *Statement on the EC's Decision in its Microsoft Investigation* (24 March 2004); *British Airways plc v Commission of the European Communities* (T-219/99) [2003] ECR II-5917; *Virgin Atlantic Airways Ltd v British Airways plc* 69 F Supp 2d 571, 580 (SDNY 1999), affirmed, 257 F 3d 256 (2d Cir 2001).

[62] 15 USC §§ 1-7 (1890) ('*Sherman Act*'). There are other US antitrust laws which address unilateral conduct in a more limited way, including Federal Trade Commission Act § 5, 15 USC § 45; Robinson-Patman Act, 15 USC § 13(a): see Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart Publishing, 2nd ed, 2011) 265–7.

[63] *Sherman Act* § 2.

[64] See Chap 2 Part V herein.

firms as valuable in itself.[65] From the late 1970s, however, US antitrust courts and agencies began to adopt a much narrower, potentially under-inclusive, approach to the enforcement of section 2, in large part due to the 'chastening' influence of the Chicago School, which challenged the assumptions of the Harvard School and expressed great skepticism about the plausibility of previously accepted categories of monopolistic conduct.[66]

At the turn of the twenty-first century there began a period of intense debate about the appropriate standard to be applied in monopolisation cases.[67] There was, at this stage, significant uncertainty about the state of the law concerning monopolisation.[68] The Department of Justice very rarely brought cases under section 2,[69] and the Supreme Court of the United States granted certiorari in monopolisation cases even more rarely.[70] The renewed debate was fuelled in large part by two highly publicised cases which were exceptions to these trends, namely *United States v Microsoft Corp* ('*Microsoft*'),[71] and *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP* ('*Trinko*').[72]

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[65] See Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 1–2, 9, 41; Jonathon B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 610.

[66] See Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 109–11. See Chap 2 Part VI herein.

[67] See Steven C Salop and R Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft' (1999) 7 *George Mason Law Review* 617, 617; Mark S Popofsky, 'Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules' (2006) 73 *Antitrust Law Journal* 435, 435.

[68] See Salop and Romaine, above n 67, 649.

[69] See William E Kovacic, 'Politics and Partisanship in US Federal Antitrust Enforcement' (2014) 79 *Antitrust Law Journal* 687, 688.

[70] See Einer Elhauge, 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 271. See also Hovenkamp, *Antitrust Enterprise*, above n 65, 6–7.

[71] 253 F 3d 34 (DC Cir, 2001).

[72] 540 US 398 (2004). See Popofsky, above n 67, 435.

In 1998, the US Department of Justice under the Clinton administration brought proceedings against Microsoft, alleging that the company had engaged in monopolisation and thereby contravened section 2 of the Sherman Act.[73] The central allegations in the *Microsoft* case concerned various exclusionary practices adopted by Microsoft to protect its dominance in the market for computer operating systems, giving rise to an enormous volume of commentary on, and theorising about, the proper characterisation of unilateral conduct.[74]

In 2001, the DC Circuit in *Microsoft* outlined a 'structured rule of reason analysis' to be applied in section 2 cases.[75] This analysis focused on the competitive effects of the impugned conduct, requiring the plaintiff to prove that the conduct had an 'anticompetitive effect' but also taking into account 'procompetitive justifications' offered by the defendant and, where necessary, weighing the two against each other.[76] The judgment of the DC Circuit encouraged some commentators to advocate an effects-based test for monopolisation claims under section 2.[77]

By contrast, in 2004, the Supreme Court in *Trinko* appeared to advocate a much narrower approach to section 2 cases.[78] *Trinko* concerned a claim that a telecommunications company had breached section 2 by refusing to provide new rivals with full access to the local telephone loop. Critically, the Court held that there would

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[73] Baker, above n 65, 607. The case was finally, and controversially, settled in the first year of the Bush administration.

[74] See, eg, Salop and Romaine, above n 67; J Bruce McDonald, 'Antitrust Division Update: *Trinko* and *Microsoft*' (Speech delivered at the Houston Bar Association, Antitrust and Trade Regulation Section, 8 April 2004); David McGowan, 'Between Logic and Experience: Error Costs and *United States v Microsoft Corp*' (2005) 20 *Berkeley Technology Law Journal* 1185.

[75] See Chap 5 Part III(C) herein.

[76] Ibid.

[77] See, eg, Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311. See further Chap 5 Part III herein.

[78] See Eleanor M Fox, 'Is There Life in *Aspen* After *Trinko*? The Silent Revolution of Section 2 of the Sherman Act' (2005) 73 *Antitrust Law Journal* 153, 155; Edward D Cavanagh, 'Detrebling Antitrust Damages in Monopolization Cases' (2009) 76 Antitrust Law Journal 97, 106.

be no claim under section 2 when the right to access was regulated by a separate legislative regime, as in this case. However, the Court also warned more generally of the need to exercise restraint in imposing liability under section 2, having regard to the risk that an over-inclusive approach could deter dominant firms from undertaking socially beneficial investments and practices.[79] Some considered that the judgment of Scalia J supported the view that it should be necessary for plaintiffs to prove a 'profit sacrifice' on the part of the defendant in monopolisation cases.[80]

These cases gave rise to vigorous debate concerning the appropriate standard for monopolisation, in which commentators proposed a variety of tests for characterising unilateral conduct as anticompetitive.[81] In Hovenkamp's words, the literature at this time was 'preoccupied to the point of obsession with the formulation of a single test for exclusionary conduct'.[82] Notwithstanding the depth of commentary in this area, there remains significant uncertainty about the basis on which unilateral anticompetitive conduct should be condemned under section 2. As Lambert recently commented, 'There is a problem with Section 2 of the Sherman Act: nobody knows what it means.'[83]

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[79] 540 US 398, 407–8, 414 (2004). See also Jonathan B Baker, 'Taking the Error Out of 'Error Cost' Analysis: What's Wrong with Antitrust's Right' (2015) 80 *Antitrust Law Journal* 1, 13.

[80] See Chap 4 Part III(D),(E) herein.

[81] See Chaps 4, 5 herein.

[82] See Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 114.

[83] Thomas A Lambert, 'Defining Unreasonably Exclusionary Conduct: the 'Exclusion of a Competitive Rival' Approach' (2014) 92 *North Carolina Law Review* 1175, 1178. See also Jonathan B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 606, 640, describing the publication of the report on single-firm conduct by the US Department of Justice under the Bush administration, which was withdrawn by the Department just months later under the Obama administration.

C. The European Union

In recent decades, there has also been vigorous debate concerning unilateral conduct standards in the EU. Unilateral anticompetitive conduct is addressed by Article 102 of the TFEU,[84] which states that:

> Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibitied as incompatible with the internal market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other practices of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

From the late 1990s, the EU began a process of 'modernising' its competition laws.[85] Central to this process was the acknowledgement that the assessment of competition complaints should depend on an analysis of the actual competitive effects of the impugned conduct, and not on presumptions that certain forms of conduct were anticompetitive and therefore unlawful per se.[86]

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[84] *Treaty on the Functioning of the European Union*, opened for signature 7 February 1992, [2009] OJ C 115/199 (entered into force 1 November 1993) ('TFEU').

[85] Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart Publishing, 2nd ed, 2013) 47–8.

[86] Ibid 67–73. See also Liza Lovdahl Gormsen, *A Principled Approach to Abuse of Dominance in European Competition Law* (Cambridge University Press, 2010) 1–3.

The Commission of the European Communities ('European Commission') and the EU courts[87] had traditionally taken a relatively expansive approach to the enforcement of competition law, often condemning conduct based on its form without having regard to its likely economic effects in a given case.[88] As part of the process of modernisation, various aspects of the competition law, including merger analysis and vertical restraint guidelines, were reformed so as to focus on the economic effects of the relevant conduct.[89] A similar process was attempted in respect of unilateral conduct, but, in this area, the EU courts demonstrated a marked reluctance to move towards an effects-based analysis.[90]

The European Commission commissioned and received an expert economic report, which recommended an effects-based approach to unilateral anticompetitive conduct under Article 102.[91] This report in turn led to the publication of the 'DG Competition Staff Discussion Paper' in December 2005, produced by the Directorate General for Competition,[92] which adopted an effects-based, consumer welfare standard for exclusionary abuses.[93] The Discussion Paper stimulated lively debate, but, in the

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[87] Ie, the General Court (previously the Court of First Instance) and the European Court of Justice.

[88] Jonathan Faull and Ali Nikpay, *The EU Law of Competition* (Oxford University Press, 3rd ed, 2014) 348 [4.85]–[4.88]; Gormsen, above n 86, 5.

[89] Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 2011) 197–201, 650–1.

[90] Ibid 273, 275.

[91] Economic Advisory Group on Competition Policy, *An Economic Approach to Article 82* (July 2005) 3, advocating an 'economics-based approach' to abuse of dominance claims, which 'requires a careful examination of how competition works in each particular market in order to evaluate how specific company strategies affect consumer welfare'.

[92] The Directorate General for Competition is the division of the European Commission responsible for competition policy.

[93] Directorate General for Competition, European Commission, *DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* (December 2005). See Jones and Sufrin, above n 89, 274.

absence of any shift in the case law, the Commission could not issue guidelines that incorporated such an approach.[94]

Accordingly, in February 2009, the European Commission instead adopted a 'Guidance Paper' which set out its own 'enforcement priorities' in respect of exclusionary abuse of dominance claims ('*EC Guidance Paper*').[95] The *EC Guidance Paper* does not have the force of law, nor is it representative of the existing legal position in the European Union: rather it outlines the manner in which the Commission will determine which claims of exclusionary abuse of dominance warrant investigation and prosecution.[96] The Commission's approach in the *EC Guidance Paper* is expressly based on economic analysis and requires a demonstration of the effects of the conduct.[97]

In the last decade, therefore, the European Commission has shown an increasing inclination to follow the more economics-based approach of the United States and to require proof that a dominant firm's conduct has an anticompetitive effect on the market.[98] Scholars and practitioners have watched with intrigue, waiting for some sign that the EU courts are changing their approach to unilateral conduct in favour of the 'more economic', effects-based approach suggested by the Commission in its *Guidance*

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[94] See Faull and Nikpay, above n 88, 351–2; Jones and Sufrin, above n 89, 274.

[95] *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2 ('*EC Guidance Paper*').

[96] See O'Donoghue and Padilla, above n 85, 75. The *EC Guidance Paper* has nonetheless been criticised for creating uncertainty by putting forward different tests to those set out in the case law or expressing legal tests in a way that does not reflect judicial precedent: see, eg, Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 155–68.

[97] *EC Guidance Paper*, above n 95.

[98] See David Gerber, *Global Competition: Law, Markets and Globalization* (Oxford University Press, 2010) 187–98; cf Assistant Attorney General for Antitrust, US Department of Justice, R Hewitt Pate, *Statement on the EC's Decision in its Microsoft Investigation* (24 March 2004).

Paper. Some claim that there are indications that this is already occurring, but the position remains uncertain.[99]

V. OUTLINE OF RESEARCH METHODOLOGIES

A. Comparative Analysis

Choosing to sanction unilateral anticompetitive conduct brings with it certain risks which have become the perennial concerns in this area. A number of issues are repeated across various jurisdictions. How can the theory that firms with market power are able to harm competition be translated into a standard or rule that allows courts to reliably identify such conduct? How can tests avoid capturing conduct that results overwhelmingly in improved long-term consumer welfare even if it has some exclusionary effect? How do different standards treat the problem of inadvertent conduct by firms? How do they avoid discouraging vigorous, beneficial competition by dominant firms?

This time of change (or potential change) in unilateral conduct laws has provided fertile ground for international debate, and comparative analyses of unilateral conduct laws in the US and the EU abound.[100] But comparisons that include jurisdictions outside the transatlantic spotlight are limited, and comparisons that include Australia even more so.[101] Scholars from the US and the EU acknowledge the distortion in international

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[99] See, eg, Ekaterina Rousseva and Mel Marquis, 'Hell Freezes Over: A Climate Change for Assessing Exclusionary Conduct under Article 102 TFEU' (2013) 4 *Journal of European Competition Law* 32.

[100] See, eg, Gerber, above n 98; Damien Geradin 'Competition Law' in Jan M Smits (ed), *Elgar Encyclopedia of Comparative Law* (Edward Elgar, 2nd ed, 2012) 208–9; Hedvig Shmidt, 'Market Power – The Root of All Evil? A Comparative Analysis of the Concepts of Market Power, Dominance and Monopolisation' in Ariel Ezrachi (ed), *Research Handbook on International Competition Law* (Edward Elgar, 2013); Philip Marsden and Liza Lovdahl Gormsen, 'Guidance on Abuse in Europe: The Continued Concern for Rivalry and a Competitive Structure' (2012) 55 *The Antitrust Bulletin* 875.

[101] There are rare exceptions: see, eg, George A Hay and Rhonda L Smith, '"Why Can't a Woman Be More Like a Man?" – American and Australian Approaches to Exclusionary Conduct' (2007) 31 *Monash University Law Review* 1099.

competition law discourse created by the overwhelming focus on those two jurisdictions.[102]

From an Australian perspective, a comparative analysis of unilateral conduct standards from other jurisdictions may be particularly useful in revealing how others navigate the common pitfalls of legislating against unilateral conduct, and whether better solutions might be available for Australia. At the same time, as outlined in the foregoing sections, the law against unilateral anticompetitive conduct in both of the major jurisdictions is presently subject to significant uncertainty.

Acknowledging this uncertainty, this dissertation does not attempt to define the existing legal position on unilateral anticompetitive conduct in the US or the EU. Instead it compares the current and proposed legal tests for unilateral anticompetitive conduct in Australia with various tests proposed for the characterisation of unilateral conduct in other jurisdictions, including those outlined in the reasoning of the D C Circuit in the *Microsoft* case and in the *EC Guidance Paper*.

The purpose of this analysis is to consider whether section 46(1) of the *CCA* should be amended and, accordingly, it is the 'social problem' that section 46(1) addresses that should act as the point of comparison.[103] The relevant social problem is that some firms, acting unilaterally, can engage in conduct that harms the competitive process and, ultimately, consumer welfare.[104] The standards, and proposed standards, compared in this dissertation are particularly concerned with identifying the type of unilateral conduct that should be prohibited under competition laws, having regard to the need to deter conduct which harms the competitive process and ultimately consumers, without unduly deterring vigorous competition which would otherwise benefit consumers.

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[102] See David J Gerber 'Comparative Antitrust Law' in Mathias Reimann and Reinhard Zimmerman (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press, 2006).

[103] See Konrad Zweigert and Hein Kotz, *An Introduction to Comparative Law* (Oxford University Press, 1998) 45.

[104] See Chap 2 Part III(E).

A word should be said about the use of the terms 'standards' and 'tests'. Laws prohibiting unilateral anticompetitive conduct tend to take the form of 'standards' rather than 'rules'. That is, they tend to make liability depend on more open-ended considerations rather than on 'a small number of concrete factors'.[105] The unilateral conduct standards considered in this dissertation share a number of characteristics, including their restricted application to firms with a certain degree of market power,[106] and their condemnation of particular conduct on the part of such firms as opposed to the possession of market power per se.[107] They also adopt certain legal 'tests' for the characterisation of unilateral conduct. For example, the misuse of market power prohibition proposed by the Harper Panel incorporates a 'substantial lessening of competition' test to determine when conduct should be regarded as anticompetitive and therefore condemned, or inoffensive and therefore absolved. The comparative analysis which follows focuses in particular on the legal tests proposed or adopted for the characterisation of unilateral anticompetitive conduct.

The use of the term 'dominant firm' also requires some qualification. In Australia, section 46(1) refers to a corporation with 'a substantial degree of power in a market'. In the EU and the US, the relevant laws refer to a firm with a 'dominant position' or to 'monopolists' or firms with 'monopoly power'. In this dissertation, the term 'dominant firm' is frequently used for ease of reference, particularly in the comparative analysis, but it should be acknowledged that the Australian concept of 'substantial market power' does not require the firm to control or dominate the market.[108]

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[105] See Daniel A Crane, 'Does Monopoly Broth Make Bad Soup?' (2010) 76 *Antitrust Law Journal* 663, 664, explaining the difference between antitrust 'standards' and 'rules'. See also Popofsky, above n 67, 457; Baker, above n 79, 31.

[106] As explained in Chap 2 Part IX herein.

[107] See Chap 2 Part VII, VIII herein.

[108] See *CCA* s 46(3C)–(3D) and Chap 2 Part IX herein.

B. Evaluation of Laws: Error Cost Analysis

Comparison alone is a not a strong basis for normative argument.[109] This dissertation evaluates the legal tests for unilateral conduct on the basis of their respective error costs, their certainty for firms seeking to comply with the law (or compliance costs), and their administrability. A legal test that identifies anticompetitive conduct with a great degree of accuracy may still be undesirable if it is inordinately costly or impracticable for the relevant authorities to apply, hence the consideration of administrability.[110] Similarly, a highly accurate rule may be inappropriate if it makes it very difficult for firms and their advisers to predict in advance whether their proposed conduct will fall foul of the rule: accordingly, the certainty of the rule for businesses must be taken into account.[111]

The use of an error cost analysis requires more detailed explanation. Error-cost analyses are based on 'decision theory', which is concerned with optimal choice in the presence of uncertainty.[112] The use of such a framework in respect of legal rules begins with the acknowledgement that, given imperfect information, the application of any legal rule inevitably results in some errors, but that the resulting social cost of different legal rules varies. This type of analysis allows different rules to be compared on the basis of their respective error costs, error cost being the product of the *likelihood* of error and the *cost* of error associated with each solution.[113] Ideally legal rules will be designed such that the total cost of legal error is minimised.

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[109] See Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann and Reinhard Zimmerman (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press, 2006) 375.

[110] See William E Kovacic, 'The Intellectual DNA of Modern US Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix' [2007] *Columbia Business Law Review* 1, 32–5; Fred S McChesney, 'Easterbrook on Errors' (2010) 6 *Journal of Competition Law & Economics* 11, 18–21.

[111] See A Douglas Melamed, 'Exclusionary Conduct under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal' (2005) 20 *Berkeley Technology Law Journal* 1247, 1251, 1252; Hovenkamp, *Antitrust Enterprise*, above n 65, 54.

[112] See Alan Devlin and Michael Jacobs, 'Antitrust Error' (2010) 52 *William and Mary Law Review* 75, 83; Baker, above n 79, 10.

[113] See Fred S McChesney, 'Easterbrook on Errors' (2010) 6 *Journal of Competition Law and Economics* 11, 16.

Statisticians and scientists refer to 'false positive' errors as Type I errors (in the legal context, mistakenly punishing the innocent) and 'false negative' errors as Type II errors (mistakenly failing to punish the guilty).[114] To avoid the confusion that can result from non-statisticians repeatedly reading (or writing) Type I and Type II, and at the risk of a little inaccuracy, the following discussion uses the more distinctive terms of 'false conviction' and 'false acquittal'.

Error-cost analyses are quite commonly used in competition law, particularly in the evaluation of alternative rules or standards,[115] but it is necessary to proceed with caution in this area for two reasons. The first is a matter of precision. In other contexts – medical tests, for example – it is possible to conduct empirical studies to arrive at a precise quantification of the likelihood of error inherent in a certain test. In competition law, however, the probable occurrence and economic impact of much of the conduct cannot be precisely quantified, even after the fact.[116] Arguments are generally limited to the relative costs and relative probabilities of different errors, and accordingly much is left to theoretical claims.

This leads to a second reason for caution. In the US, at least, the error-cost framework is strongly associated with the Chicago School of antitrust – it tends to be used in arguments that are pro-defendant, laissez-faire and most concerned about false convictions.[117] This trend can be traced back to the use of an error-cost framework by then-Professor Frank Easterbrook in his influential and enduring article, *The Limits of*

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[114] Ibid 15.

[115] See, eg, Campbell and Rowley, above n 58; Devlin and Jacobs, above n 112; Geoffrey A Manne and Joshua D Wright, 'Google and the Limits of Antitrust: The Case Against the Case Against Google' 34 *Harvard Journal of Law & Public Policy* 171; David S Evans and A Jorge Padilla 'Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach' (2005) 72 *University of Chicago Law Review* 73.

[116] See Devlin and Jacobs, above n 112, 95; Evans and Padilla, above n 115, 92.

[117] See Harry First and Spencer Weber Waller, 'Antitrust's Democracy Deficit' (2013) 81 *Fordham Law Review* 2543, 2567, 2570–2; Baker, above n 79, 4, 6, 37.

Antitrust.[118] In his use of the error-cost framework, Easterbrook relied on certain assumptions about the likelihood and cost of errors. In particular, he argued that false convictions are more likely to occur than false acquittals, and further that the cost of false convictions is far greater than the cost of false acquittals because the former are perpetual whereas the latter will be promptly eroded by the self-correcting forces of the market.[119] Accordingly, since the error costs of false convictions are significantly greater than the error costs of false acquittals, Easterbrook considered that antitrust rules should be designed to make it relatively difficult for a plaintiff to prove a contravention.[120]

Many error-cost analyses have proceeded in Easterbrook's footsteps and adopted his assumptions about the probability and costs of the respective errors.[121] While it is important to acknowledge this trend, an error-cost analysis need not adopt the same assumptions. On the contrary, a number of scholars have challenged Easterbrook's arguments and assumptions,[122] and offered alternative frameworks for error-cost analysis.[123]

An analysis of likely error costs provides important insights in the evaluation of unilateral conduct tests. At the outset, competition law has been described as uniquely prone to error[124] – depending, as it often does, on contestable economic concepts, as well as requiring speculation about future economic consequences, not to mention

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[118] Frank Easterbrook, 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1, 9–14. See Fred S. McChesney, above n 95, 11–31.

[119] Frank H Easterbrook, 'Monopolization: Past, Present and Future' (1992) 61 *Antitrust Law Journal* 99, 108. See the more detailed discussion of these views in Chap 5 Part II herein.

[120] Frank H Easterbrook, 'On Identifying Exclusionary Conduct' (1986) 61 *Notre Dame Law Review* 972, 977.

[121] See Fred S McChesney, above n 113, 11–31.

[122] See, in particular, Richard S Markovits, 'The Limits to Simplifying the Application of US Antitrust Law' (2010) 6 *Journal of Competition Law and Economics* 51, 66–7.

[123] See, eg, Devlin and Jacobs, above n 112, 99–101; Evans and Padilla, above n 115, 83–4; First and Waller, above n 117, 2570–2.

[124] Devlin and Jacobs, above n 112, 75, 86, 94. See also Manne and Wright, above n 115, 178.

balancing those consequences. The economic thinking related to unilateral anticompetitive conduct is particularly complex, and continuing to evolve, so that unilateral conduct laws are characterised by even greater uncertainty than other areas of competition law.[125]

An error cost analysis also has special relevance in the Australian context. The review committees that have refused to amend the test under section 46(1) have done so largely due to a concern that a change might result in an increase in error costs, and particularly false positives, which they argue could dampen the competitive urge in firms with substantial market power.[126] Further, the central arguments of opponents of effects-based tests are that an effects-based test would erroneously capture procompetitive conduct – that is, it would result in false convictions – and 'chill' vigorous, pro-consumer behaviour particularly by creating uncertainty for businesses.[127] Given the prominence of claims about the fallibility of an effects-based test in the Australian debate, it is particularly appropriate to have regard to likely error costs in evaluating the respective tests and standards in this comparative analysis.

VI. OUTLINE OF DISSERTATION

The remainder of the dissertation is organised as follows.

Chapter 2 explains the historical origins of, and underlying economic rationale for, concerns about the harm caused by monopolists or firms with substantial market power. It summarises the range of potential solutions to this problem, and how regulators have arrived at the solution of prohibiting certain unilateral conduct by such firms, as opposed to an interventionist approach to the possession of market power per se or a laissez-faire approach which entrusts any necessary correction to the market itself.

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[125] See Campbell and Rowley, above n 58, 272–4.

[126] See *Cooney Report*, above n 17, 96; *Hilmer Report*, above n 17, 70–1; *Dawson Report*, above n 17, 81; *Stephens Report*, above n 17, 28.

[127] See Business Council of Australia, *Submission on Options to Strengthen the Misuse of Market Power Law* (February 2016) 19–21.

Chapter 3 outlines the history of unilateral conduct legislation in Australia, providing important context for understanding the underlying policy choices and wording of the current provision in section 46(1) of the *CCA*. It also explains the objective of the provision and the underlying rationale for three of its features, namely: the absence of an efficiency defence; the absence of an effects-based test; and the critical requirement that the corporation 'takes advantage' of its substantial market power.

Chapter 4 proposes and defines a category of 'profit-focused tests' for unilateral conduct, which focus on why the impugned conduct is profitable for the dominant firm rather than on the impact of the conduct on the market. It examines the Australian 'take advantage' test in the context of the broader international debate over unilateral conduct standards, arguing that it can be viewed as a 'profit-focused' test, with important similarities to 'profit-focused' tests proposed by US antitrust agencies and commentators. It makes a comparative analysis of these tests, including the 'no economic sense' test and the 'profit sacrifice' test, and concludes that the 'take advantage' test is less certain and less inclusive than its counterparts in this category.

Chapter 5 explains that, while an effects-based test may seem an obvious means of characterising unilateral anticompetitive conduct, especially in light of the consumer welfare objective, there are concerns that such tests may be difficult and expensive to administer in practice and may deter dominant firms from engaging in socially beneficial conduct. It makes a comparative analysis of the test proposed by the Harper Panel, namely the 'substantial lessening of competition' test, against other effects-based tests, including Salop's 'consumer harm' test and the test proposed by the European Commission in the *EC Guidance Paper*, and concludes that the test proposed by the Harper Panel would likely deter some socially beneficial conduct by dominant firms.

Chapter 6 explains that, while considerations of the dominant firm's eliminatory intent or purpose have often been disparaged in antitrust commentary and jurisprudence, courts and commentators continue to make reference to purpose in the characterisation of unilateral conduct. It analyses the current requirement of subjective purpose under section 46(1) and other provisions of the *CCA*, and argues that subjective purpose is a poor foundation for a unilateral conduct rule. However, the chapter proceeds to identify

a common, but often unarticulated, concern with the *objective* anticompetitive purpose of the impugned conduct evident both in US and Australian jurisprudence as well as in proposed tests for unilateral conduct. It argues that a standard which expressly focuses on whether the impugned conduct had an 'objective anticompetitive purpose' is superior to both the existing 'take advantage' test and the 'SLC' test proposed by the Harper Panel, having regard to the respective error costs, certainty and administrability of the tests.

CHAPTER 2: UNILATERAL CONDUCT LAWS: ORIGINS, OBJECTIVES AND THEORY

I. INTRODUCTION

Before it is possible to make a meaningful comparison of the various proposals for unilateral conduct standards it is necessary to understand the nature of the threat that unilateral conduct laws are intended to address. Why should conduct that harms the competitive process be sanctioned? What is the concern raised by unilateral conduct in particular? In what ways is the conduct of a single firm able to harm the competitive process? This chapter addresses these questions. Part II outlines the origins of unilateral conduct laws and particularly the first modern competition legislation, namely the US *Sherman Act* of 1890.[1] Part III examines various potential objectives of unilateral conduct laws, as well as the threats which the possession of substantial market power poses to these objectives. Parts IV to VII describe alternative legal responses to these threats, including the prevailing 'conduct' approach to regulating unilateral market power. Parts VIII and IX explain two common features of unilateral conduct laws, namely the requirement that the firm engages in some 'anticompetitive' conduct and the requirement that the firm possesses a substantial or significant degree of market power.

II. THE ORIGINS OF UNILATERAL CONDUCT LAWS

A. Introduction

Laws prohibiting unilateral anticompetitive conduct are a relatively recent phenomenon. They first made an appearance in the late nineteenth century when the US legislature distinguished between 'monopolization' and agreements in restraint of trade in the country's first antitrust statute. Before this time, there were laws that affected monopolies, or firms that behaved in similar ways to monopolies, but they did not do so with the objective of protecting the competitive process as we understand that concept

[1] 15 USC §§ 1–7 (1890) ('*Sherman Act*').

today.[2] Under the *Sherman Act*, unilateral conduct and multilateral conduct were made the subject of separate prohibitions.[3] The US courts applying the *Sherman Act* also distinguished the type of competitive harm caused by a firm acting alone from the type of competitive harm caused by multiple firms acting in concert.[4] In time, other jurisdictions followed this model.[5]

To understand the origins of these laws, it is helpful to have a brief sketch of the lineage of the ideas and rules that eventually produced US laws against monopolisation. The English laws in respect of monopolies and contracts in restraint of trade had a significant influence on US antitrust laws,[6] and on Australia's first competition legislation,[7] and so particular attention is given to these laws.

B. Formal Monopolies: Revenue and Resentment

Monopolists have the power to control the price of the goods they sell. This much we have understood from ancient times. Aristotle gave accounts of men who established monopolies in olive presses and iron respectively, which permitted the monopolists to

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[2] See Parts II(B)–(D), III(B) below. See generally, William L Letwin, 'The English Common Law Concerning Monopolies' (1954) 21 *University of Chicago Law Review* 355. As Herbert Hovenkamp, 'The Sherman Act and the Classical Theory of Competition' (1989) 74 *Iowa Law Review* 1019, 1021, explains:

> Although classicists were concerned to preserve 'competition', they did not understand that term as we understand it today. … Competition was not a theory about price/cost relationships, as it came to be in neoclassical economics. … Rather, competition was a belief about the role of individual selfdetermination in directing the allocation of resources; it was a theory about the limits of state power to give privileges to one person or class at the expense of others.

[3] *Sherman Act* § 1 addresses concerted conduct between firms, while section 2 largely addresses unilateral conduct in the form of monopolisation and attempted monopolisation. Section 2 also prohibits conspiracy to monopolise, but this prohibition has 'never enjoyed the distinctive status held by monopolization and attempt': Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (Thomson Reuters, 4th ed, 2011) 310–1.

[4] See, eg, *Copperweld Corp v Independence Tube Corp*, 467 US 752, 768 (1984); Jonathan B Baker, 'Exclusion as a Core Competition Concern' (2013) 78 *Antitrust Law Journal* 527, 528–9, 533–5.

[5] See Part II(G) below.

[6] See Hovenkamp, 'Classical Theory of Competition', above n 2, 1020, 1034–8.

[7] See Chap 3 herein.

set their price and 'make a great quantity of money'.[8] Aristotle noted that this was 'an art often practised by cities when they are in want of money; they make a monopoly of provisions'.[9]

For hundreds of years, the knowledge of this relationship between monopolies and price control was used by states for the purpose of raising revenue.[10] By the 16th and 17th centuries, monarchs in England and France, for instance, made a practice of granting a wide range of monopoly privileges to their allies in the nobility in return for sizeable fees.[11] The elimination of competition from these markets resulted in lower quality products and hefty price increases, as well as significant public resentment.[12] However, on the rare occasion that the English courts were called to adjudicate on the question of monopolies in this period, their approbation most often focused on the infringement of the rival's right to follow his trade.[13] The courts favoured low prices and the right of men to trade, but not free competition.[14]

The Statute of Monopolies, passed in 1623, eventually declared all monopolies granted by the Crown to be void (with some limited exceptions).[15] However, even this law was 'not based on a preference for competition but on constitutional objections to the power

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[8] David Harris Sacks, 'The Greed of Judas: Avarice, Monopoly and the Moral Economy in England, ca. 1350 - ca. 1600' (1998) 28 *Journal of Medieval and Early Modern Studies* 263, 267–9, citing Aristotle, *Politica,* Latin trans. Leonardo Bruni (1510).

[9] Ibid 268.

[10] Ibid 275–87; Wendell Berge, 'Monopoly and the American Future' (1947) 23 *The Virginia Quarterly Review* 491, 495–6.

[11] Murray N Rothbard, *An Austrian Perspective on the History of Economic Thought* (Edward Elgar Publishing, 1995) 213–26.

[12] Ibid. See also Berge, above n 10, 496, quoting Sir John Colepeper, Address to the Long Parliament (9 November 1640):

> [I]t is a nest of wasps or a swarm of vermin which have overcrept the land. I mean the monopolizers and pollers of the people. These, like the frogs of Egypt, have got possession of our dwellings and we have scarce a room free from them …

[13] See, eg, *Darcy v Allein* (1602) 11 Co Rep 84b, 86a–87a; Letwin, above n 2, 364.

[14] Letwin, above n 2, 367.

[15] See J D Heydon, *The Restraint of Trade Doctrine* (Butterworths, 2nd ed, 1999) 6.

which the Crown presumed in granting monopolies and to the arbitrary reasons for which it had granted them'.[16] In the view of the Statute's proponents, it was Parliament which should possess such power, and Parliament continued to grant monopoly privileges after the passage of the law.[17]

C. Laws in respect of Formal Markets

In earlier times, English law also prohibited some private attempts to raise prices, including 'forestalling', 'engrossing' and 'regrating'.[18] In general terms, these offences concerned private parties 'interfering with markets' by buying goods at low prices and selling them at higher prices, sometimes outside the formal markets.[19] It has been said that these laws condemned 'acts which, although they did not constitute a monopoly, were thought to produce some of its baneful effects'.[20] However, others argue that the practices prohibited were not actually monopolistic practices, but more in the nature of speculation, arbitrage and wholesaling.[21] The laws required no proof of exclusivity in supply.[22]

In part, the objective of these laws was to keep prices low, in line with the price-fixing regulations administered by the medieval governments.[23] These laws also reflected the prevailing public sentiment that merchants who acted as speculators and middlemen were 'parasites profiting by the distress of others'.[24] But more importantly, the laws

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[16] Letwin, above n 2, 366.

[17] Ibid 366–7.

[18] Ibid 368. See also Donald Dewey, 'The Common-Law Background of Antirust Policy' (1955) 41 *Virginia Law Review* 759, 762–3.

[19] See Dewey, above n 18, 762–3; Wendell Herbruck, 'Forestalling, Regrating and Engrossing' (1929) 27 *Michigan Law Review* 365, 365–6, 383–4.

[20] *Standard Oil Co of New Jersey v United States* 221 US 1, 54 (1911).

[21] Letwin, above n 2, 371.

[22] *Standard Oil Co of New Jersey v United States* 221 US 1, 53 (1911).

[23] Letwin, above n 2, 369.

[24] Ibid 370. See also Herbruck, above n 19, 365–6, 383–4.

protected the monopoly of the markets in which vendors and purchasers were required to transact.[25] If traders operated outside these markets, the owners of the market franchises lost their tolls and fees.[26]

D. Common Law on Contracts in Restraint of Trade

The other branch of English law that affected the competitive activity of firms was the common law in respect of contracts in restraint of trade.[27] These laws did not address the unilateral conduct of firms,[28] but they did indicate the attitude of the courts towards conduct which restricted competition.

Early cases in respect of contracts in restraint of trade most often concerned restrictions on tradesmen or apprentices.[29] The decisions in these cases established a general principle that contracts in restraint of trade were illegal,[30] suggesting a preference for freedom of trade over freedom of contract. These decisions, however, must be understood in the context of the era and the parties in question. As a result of the prevailing guild system, it was almost impossible for a tradesman to earn a living if he could not practice his own trade in his own town.[31] If he could not trade, he could not support his family, and he would become a burden on the community, and this the courts would not countenance.[32]

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[25] Letwin, above n 2, 370–1.

[26] Heydon, above n 15, 2.

[27] Hovenkamp, 'The Classical Theory of Competition', above n 2, 1024.

[28] *Standard Oil Co of New Jersey v United States* 221 US 1, 52 (1911).

[29] Wayne D Collins, 'Trusts and the Origins of Antitrust Legislation' (2013) 81 *Fordham Law Review* 2279, 2295.

[30] Ibid.

[31] Letwin, above n 2, 375; Collins, above n 29, 2295.

[32] See *Darcy v Allein* (1602) 11 Co Rep 84b, 86b.

This context changed over the following centuries. When the courts began to attack the monopolistic powers of guilds,[33] and tradesmen became more mobile, it was possible to conceive of reasonable restraints of trade, provided that they were limited to a certain period and a certain region.[34] In time, as the means of travel and communication improved, even general restraints could be found to be reasonable, and therefore lawful, if they did no more than protect the covenantee's interests.[35]

While the courts acknowledged that agreements in restraint of trade could damage the public interest, particularly by depriving the public of a useful worker,[36] considerations of consumer welfare played no significant part in determining whether a contract in restraint of trade was reasonable and therefore valid.[37] Where competitors entered into contracts to fix prices or not to compete with each other, these agreements were most often held valid, having regard to the parties' interests in conveniently arranging their affairs.[38] Most combinations between merchants were also permissible, so long as they were merely for the benefit of those combining and not formed with the intent to injure others.[39] Such unlawful intent was not found to exist even where firms combined to engage in predatory behaviour with the aim of driving a rival out of the market.[40]

In the case of contracts and combinations of restraint of trade, therefore, the English common law very rarely opposed rivals acting together to raise prices or suppress

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[33] See, eg, *Davenant v Hurdis* (1598) Moore KB 576.

[34] See Collins, above n 29, 2295–7.

[35] Heydon, above n 15, 17–19.

[36] *Mitchel v Reynolds* (1711) 1 P Wms 181, 189 (Parker CJ).

[37] *A-G (Cth) v The Adelaide Steamship Co Ltd* (1913) 18 CLR 30, 33.

[38] See Heydon, above n 15, 20–1. See also *Mogul Steamship Company Ltd v McGregor Gow & Co* [1891] AC 2547 (Lord Bramwell).

[39] Letwin, above n 2, 381–2. See also *Mogul Steamship* [1891] AC 25, 60 (Lord Hannen). Combinations were lawful when formed 'with a single view to the extension of their business and the increase of its profits' and not 'with the main or ulterior design of effecting an unlawful object': at 42 (Lord Watson).

[40] See *Mogul Steamship* [1891] AC 25, 40 (Lord Halsbury LC).

competition.[41] But even where such a restraint was invalid, third parties had no standing to bring proceedings.[42] Still less was there any right of action against a single firm that unilaterally exercised market power.[43]

E. The Free Market and Laissez-Faire

From the eighteenth century, early 'economists' in France and England began to advocate free markets and to explain the manner in which self-regulating markets could operate to produce greater social benefits than markets regulated by government.[44] Turgot, for instance, pointed out that, in the free market, the individual interest coincides with the general interest, since the general freedom of buying and selling would assure 'the seller of a price sufficient to encourage production' and 'the consumer of the best merchandise at the lowest price'.[45]

Of course the most famous early advocate of the free market was Adam Smith, who published 'An Inquiry into the Nature and Causes of the Wealth of Nations' in 1776.[46] Smith criticised states for creating monopolies and conferring privileges on special interest groups. Like Turgot, Smith argued that individual self-interest harmonised with the interests of all through the operation of competition and the free market, and it did so far more ably than any attempt to create such results directly.[47] The free market was promoted on the basis that it increased the value of the economy as a whole: it directed 'industry in such a manner as its produce may be of the greatest value' to society.

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[41] See Collins, above n 29, 2299; Heydon, above n 15, 20–1.

[42] *Mogul Steamship* [1891] AC 25, 47–9 (Lord Bramwell).

[43] See *Mogul Steamship* [1891] AC 25, 44–5 (Lord Bramwell); *Standard Oil Co of New Jersey v United States* 221 US 1, 52 (1911). See also Collins, above n 29, 2299.

[44] Although not yet known as 'economists', they produced early economic theory: Rothbard, above n 11, 365, 367–8.

[45] Rothbard, above n 11, 387, citing A R J Turgot, *Elegy to Gournay* (1759).

[46] Daniel A Crane and Herbert Hovenkamp (eds) *The Making of Competition Policy: Legal and Economic Sources* (Oxford University Press, 2013) 1–2; cf Rothbard, above n 11, 435–8, 463–9.

[47] Rothbard, above n 11, 464–5.

By the end of the nineteenth century, there was a growing appreciation of the benefits of competition and of the superiority of free markets in achieving the greatest social benefit.[48] The law changed under the influence of these views: state monopolies were viewed more critically at common law, and laws against forestalling were abolished on the ground that they impeded free trade.[49]

The acknowledgement that competition produced social benefits, however, did not lead English law makers to prohibit agreements between competitors such as price-fixing or market allocation, let alone to condemn exercises of market power by a single firm. The prevailing laissez-faire school of thought was not concerned with the detriment to consumers caused by private restraints on competition, or exercises of market power, but with freedom from state interference: the state, including the judiciary, should interfere as little as possible with the workings of the economy.[50]

It should also be understood that the new priority granted to free trade occurred in a broader context. As Williston puts it, '[a] gospel of freedom was preached by both metaphysical and political philosophers in the latter half of the eighteenth century'.[51] In keeping with the new philosophy of freedom and individualism, the law gave greater priority to the freedom to contract.[52] In the area of contracts in restraint of trade, public policy came to favour 'the utmost liberty of contracting', such that free and voluntary contracts would be 'held sacred' and enforced by the courts.[53] If contracts preventing

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[48] See Hovenkamp, 'Classical Theory of Competition', above n 2, 1021.

[49] Letwin, above n 2, 371–3; Herbruck, above n 19, 380

[50] Heydon, above n 15, 22; Herbert Hovenkamp, *Enterprise and American Law: 1836-1937* (1991) 4–5, 11; Hovenkamp, 'Classical Theory of Competition', above n 2, 1025.

[51] Samuel Williston, 'Freedom of Contract' (1921) 5 *Cornell Law Quarterly* 365, 366.

[52] Ibid 367, 373–4.

[53] *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462, 465 (Sir George Jessel MR). There was an exception to this rule for contracts to commit a crime or an 'immoral offence'.

competition were to be condemned, it was on the ground that they unreasonably restricted the freedom of the covenantor and not that they caused injury to the public.[54]

F. Nineteenth Century Large Enterprise and the US Sherman Act

At the same time, there were some dramatic changes in the commercial landscape. Industrialisation had already given rise to the concentration of production in certain regions and in the hands of fewer and larger firms. After the depression of the late nineteenth century, firms attempting to adapt to changed trends in demand formed associations with each other, or merged, to create larger business enterprises.[55] In the US, corporations seeking to combine or extend their operations invented a new use for the common law trust arrangement.[56] Company laws and corporate charter provisions prevented corporations from doing business beyond the state in which they were incorporated.[57] The trust was used to evade these limitations: instead of a single corporation conducting business between states, a number of corporations incorporated in different states could combine their interests by means of a trust.[58]

Classical economists were unperturbed by these developments. In their view, the 'modern system of large business establishments was the outgrowth of natural industrial evolution'.[59] They believed that the large business firm, or the US 'trust', was efficient and would result in higher output and lower consumer prices.[60] But the power wielded by large firms and associations caused great consternation in other quarters, a consternation that gained particular traction in the US.

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[54] Williston, above n 51, 374.

[55] Tony Freyer, 'The Sherman Antitrust Act, Comparative Business Structure, and the Rule of Reason: America and Great Britain, 1880-1920' (1989) 74 *Iowa Law Review* 991, 994.

[56] Hovenkamp, *Enterprise and American Law*, above n 50, 63–4.

[57] Ibid.

[58] Ibid.

[59] Henry Rand Hatfield, 'The Chicago Trust Conference' (1899) 8 *The Journal of Political Economy* 1, 6.

[60] See W M Coleman, 'Trusts From an Economic Standpoint' (1899) 8 *The Journal of Political Economy* 19, 26–7, 30–3; Hovenkamp, *Federal Antitrust Policy*, above n 3, 60, 69.

Some of these concerns had little to do with competition: small producers, whose businesses 'had been destroyed by fair means or foul', were said to supply 'the virulence of the attack'.[61] But the US trusts were also more generally criticised for their monopolistic features and their destruction of competition.[62] Monopoly power entailed the power 'arbitrarily to maintain high prices', and it was argued that this power should not be entrusted to private control.[63] Some went further and claimed that the possession of great industrial power would translate into the possession of political power, leading to 'the corruption of legislatures and the overthrow of democracy'.[64] The freedom and economic power of these corporations should be restrained, lest they trample the nation which gave them their freedom.[65]

The English common law did not regulate the possession or use of market power. As already noted, even agreements and combinations to eliminate competition were generally tolerated. Even the evolution of this branch of the law in the US produced no clear rules regarding the position of monopolies at common law. If the law was to address the power of these entities, and particularly impose sanctions for its abuse, it would need to be by legislation.[66] Accordingly, in 1890, against the protests of classical

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[61] Hatfield, above n 59, 16.

[62] Ibid 12.

[63] Ibid.

[64] Ibid 7–8.

[65] See Senator Cushman K Davis, Address delivered at the Annual Commencement of the University of Michigan (1 July 1886), quoted in Theodore Roosevelt, 'The Trusts, The People and The Square Deal' (1911) *The Outlook* 649, 653–54:

> [T]he modern corporations … [have] grown from an unrestrained freedom of action, aggression, and development, which they commend as the very ideal of political wisdom. *Laissez-faire*, says the professor, when it often means bind and gag that the strongest may work his will. … The liberty of the individual has been annihilated by the logical process constructed to maintain it.

See also *Standard Oil Co of New Jersey v United States* 221 US 1, 50 (1911).

[66] Ibid: 'The debates show that doubt as to whether there was a common law of the United States which governed the subject in the absence of legislation was among the influences leading to the passage of the act.'

economists, the *Sherman Act* was passed in the US.[67] Sections 1 and 2 prohibited contracts and combinations in restraint of trade, and monopolisation respectively. The latter was the first rule prohibiting unilateral anticompetitive conduct. In time, other jurisdictions adopted similar laws.

G. Unilateral Conduct Laws in Other Countries

Almost all modern competition laws incorporate provisions regulating unilateral conduct on the part of firms which possess some degree of market power.[68] For the purposes of this dissertation, those passed in Australia and the EU are particularly relevant.

In Australia, the first law against unilateral anticompetitive conduct was passed in 1908, in the form of the *Australian Industries Preservation Act* (Cth), which was closely modelled on the Sherman Act.[69] Later competition laws in Australia were also influenced by US antitrust law, including the *Trade Practices Act 1974* (Cth), which was regarded as a hybrid of the US law and the more administrative approach of the British competition law.[70]

In 1957, West Germany also passed competition legislation, under the influence of the US occupation officials and having regard to the US antitrust law.[71] Like the *Sherman Act*, the German competition law distinguished multilateral cartel conduct from

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[67] Hovenkamp, *Federal Antitrust Policy*, above n 3, 60 and 69; Hatfield, above n 59, 4–6.

[68] Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart Publishing, 2nd ed, 2011) 273.

[69] See Chap 3 herein.

[70] Ibid.

[71] The German competition law, the *Gesetz gegen Wettbewerbsbeschränkungen* ('*GWB*'), was passed in 1957 and came into force on 1 January 1958. See David J Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Clarendon Press, 1998) 266–80, explaining the influence of US antitrust on the drafting of the *GWB*, even beyond the requirement of the US occupation officials that such a law would be passed before the return of full sovereignty to the new German state.

unilateral abuse of a market-dominating position.[72] This law was also shaped in large part by the views of the 'ordoliberal' scholars,[73] who believed that an economic order based on competition was necessary to create a prosperous and equitable society in which the evils of the Nazi regime could not be repeated.[74] The newly-enacted German competition law had a significant influence on the drafting of Article 82 of the Treaty of Rome (the predecessor of Article 102 of the TFEU),[75] which was signed by the six founding Member States of the European Economic Community in 1957.[76] Ordoliberal thought also influenced the later case law and decisional practice under Article 82, and particularly the adoption of economic freedom as an objective of competition law,[77] as explained below.

III. THE OBJECTIVES OF UNILATERAL CONDUCT LAWS

A. Introduction

Modern unilateral conduct laws generally only apply to firms that possess sufficient market power, expressed, for example, as 'monopoly power', 'a substantial degree of market power', or 'a dominant position'.[78] To understand the harm addressed by these

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[72] Ibid 279, noting that the *GWB* contained three separate groups of norms, concerning 'horizontal restrains, vertical restraints, and abuse of a market-dominating position' respectively.

[73] Ordoliberalism had its origins in pre-World War II Germany, where a group of professors at the University of Freiburg published their *Ordo Manifesto* in 1936 during the rise of National Socialism: Crane and Hovenkamp, above n 46, 252.

[74] Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart Publishing, 2nd ed, 2013) 56.

[75] See Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 127–8; David Gerber, *Global Competition: Law, Markets and Globalization* (Oxford University Press, 2010) 182–3.

[76] O'Donoghue and Padilla, above n 74, 55.

[77] See Liza Lovdahl Gormsen, *A Principled Approach to Abuse of Dominance in European Competition Law* (Cambridge University Press, 2010) 39.

[78] See International Competition Network Unilateral Conduct Working Group, 'Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies' (Paper presented at the 6th Annual Conference of the ICN, Moscow, May 2007) 40 ('*ICN*

laws it is important to understand their objectives; the threat which the possession of substantial market power poses to those objectives; and the reasons that modern competition laws nonetheless permit the mere possession of this degree of market power.

B. Protection of the Competitive Process

It is often said that the aim of unilateral conduct laws is the protection of 'competition' or the 'competitive process'.[79] All of these laws are based on the underlying premise of competition laws, which is that, generally speaking, competition between firms in free markets enhances social welfare and that market failures are the exception rather than the rule.[80] In the interests of social welfare, all of these laws aim to limit the extent to which a single firm can exercise, maintain or increase its economic power to the detriment of the competitive process.

However, as the main objective of unilateral conduct laws, the promotion of competition or the competitive process lacks content.[81] To be sure, in recent decades, antitrust courts and commentators have consistently stressed that the objective of these laws is not to protect *competitors*, but *competition*;[82] and that competition refers to a

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Report'); Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart Publishing, 2nd ed, 2011) 273–5.

[79] See *ICN Report*, above n 78, 6–7; European Commission, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2, [6] ('*EC Guidance Paper*'); *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 191 (Mason CJ and Wilson J); at 194 (Deane J); *Rural Press Ltd v ACCC* (2003) 216 CLR 53, 94 [100], 101 [125] (Kirby J).

[80] Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 48.

[81] See Nazzini, above n 75, 14–17; Maurice E Stucke, 'Reconsidering Antitrust's Goals' (2012) 53 *Boston College Law Review* 551, 568–69.

[82] See, eg, US Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (2008) 11–12, <http://www.usdoj.gov/atr/public/reports/236681.htm> ('*US Department of Justice Report on Single-Firm Conduct*'); *EC Guidance Paper*, above n 79, 7 [6]; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1, 13 [17].

dynamic process of rivalry in a market, rather than any fixed market structure.[83] As the Economic Advisory Group on Competition Policy explained the concept in its 2005 report to the European Commission:

> Competition is a process that forces firms to be responsive to consumers' needs with respect to price, quality, variety, etc; over time it also acts as a selection mechanism, with more efficient firms replacing less efficient ones. Competition is therefore a key element in the promotion of a faster growing, consumer-oriented and more competitive … economy.[84]

Nonetheless questions remain. How can a court determine whether a given practice harms or enhances the process of rivalry? If a firm's price cut eliminates competitors from the market, has competition increased or decreased? What if the firm's exclusionary conduct improves its own efficiency but it does not pass the savings on to consumers? If a firm's rivals wish to compete with the firm by gaining access to its infrastructure or intellectual property, the firm's refusal to grant such access might lessen competition on one level, but that refusal may also be necessary to preserve the firm's incentives to invest in an asset which is highly valuable to society. Has the competitive process been harmed in these circumstances?

To answer these questions it is necessary to identify a further normative standard which competition law serves.[85] Policymakers and commentators have put forward several possible goals.

C. Political Freedom

One potential objective of unilateral conduct rules is the protection of political freedom. At the time the *Sherman Act* was passed, many considered that the concentration of

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[83] See, eg, *Re Queensland Co-Operative Milling Association Limited and Defiance Holdings Limited* (1976) 25 FLR 169, 188–9 ('*QCMA*'). Cf the 'structuralist' conception of competition explained in Part V below.

[84] Economic Advisory Group on Competition Policy, *An Economic Approach to Article 82* (July 2005) 2.

[85] See Nazzini, above n 75, 16–17.

great economic power in the hands of relatively few firms posed a threat to democratic government, given the political influence that could be exerted by dominant firms.[86] During the first half of the twentieth century in particular, US courts and commentators continued to express the view that a society of small, independent, decentralized businesses could ensure that both economic and political power were safely dispersed.[87]

The aim of protecting political freedom was even more central to the passage of the first competition laws in post-war Germany. Having witnessed the substantial role played by private economic power in creating the totalitarian Nazi regime, 'first generation' Ordoliberals were particularly concerned that private economic power could be leveraged into political power.[88] In their view 'it was not sufficient to protect the individual from the power of government'.[89] Abuses of private economic power – of the kind that destroyed political and social institutions during the Weimar period – should also be prevented.[90] Ordoliberals therefore valued a pluralistic market structure as a means to preserve democracy.[91]

Even today, a number of commentators in the US and Australia express the view that a key threat posed by dominant firms is that they may exert undue influence in the democratic processes of government and that unilateral conduct laws may assist in reducing this threat.[92] But while the objective of political freedom may have provided

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[86] See, eg, Hatfield, above n 59, 7–8; *Standard Oil Co of New Jersey v United States* 221 US 1, 50 (1911).

[87] See Robert Pitofsky, 'The Political Content of Antitrust' (1979) 127 *University of Pennsylvania Law Review* 1051, 1057–8; Stucke, above n 81, 562 fn 77; Eleanor M Fox, 'The Modernization of Antitrust: A New Equilibrium' (1981) 66 *Cornell Law Review* 1140, 1150–1.

[88] See Gormsen, above n 77, 39–40; Nazzini, above n 75, 16 fn 15.

[89] Gerber, *Protecting Prometheus*, above n 71, 240.

[90] Ibid.

[91] Nazzini, above n 75, 119 fn 44. See also Gormsen, above n 77, 41.

[92] See, eg, Stucke, above n 81, 623–4; David Dayen, 'The Most Important 2016 Issue You Don't Know About', *New Republic* (11 March 2016) <https://newrepublic.com/article/131412/important-2016-issue-dont-know>; Ken Phillips, 'Big Firms Aren't Budging on Business Behaviour', *The Australian: Business Review* (11 March 2016) <http://www.businessspectator.com.au/article/2016/3/9/industries/big-firms-

some of the impetus for the passage of these laws, and the fulfillment of this objective may be a valued side effect of the application of the law, there is general consensus among modern antitrust scholars and policymakers that this is not a central objective of the law.[93] Competition law is concerned with market conduct and the economic impact of market power, rather than the political consequences of concentrated economic power.[94]

D. Economic Freedom

Another potential objective of unilateral conduct rules is the protection of economic freedom, and particularly the economic freedom of a dominant firm's smaller rivals.[95] As unpopular as the idea might be today, there is little doubt that the *Sherman Act* began its life as special interest legislation and that the special interest in question was small business.[96] There is a strong argument that the statute was passed at the behest of a well-organised lobby, representing small firms which had been marginalised by the technological revolution of the late nineteenth century.[97] In the early days of the statute's application, the Supreme Court also emphasized the objectives of freedom, opportunity and incentives for small firms.[98]

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arent-budging-business-behaviour?utm_source=exact>. See also Harry First and Spencer Weber Waller, 'Antitrust's Democracy Deficit' (2013) 81 *Fordham Law Review* 2543, 2543.

[93] See, eg, Nazzini, above n 75, 119–20; Donald Robertson, 'The Primacy of "Purpose" in Competition Law - Part 2' (2002) 10 *Competition and Consumer Law Journal* 42; Hovenkamp, *Antitrust Enterprise*, above n 80, 7, 10; Herbert Hovenkamp, 'Implementing Antitrust's Welfare Goals' (2013) 81 *Fordham Law Review* 2471, 2471; Joshua D Wright and Douglas H Ginsburg, 'The Goals of Antitrust: Welfare Trumps Choice' (2013) 81 *Fordham Law Review* 2405, 2405–7.

[94] Ibid.

[95] See *ICN Report*, above n 78, 14, citing 13 jurisdictions in which respondent competition agencies stated that ensuring 'economic freedom' or 'freedom to participate in the market' was an objective of the relevant unilateral conduct law.

[96] Hovenkamp, *Antitrust Enterprise*, above n 80, 39–41.

[97] Ibid 41–2.

[98] Fox, above n 87, 1142; Stucke, above n 81, 560–4, 591–3.

Early US case law under the Sherman Act drew on the language of the common law on restraint of trade to prioritise economic freedom or the freedom to trade, both to protect the 'independent discretion' of dealers and to preserve the 'free and natural flow' of the competitive market.[99] Antitrust law valued the freedom and opportunity of smaller firms, not just as a means of serving consumer interests, but as a right of small firms in itself.[100] Courts and policymakers did not overlook the fact that large enterprises might in fact be more efficient, rather they expressed the view that the law favoured the freedom and opportunity of small firms over such efficiency.[101]

Economic freedom for small firms (and for consumers) was also a central objective of the first German competition law. Ordoliberal scholars believed that 'individual economic freedom [was] an essential accompaniment to political freedom' and that competition was necessary for the economic liberty of the individual.[102] In their view, 'the economy was the primary means for integrating society around democratic and humane principles', but to perform this role '[t]he market had to function in a way that all members of society perceived as fair and that provided equal opportunities for participation by all'.[103] By contrast, concentrated economic power was 'a major obstacle to social justice, because it created the perception that the market was unfair', reducing its usefulness as a tool for promoting social integration.[104] Thus the main objective of competition policy was to ensure individual economic freedom in the market, an end which, in the view of Ordoliberals, was more important than economic efficiency.[105]

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[99] Jean Wegman Burns, 'The New Role of Coercion in Antitrust' (1991) 60 *Fordham Law Review* 379, 386–87, citing *United States v Colgate & Co*, 250 US 300, 307 (1919).

[100] Hovenkamp, 'Classical Theory of Competition', above n 2, 1026.

[101] Fox, above n 87, 1142.

[102] Gormsen, above n 77, 43.

[103] Gerber, *Protecting Prometheus*, above n 71, 241.

[104] Ibid.

[105] Pinar Akman, *The Concept of Abuse in EU Competition Law: Law and Economic Approaches* (Hart Publishing, 2012) 55–7, 296.

The protection of economic freedom remains at least one of the goals of unilateral conduct laws in the EU today.[106] In this context, the promotion of economic freedom means that 'the economic system should allow all individuals the freedom to participate in the marketplace unimpaired by the power of other companies'.[107] Clearly, however, this goal must be tempered by some other imperative. Few would argue that small firms have an unqualified right to survive and prosper. An inevitable consequence of competition is that more efficient firms will outcompete less efficient firms, damaging and potentially eliminating the less efficient firms. To what extent should the less efficient firm's freedom to participate in the marketplace be protected? What type of limitation on this firm's economic freedom is objectionable? On the other hand, to what extent should the law protect the economic freedom of dominant firms to conduct their business in the most effective way?[108]

Qualifications on the goal of economic freedom have been suggested. Some have expressed the view that small firms should not be 'unfairly' excluded from the marketplace, and particularly that small firms should have an 'equal opportunity' to compete.[109] Does this mean that small firms should only be protected when they are as efficient as the dominant incumbent, or is it fair that a less efficient entrant should be protected for a period until it can match the efficiency of the dominant firm?[110] In Australia, on the other hand, the ACCC has stated that the law against misuse of market power promotes competition by protecting SME's from larger rival firms that engage in *anticompetitive* conduct.[111] Of course this begs the question: if the competition

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[106] Ibid 51–2.

[107] Gormsen, above n 77, 5, fn 19. See also Akman, above n 105, 52.

[108] See *ICN Report*, above n 78, 14.

[109] See David Gerber, *Global Competition: Law, Markets and Globalization* (Oxford University Press, 2010) 125–6; *ICN Report*, above n 78, 18. See also Nazzini, above n 75, 24; Christian Ahlborn and A Jorge Padilla, 'From Fairness to Welfare: Implications for the Assessment of Unilateral Conduct under EC Competition Law' (Paper presented at 12th Annual Competition Law and Policy Workshop, Robert Schuman Centre, Florence, Italy, 8-9 June 2007, Revised 13 September 2007) 6.

[110] See Nazzini, above n 75, 23.

[111] See *ICN Report*, above n 78, 17.

legislation only protects small firms from the 'anticompetitive' conduct of larger rivals, when is conduct considered to be 'anticompetitive'? To answer these questions, a further objective must be identified.

E. Consumer Welfare and Economic Efficiency

1. Meaning of 'Consumer Welfare'

The two most widely accepted objectives of modern unilateral conduct laws are the promotion or protection of consumer welfare, and the promotion of economic efficiency.[112] 'Consumer welfare' does not have a fixed meaning in competition law.[113] It is sometimes used to mean 'consumer surplus': that is, 'the difference between the sum of the consumers' willingness to pay for a product and the sum of what they actually paid for it'.[114] But it is also used to refer to a broader concept of consumer welfare, which does not depend on low prices alone, but takes into account other aspects of welfare such as innovation, service and variety.[115] This concept is explained in more detail at the conclusion of this section.

Consumer welfare is generally distinguished from 'producer welfare' or 'producer surplus', which is the sum of the profits of producers, and from 'total welfare', which is

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[112] Ibid 9–14, stating that 30 out of 33 respondent competition agencies indicated that 'promoting consumer welfare' was an objective of their unilateral conduct law, while 20 agencies answered that 'enhancing efficiency' was one of the objectives or effects of their unilateral conduct law. See, generally, Russell W Pittman, 'Consumer Surplus as the Appropriate Standard for Antitrust Enforcement' (2007) 3 *Competition Policy International* 205; Steven C Salop, 'Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The *True* Consumer Welfare Standard' (2010) 22 *Loyola Consumer Law Review* 336.

[113] Gormsen, above n 77, 20; Barak Y Orbach, 'The Antitrust Consumer Welfare Paradox' (2010) 7 Journal of Competition Law and Economics 133, 137–51.

[114] Nazzini, above n 75, 33.

[115] See Hovenkamp, *Antitrust Enterprise*, above n 80, 1 ('Few dispute that antitrust's core mission is protecting consumers' right to the low prices, innovation, and diverse production that competition promises.'); S G Corones, *Competition Law in Australia* (Thomson Reuters, 6th ed, 2014) 34 [1.135].

the sum of the surplus of producers and consumers.[116] Under a total welfare standard, increases in consumer welfare and increases in producer welfare are equally valuable.[117]

2. Monopoly Pricing and Allocative Inefficiency

To understand the threat posed by firms with substantial market power to the objectives of economic efficiency and ultimately consumer welfare, it is useful to outline some basic concepts from microeconomics and welfare economics, beginning with the distinctions drawn between competition and monopoly. The discussion that follows contrasts perfectly competitive markets with monopolies. Perfectly competitive markets and absolute monopolies almost never exist in the real world, and the concepts discussed below are highly simplified illustrations of movements in demand, supply, costs and revenues. Nonetheless, these concepts provide a useful way of understanding the *direction* and the *nature* of changes that occur as a market moves from a perfectly competitive state to a monopoly.

In the theoretical perfectly competitive market, no firm possesses market power. There are a large number of suppliers, a large number of consumers and all participants are price takers. Other conditions of a perfectly competitive market include that the product is homogenous, that all suppliers and consumers have perfect information, and that there are no barriers to entry or exit.[118] Each supplier in such a market will reduce its prices to compete with the myriad other suppliers, and each consumer will increase the price it offers to bid against the myriad other consumers, up to the equilibrium point at which the suppliers' willingness to supply and the consumers' willingness to purchase intersect.

The extent of supply in a perfectly competitive market depends on the marginal cost of supply. Suppliers will increase their output, and thereby lower the market price to bid

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[116] Nazzini, above n 75, 33; Roger D Blair and D Daniel Sokol, 'The Rule of Reason and the Goals of Antitrust: An Economic Approach' (2012) 78 *Antitrust Law Journal* 471, 473.

[117] Corones, above n 115, 34 [1.135].

[118] See Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 7.

for the custom of the next consumer,[119] but only up to a point. The supplier of the last unit of production will not supply at a price that is less than the cost of producing that unit. Supply increases up to the point at which price is equal to the marginal cost of producing the last unit.[120] Accordingly, in a competitive market price is equal to the marginal cost of production.

To an economist, 'market power' is the ability of a firm to exercise control over price:[121] that is, to maintain price above the competitive level (or quality below the competitive level) for a sustained period without so many consumers switching that the price increase is unprofitable.[122] While almost all firms in modern markets have some ability to control the price they charge,[123] unilateral conduct laws generally only apply to firms with a substantial degree of market power.[124] A firm's possession of a substantial degree of market power is considered to pose several threats to economic efficiency as follows.

First, the greater a firm's market power, the greater is its ability to limit output and thereby increase price above the level that would prevail in a competitive market.[125] Accordingly, as a market moves towards monopoly, some consumers who would otherwise pay a lower price in a competitive market will be forced to pay more for the same product, up to their reserve price (that is, the limit of their individual willingness

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[119] The next consumer to be supplied will only buy at a lower price than the previous consumer.

[120] The marginal cost includes a normal return on capital.

[121] See Louis Kaplow and Karl Shapiro, *Antitrust*, 3 (NBER Working Paper Series, Working Paper 12867, 2007) <http://www.nber.org/papers/w12867>; Geoff Edwards, 'The Hole in the Section 46 Net: The Boral Case, Recoupment Analysis, the Problem of Predation and What to Do About It' (2003) 31 *Australian Business Law Review* 151, 157–58, 161; *Queensland Wire Industries* (1989) 167 CLR 177, 188 (Mason CJ and Wilson J).

[122] Gunnar Niels, Helen Jenkins and James Kavanagh, *Economics for Competition Lawyers* (Oxford University Press, 2011) 116 [3.1].

[123] Kaplow and Shapiro, above n 121, 3; Einer Elhauge, 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 330.

[124] See Part IX below.

[125] See Kaplow and Shapiro, above n 121, 3–4.

to pay). There is a wealth transfer from the consumer to the producer,[126] and a reduction in 'consumer surplus', or the amount which consumers would save in a competitive market by paying less than they were willing to pay.

Those who advocate a 'total welfare' standard for antitrust policy are not concerned with the wealth transfer which attends a monopolist's price increase.[127] After all, the consumers in question are still paying what they are willing to pay or less, and their loss is equalled by the gain in producer welfare.[128] But, even under a 'total welfare' standard, a monopolist's price increase raises concerns with regard to another group of consumers: those who were willing to purchase the product at the competitive price,[129] but who, under monopoly conditions, will not be supplied at all since the price exceeds their reserve price.[130] The dominant firm makes no direct gain in this respect: this group represents only lost sales for the dominant firm. The consumers also lose since they will now spend their resources on a product that was not their first choice. These lost sales represent a 'deadweight loss', a loss resulting from an increase in market power which benefits no one.[131]

In this way, monopolies fail to satisfy consumer wants as completely as possible. In a competitive market, allocative efficiency is maximised: the cost of resources used in production is equal to the consumers' willingness to pay (price equals marginal cost) and resources are therefore allocated to their highest value use.[132] More particularly, 'resources are used to produce what society values most highly and production cannot be increased without forgoing production of a more valued product'.[133] In contrast, in a

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[126] See Jones and Sufrin, above n 118, 9.

[127] See Orbach, above n 113, 138; Niels, Jenkins and Kavanagh, above n 122, 14–5.

[128] See Niels, Jenkins and Kavanagh, above n 122, 14.

[129] The cost of production including a normal profit.

[130] See Niels, Jenkins and Kavanagh, above n 122, 15.

[131] See Jones and Sufrin, above n 118, 9; Niels, Jenkins and Kavanagh, above n 122, 14–5.

[132] Orbach, above n 113, 141; Nazzini, above n 75, 33.

[133] Nazzini, above n 75, 33.

monopoly, there is a misallocation of resources, or allocative inefficiency.[134] When the monopolist reduces its output, some resources are diverted from their highest value use to the production of less valued products.[135] The deadweight loss mentioned above measures the extent of allocative inefficiency created by an increase in market power. That is, it measures the extent to which the increase in market power, and thus price, leads consumers to substitute a product that would have been their second choice in a competitive market, and therefore the extent to which resources are reallocated to a transaction that produces less social value than their first choice.[136]

3. Productive Inefficiency and 'X-inefficiency'

Another important objection to monopoly is that it gives rise to inefficiencies in production. Productive efficiency occurs 'when a given output is produced at the lowest possible cost given the current technology'.[137] While in a perfectly competitive market, firms supply at the minimum point on the average cost curve, the monopolist, by reducing its output to maximize profits, opts not to produce at the lowest point on the average cost curve.[138] There is therefore a loss in productive efficiency as a market moves from a competitive state towards a monopoly.

Further a monopolist may not experience the same pressure to reduce its costs which firms experience in a competitive market. This detriment has become known as 'X-inefficiency' or 'managerial slack'.[139] In the absence of competitive pressure, the

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[134] The concepts now referred to as 'allocative efficiency' and 'deadweight loss from monopoly' were largely developed by Alfred Marshall, a Cambridge University economist, in his 1890 text, 'Principles of Economics': Hovenkamp, *Federal Antitrust Policy*, above n 3, 58.

[135] See Walter Adams, James W Brock and Normal P Obst, 'Pareto Optimality and Antitrust Policy: The Old Chicago Policy and the New Learning' (1991) 58 *Southern Economic Journal* 1, 5–6, 9–10.

[136] Hovenkamp, *Federal Antitrust Policy*, above n 3, 20.

[137] Nazzini, above n 75, 35.

[138] Ibid.

[139] See Nazzini, above n 75, 35–7; Niels, Jenkins and Kavanagh, above n 122, 15; Elhauge, above n 123, 299.

monopolist's internal efficiency may decline, giving rise to higher costs from inefficient methods of production, employee perks and over-manning.[140]

4. Dynamic Inefficiency

Aside from losses in allocative and productive efficiency, there is an argument that monopolies are detrimental to dynamic efficiency. While losses in allocative and productive efficiency are assessed in the context of a static analysis of the market – with fixed technology and a given cost situation – dynamic efficiency is concerned with the *rate* at which markets innovate.[141] In the absence of competitive pressure, monopolists may lack the incentive to introduce new production technologies (which could increase productive efficiency) or product developments (which could increase demand and therefore the price that consumers are willing to pay for the product).[142] In short, the 'push of competition generally spurs innovation and investment more than the pull of monopoly'.[143] There is, however, significant debate on this point, as explained in Part VI below.

The distinction between competitive markets and monopolies may be summarized as follows. Allocative efficiency, at least from a static perspective, maximises consumer welfare. Productive efficiency may benefit either consumers (increasing consumer welfare) or shareholders (increasing producer welfare), depending on whether gains from cost reductions are passed on to consumers or retained by producers.[144] Dynamic efficiency generally increases consumer welfare in the long term. Monopolies are

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[140] Jones and Sufrin, above n 118, 11.

[141] Ibid 9.

[142] See Nazzini, above n 75, 37.

[143] See Jonathan B Baker, 'Beyond Schumpeter Versus Arrow: How Antitrust Fosters Innovation' (2007) 74 *Antitrust Law Journal* 575, 583-86; Jonathan B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 619.

[144] But even where producers retain the gains from cost reductions, society benefits from the resources saved. See further Part VI below.

believed to reduce economic efficiency in each of these dimensions and thereby reduce consumer welfare and total welfare.

However, certain practices by monopolists or firms with substantial market power may have mixed outcomes for these different types of efficiency. For instance, conduct which enhances a firm's market power may give rise to higher prices and decreases in allocative efficiency, at the same time as it lowers production costs and increases productive efficiency, or enhances dynamic efficiency, giving rise to valuable innovations.[145] Changes in the three types of economic efficiency are not always in the same direction. For this reason, it is sometimes argued that antitrust should be concerned with the long term interests of consumers, rather than focusing on short-term changes in price or allocative efficiency alone.[146] Accordingly, conduct may benefit consumers even though it increases prices (and therefore reduces consumer surplus), if it also gives rise to more significant gains in dynamic efficiency.[147] This concept of consumer welfare takes into account factors other than short term increases in price, particularly innovation, service and variety.[148]

It is not within the scope of this dissertation to enter the debate over whether consumer welfare or total welfare is the more appropriate objective of competition law.[149] For present purposes, and in contrast to the objectives of political and economic freedom, the dominant consumer welfare objective provides justifiable normative criteria for assessing unilateral conduct.[150] Nonetheless there remain areas where trade-offs and

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[145] See Joshua D Wright, 'Antitrust, Multidimensional Competition and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now?' in Geoffrey A Manne and Joshua D Wright (eds), *Competition Policy And Patent Law Under Uncertainty* (2014) 231.

[146] See, eg, Ian Harper et al, *Competition Policy Review: Draft Report* (September 2014) 15–16, 42–4. Cf Nazzini, above n 75, 45–6, arguing in favour of a social (or total) welfare objective, but explaining that 'a focus on the short-term or long-term effect of a practice on consumers may provide a workable enforcement standard that ensures that social welfare is maximized in the long term'.

[147] Nazzini, above n 75, 40–1. See also Gormsen, above n 77, 25–6, 27.

[148] See Hovenkamp, *Antitrust Enterprise*, above n 80, 1; Corones, above n 115, 34 [1.135].

[149] See, generally, Orbach, above n 113; Blair and Sokol, above n 116.

[150] See Salop, above n 112.

difficult decisions between competing values will be required, as explained in later chapters.[151] The objective of Australia's misuse of market power prohibition is explained in more detail in the following chapter.

IV. POSSIBLE RESPONSES TO THE THREAT POSED BY DOMINANT FIRMS

Having identified the threats posed by firms with substantial market power to consumer welfare, the question remains how governments should respond to these threats. Should the state prevent firms from becoming monopolists or obtaining substantial market power; or should it prohibit the reduction of output, or the increase of prices, by such firms? Or perhaps governments should refrain from intervening on the basis that unrestrained competition will do a better job of constraining monopolistic behaviour than any ham-fisted legal institution.

The following parts examine two possible responses to the monopoly problem. These are two extremes on the spectrum of possible solutions, which have been advocated at various times – namely, the prohibition of dominance per se and the exemption of unilateral conduct from antitrust regulation. These solutions have ultimately been rejected in favour of a third solution – the prohibition of certain unilateral anticompetitive conduct – as outlined in the final section.

Although various theories of antitrust from the last century will be outlined, this discussion does not seek to produce a chronology of economic and antitrust theories in respect of unilateral anticompetitive conduct for two reasons. First, the purpose of this analysis is to define the nature of the perceived threat and appropriate responses to that threat, and there is now a reasonable degree of consensus in this respect.[152] Second, the history of economic and antitrust theories regarding the kind of unilateral conduct that warrants intervention resembles not so much an evolutionary process as a pendulum

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[151] See, in particular, the discussion of 'balancing' effects in Chap 5 Part VIII herein.

[152] See Kovacic, above n 93.

swinging between two extremes.[153] It is useful to understand the nature of these extremes to provide the context for the current position.

V. PROHIBIT DOMINANCE PER SE

It is customary for texts on monopolization or abuse of dominance to begin with the acknowledgement that the law does not prohibit dominance per se: it is only the abuse of that dominance that the law condemns.[154] But it is important to remember that this has not always been the accepted position. A choice was made, and if we forget the fact of that choice, let alone the reasons for it, the chosen option can take on a life of its own, sacrosanct and divorced from its justification.

Given what is known about the harm that can be caused by monopolistic markets, it has sometimes been argued that it is best to prevent firms from possessing substantial market power.[155] The state should prohibit dominance itself. Thus, in *United States v Aluminum Co of America* ('*Alcoa*'),[156] Judge Learned Hand suggested that a firm that has acquired 'an overwhelming share of the market' might be guilty of monopolisation whenever it 'does business'.[157] There was, in the first decades of the twentieth century,

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[153] See Herbert Hovenkamp, 'Post-Chicago Antitrust: A Review and Critique' [2001] *Columbia Business Law Review* 257, 266–7.

[154] See, eg, Jones and Sufrin, above n 118, 358; Corones, above n 115, 474; O'Donoghue and Padilla, above n 74, 141.

[155] See, eg, Hatfield, above n 59, 10: 'The simplest program was to destroy or prevent all large aggregations of capital.'

[156] 148 F 2d 416, 432 (2d Cir 1945).

[157] According to Judge Wyzanski description of Judge Hand's judgment in *Alcoa*, in *United States v United Shoe Machinery Corp*, 110 F Supp 295, 342 (D Mass 1953). Although an exception would be made where the defendant could show that he acquired this position exclusively by his superior skill or products, natural advantages, economic or technical efficiency, low margins of profit or legally used patents: at 342.

a deep distrust of large corporations with economic power in the US and many believed that the government should suppress this power directly.[158]

Similar views were held in Europe, and particularly in Germany, under the influence of the Ordoliberal school of thought.[159] Ordoliberals believed that the law should promote a state of 'complete competition', meaning that no firm should have the power to coerce conduct of other firms in a market.[160] They therefore sought to promote 'a deconcentrated market structure where players have no (significant) market power' and in which firms were more likely to compete 'on the merits', than by hindering their rivals.[161]

Ordoliberal thought has been much criticised in recent times for judging the impact of market power with reference to values other than economic efficiency.[162] As noted earlier, Ordoliberals were concerned with the impact of dominant firms on individual freedom, including economic freedom, and with the political influence that might be exerted by dominant firms.[163] These, say modern critics, are not appropriate goals for antitrust.[164]

Ordoliberals, however, did not set out to maximise efficiency or total welfare in economic terms. Rather they gave consideration to broader questions of how private enterprise might exercise private power. Franz Bohm, for example, acknowledged that dominant firms may be more efficient than their weaker rivals; nonetheless, a nation may choose to sacrifice some economic efficiency to avoid coming under the control of

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[158] See, eg, Walter Adams, 'The Aluminium Case: Legal Victory - Economic Defeat' (1951) *The American Economic Review* 915. See also Roosevelt, above n 65, 654: '[T]he only way to meet a billion-dollar corporation is by invoking the protection of a hundred-billion-dollar government …'

[159] See the explanation of the origins of Ordoliberalism in Part II(G) above.

[160] Gormsen, above n 77, 45.

[161] Ahlborn and Padilla, above n 109, 11.

[162] See, eg, ibid.

[163] Jones and Sufrin, above n 118, 35.

[164] See Ahlborn and Padilla, above n 109.

unelected rulers.[165] Firms that posed such a threat, Ordoliberals argued, should be broken up.[166]

The Harvard School of antitrust thought, which dominated in the US in the mid-twentieth century, sometimes came close to such a position. Harvard School theorists, also known as the 'structuralists', placed the highest priority on controlling the structure of markets.[167] According to their favoured 'structure-conduct-performance' ('S-C-P') paradigm, the structure of a market influenced the conduct of firms in it, which ultimately determined how the firms performed in terms of price, output and quality.[168] While it was practically impossible for government to dictate levels of performance, and conduct was often difficult to capture or categorise, government could monitor and control the structure of the market, which so heavily influenced conduct and ultimately performance.[169] One result of this position was that Harvard Scholars believed the government should break up durable monopolists, even if they had not engaged in any unlawful exclusionary conduct.[170] In 1978, for instance, Areeda and Turner, made a specific proposal for a legal rule against 'mere monopoly' for those monopolies that were both 'substantial' and 'persistent'.[171]

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[165] Franz Bohm, 'Democracy and Economic Power in Cartel and Monopoly in Modern Law', Reports on Supranational and National European and American Law (Presented at the International Conference on Restraints of Competition, Frankfurt on Main, June 1960), extracted in Crane and Hovenkamp, above n 46, 264, 271:

> Nothing in this world can be had without paying for it, including freedom. If we want freedom, we have no option but to sacrifice some advantage which we could obtain only by employing concentrated power.

[166] Nazzini, above n 75, 131–2. In particular, ordoliberals considered that 'avoidable monopolies', as opposed to 'unavoidable monopolies' (natural monopolies), should be required to divest themselves of components of their operations or otherwise eliminate their monopoly positions.

[167] Crane and Hovenkamp, above n 46, 318–9.

[168] Ibid.

[169] Ibid.

[170] See Hovenkamp, *Antitrust Enterprise*, above n 80, 37; Hovenkamp, *Federal Antitrust*, above n 3, 297.

[171] Ibid, citing Philip E Areeda and Donald F Turner, *Antitrust Law* (1978) ¶ 623d.This requirement would generally be met where the firm had 'substantial market power that has persisted 10 years or

The structuralist theories of the 'old' Harvard School have long since lost any overt sway in United States antitrust decisions.[172] Nonetheless, there are those who have argued for the prohibition of enduring dominance more recently and on different grounds.

Williamson,[173] for instance, did not claim that structure is the be-all and end-all of the monopoly problem. Rather he advocated a candid approach to addressing undesirable monopolies. In Williamson's view, it is accepted that, generally, dominant firms have the power to reduce output and increase prices in comparison to firms in a competitive market.[174] On the other hand, antitrust courts and authorities are severely limited in their ability accurately to judge the nature, and likely effects, of a firm's conduct. In fact, he argues, antitrust institutions often engage in an 'artificial and contrived' process, pretending the skill of distinguishing between competitive and anticompetitive conduct where they have none.[175] Further, undesirable monopolies may be the result of factors other than superior efficiency or exclusionary conduct.[176]

Given our relative certainty about the general effects of firms that enjoy enduring dominance, and our relative uncertainty about character of firm conduct, Williamson argued that government should at least have a residual power to address enduring

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more'. But such attacks on monopoly would only be allowed in equitable proceedings brought by the government.

[172] Cf the ongoing influence of the 'new' Harvard School explained in Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008).

[173] Williamson is renowned for bringing the 'Transaction Cost Economics' ('TCE') approach to bear on antitrust problems: Crane and Hovenkamp, above n 46, 445.

[174] Oliver E Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications: A Study in the Economics of Internal Organization* (The Free Press, 1975) 211.

[175] Ibid 212, 230–1.

[176] Ibid 211–8. Williamson advocated an 'expanded market failures interpretation of dominance', arguing that enduring dominance sometimes results not from any exclusionary conduct by the dominant firm, but from 'a breakdown of the self-policing properties of markets': at 208.

dominance.[177] He proposed that persistent dominance should be presumptively unlawful,[178] provided that the industry in question has reached an advanced stage of development.[179] The dominant firm should be able to rebut this presumption of unlawfulness 'by demonstrating that its dominance was the result of economies of scale leading to a natural monopoly, of the exercise of an unexpired patent, or continuing indivisible, absolute management superiority'.[180]

Similar proposals have been made at other times. Surprisingly, the 'high water mark' of 'structuralist' thinking came from a group of advisers at the University of Chicago. In 1968, a group of distinguished economists and lawyers led by University of Chicago Law School Dean, Phil C Neal, proposed a 'Concentrated Industries Act', which would give the US Attorney General power to order divestiture in oligopolistic industries to the extent that no firm would have a market share in excess of 12 percent.[181] In Australia, there has been a more recent proposal that market shares be capped at 25 percent in the grocery industry.[182]

These views, however, have not succeeded as a general approach to unilateral market power. Modern antitrust laws generally do not prohibit the possession of substantial market power, or even monopoly, by itself.[183] The key reasons for this can be explained as follows.

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[177] Ibid 231–2.

[178] Ibid 220. A firm would be defined as dominant if its output 'persistently exceeded sixty percent of the relevant market and entry barriers are great', but much higher market shares would be required if entry barriers were 'insubstantial': at 209.

[179] Ibid 220. This proviso reflects the view 'that the dominant outcome is unlikely to be undone by unassisted market forces in any short period of time once the industry has reached maturity'.

[180] Ibid 221.

[181] Crane and Hovenkamp, above n 46, 319, 360–1.

[182] See Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia's Retailing Sector* (August 1999) 47–53 ('*Retailing Sector Report*').

[183] *ICN Report*, above n 78, 17, 40, 59–60.

First, as a practical matter, the prohibition of a given level of dominance is often likely to fail to achieve its goal. Whether firms are already dominant or coming dangerously close to dominance, it is very difficult for the firms, or enforcement agencies, to determine what action to take to avoid a position of dominance. Perhaps the firm could be broken into smaller independent entities none of which possess substantial market power. But what if no 'fault lines' present themselves to permit the sensible division of the firm?[184] The breaking up of powerful firms would often be arbitrary and prone to dissipate socially beneficial efficiencies.[185] On the other hand, a firm might avoid beneficial price cuts or other improvements to avoid gaining market share in excess of any imposed cap. But if the purpose of the prohibition of dominance is to prevent the inefficiencies that may be created by monopolists, it would not make sense for the solution to result in similar levels of inefficiency and waste.

Second, and related to the first, some industries are not actually amenable to numerous small rivals competing efficiently. Minimum efficient scale in a given market may be such that only one or two firms with a large market share can efficiently supply the market.[186] Where the market can support only one firm at minimum efficient scale it is said to be a 'natural monopoly': these markets 'perform optimally when they are occupied by a single firm that charges a competitive price'.[187] If firms are forced to operate below minimum efficient scale, potential cost savings will be squandered.[188]

Third, at the level of national interest, a country that reduces the power of its most substantial operators may handicap itself in international trade by holding back potential

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[184] Hovenkamp, *Federal Antitrust Policy*, above n 3, 297.

[185] See Hovenkamp, *Antitrust Enterprise*, above n 80, 63.

[186] Michal S Gal, *Competition Policy for Small Market Economies* (Harvard University Press, 2003) 15. Minimum efficient scale is the scale of operation at which average unit costs of production are first mimimised and is largely dependent on production techniques.

[187] Hovenkamp, *Federal Antitrust Policy*, above n 3, 33.

[188] See Frank H Easterbrook, 'When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?' (2003) *Columbia Business Law Review* 345, 352.

'national champions'.[189] Given that competition laws are concerned with the benefits a nation derives from its economy, this been a consistent consideration in the framing of such laws.[190]

Fourth, monopolists, or firms with substantial market power, might not in fact conduct themselves in a way that gives rise to the apprehended harm. Woodrow Wilson compared monopolization to joy riding.[191] A monopoly, like a car, can be used for good or ill. Substantial market power is often achieved and maintained by a corporation's superior efficiency, innovation and ability to meet consumer desires.[192] The mere possession of the power to do ill should not be prohibited: to do so would be to prevent the potential for good as well.[193]

Fifth, the existence of monopoly profits indirectly benefits society as a whole. It is the pursuit of monopoly profits which spurs firms on in their attempts to outperform their rivals.[194] The prospect of pricing above the competitive level gives firms an incentive to outcompete their rivals by making better and cheaper products, and to invest in crucial innovation, to the benefit of society in general and consumers in particular.[195] Importantly, some argue that monopolistic markets actually spur innovation even more

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[189] See, eg, Roosevelt, above n 65, 115: 'Nothing is gained by depriving the American Nation of good weapons wherewith to fight in the great field of international industrial competition.'

[190] See, eg, *Retailing Sector Report*, above n 182, 121, 123–24; David S Evans, 'Why Different Jurisdictions Do Not (And Should Not) Adopt the Same Antitrust Rules' (2009) 10 *Chicago Journal of International Law* 161, 172.

[191] Woodrow Wilson, 'The Tariff and the Trusts' (Speech delivered at Nashville, Tennessee, 24 February 1912), extracted in Crane and Hovenkamp, above n 46, 119, 121.

[192] This reflects both the view that monopoly profits are a fair reward for superior skill and ingenuity, and the economic viewpoint that the prospect of monopoly profits motivates firms to innovate, improve quality and lower their costs. See Andrew I Gavil, 'Exclusionary Distribution Strategies By Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 33, 42–3.

[193] See Roosevelt, above n 65, 654–5.

[194] See Part VI below.

[195] See *Verizon Communications Inc v Law Offices of Curtis V Trinko*, 540 US 398, 407 (2004).

than competitive markets.[196] Abolishing the incentive of monopoly profits would discourage the superior industry, enterprise, skill, and innovation which firms engage in the pursuit of monopoly.

Finally, it is argued that rivals and potential rivals will generally do a better job than government in curtailing the power of monopolists or potential monopolists.[197] If a firm does, in fact, earn monopoly profits, other firms will be attracted to the market in search of a share of those profits. Over time, new or existing rivals will outcompete the dominant firm for the 'top spot', or at least force it to compete more vigorously.[198] So long as monopoly power is not the result of, or shored up by, privileges granted by government, rivals and potential rivals will have the incentive, and potentially the ability, to outperform the incumbent.

These are the six arguments most commonly advanced in opposition to the prohibition of dominance or substantial market power alone. However, in essence, they can be reduced to two key contentions. First, prohibiting dominance across the board would entail a loss in economic efficiency to the detriment of society as a whole. Second, even where a monopolist exercises its market power in a way that harms consumers, competition from its rivals, or potential rivals, will constrain the monopolist more effectively than government regulation. The market will 'self correct'.

VI. DO NOTHING: MARKETS ARE SELF-CORRECTING

Given these arguments against the prohibition of substantial market power, it may seem advisable for governments to leave the market to its own devices: in effect, to do nothing. One prominent theorist who is particularly renowned for advocating a hands-off approach to dominance was the Austrian economist Joseph Schumpeter. Schumpeter

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[196] See the discussion of Schumpeter's views in Part VI below.

[197] See the discussion of Chicago School theories in Part VI below.

[198] See, eg, Frank H Easterbrook, 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1, 15; Fred S McChesney, 'Talkin' 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law' (2003) 52 *Emory Law Journal* 1401, 1412. See also Gavil, above n 192, 35.

emphasised the role of dynamic competition. He argued, in essence, that 'innovation contributes much more to economic development than simple competitiveness under constant technology' and that monopoly is actually the ideal market structure for the maximization of innovation.[199] According to Schumpeter, the prospect of monopoly profits is necessary for firms to justify investing in the high-risk research and development which gives rise to innovation.[200] Increased economic growth from this increased innovation is likely to outweigh any less-than-optimal allocation of resources identified in the static equilibrium.[201]

Even when an innovating firm is successful in creating a monopoly and charging monopoly prices, this situation is neither permanent nor necessarily detrimental to consumers. The monopolist's reign, if not limited by the pressure of existing rivals, is limited by potential and future rivals.[202] While the monopolist may not have competition for each sale, there is competition for the market *as a whole*. The market is contestable. If a rival for the market is successful, the monopolist's product becomes obsolete in the course of the 'creative destruction' inherent in competition.[203] With this knowledge, the monopolist and its would-be successors continue to engage in competition to innovate, to the benefit of consumers.

Kenneth Arrow, on the other hand, has 'argued that Schumpeter severely underestimated the impact of competitive pressure in inducing innovation', and particularly incremental gains to innovation.[204] There is ongoing debate over whether

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[199] Crane and Hovenkamp, above n 46, 282–3.

[200] Joseph A Schumpeter, *Capitalism, Socialism and Democracy* (George Allen & Unwin, 5th ed, 1976), 102–3. See also David S Evans and Keith N Hylton, 'The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust' (2008) 4 *Competition Policy International* 203, 203, 220, 225, 234–6.

[201] See D Hildebrand, 'The European School in EC Competition Law' (2002) 25 *World Competition* 3, 8–9.

[202] See Easterbook, 'When is it Worthwhile?', above n 188, 352–3.

[203] Schumpeter, above n 200, 83–4.

[204] Crane and Hovenkamp, above n 46, 283. See Kenneth Arrow, 'Economic Welfare and the Allocation of Resources for Invention' in National Bureau Committee for Economic Research (ed), *The Rate and*

there is greater incentive to innovate from the lure of monopoly profits or from the pressure of existing competitors within a market.[205] Some claim that 'the empirical evidence indicates that the "push of competition" is generally more important for innovation than the "pull of monopoly"'.[206] The general consensus appears to be that 'both absolute monopoly and atomistic competition tend to produce a low rate of innovation'.[207] The highest rate of innovation occurs between these extremes, in moderately concentrated markets.[208]

In the 1970s, the Chicago School came very close to arguing that single-firm market power should not concern antitrust policy makers. While the Harvard School had, for a long time, emphasized the ways in which firms were prevented from competing in a market, the Chicago School rose in criticism of the Harvard School, emphasizing the ways in which firms were still able to compete, notwithstanding the existence of strong or monopolistic incumbents.[209]

According to Chicago Scholars, there was very little about firms with substantial market power, acting alone, that should concern antitrust policy makers.[210] Those who argued for stringent unilateral conduct rules, they said, were ignoring the productive efficiencies generated by dominant firms. Such firms most often attained their power as a result of their superior efficiency and business acumen. Other firms, seeing the

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Direction of Inventive Activity: Economic and Social Factors (NBER Books, 1962). Cf J Gregory Sidak and David J Teece, 'Dynamic Competition in Antitrust Law' (2009) 5 *Journal of Competition Law and Economics* 581.

[205] See Baker, 'Exclusion as Core', above n 4, 561–2.

[206] Ibid 584. See generally Jonathan B Baker, 'Beyond Schumpeter vs Arrow: How Antitrust Fosters Innovation' (2007) 74 *Antitrust Law Journal* 575, 579; Carl Shapiro, 'Competition and Innovation: Did Arrow Hit the Bull's Eye?' in Josh Lerner and Scott Stern (eds) *The Rate And Direction Of Inventive Activity Revisited* (2012) 361.

[207] Crane and Hovenkamp, above n 46, 283.

[208] Ibid.

[209] See Hovenkamp, *Antitrust Enterprise*, above n 80, 35.

[210] See, eg, Robert Bork, *The Antitrust Paradox* (Basic Books, 1978) 156, 344-6. Cf Richard A Posner, *Antitrust Law* (University of Chicago Press, 2nd ed, 2001) 194.

rewards reaped by successful incumbents, would be encouraged to greater efficiency in an attempt to achieve such rewards themselves.

Chicago Scholars did admit that firms with monopoly power would reduce output and charge monopoly prices. This was no more than rational profit-maximization. Nonetheless they argued that governments should not be concerned by reduced output and monopoly prices, because markets are self-correcting.[211] In the absence of government interference, rival firms would reduce prices and increase output within a reasonable time.[212]

Further, Chicago Scholars rejected the theory that dominant firms can stymy this process of self-correction by engaging in unilateral exclusionary conduct. They used price theory to demonstrate that firms with monopoly power lack the incentive to use certain practices for anticompetitive purposes, because such practices could not be profitable.[213] For instance, they explained that tying (that is, requiring a purchaser to buy a second product as a condition of buying the first) could not be profitable because, if the tying firm attempted to increase the price of the second product, this would reduce the price consumers would be willing to pay for the first product.[214] Chicago Scholars also argued that predatory pricing could not be profitable, because the firm would suffer losses from below-cost pricing in the short term, and, in the long term, if it attempted to recoup those losses by charging supra-competitive prices, new rivals would enter the market and bid the price down to the competitive level.[215]

These observations by Chicago Scholars could be generalised. The reasoning applied to tying could be applied to any conduct by which a firm attempted to 'leverage' its market

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[211] See Hovenkamp, 'Post-Chicago Antitrust', above n 153, 266.

[212] Ibid. This view relied on the Chicago School belief that entry barriers were low.

[213] See David S Evans and A Jorge Padilla, 'Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach' (2005) 72 *University of Chicago Law Review* 73, 74, 77–8.

[214] Richard A Posner, 'The Chicago School of Antitrust Analysis' (1979) 127 *University of Pennsylvania Law Review* 925, 926.

[215] Ibid 927.

power into a second non-dominated market: there was, they explained, only one monopoly profit to be had (this is known as the 'single monopoly profit theorem').[216] The reasoning applied to predatory pricing could also be applied to any conduct by which a firm attempted to harm others by 'harming itself'.[217] As a general rule, therefore, firms could not obtain or enhance monopoly power by unilateral action, unless 'they are irrationally willing to trade profits for position'.[218] Antitrust should focus on cartels, and horizontal mergers that create monopolies, rather than unilateral conduct.[219]

These arguments explain the first of the Chicago School's two foundational principles, namely that 'markets are extremely robust and competitive outcomes are highly likely'.[220] The second principle was that 'government tribunals and agencies are frail and imperfect decision makers'.[221] Even if there was competitive harm which the market did not resolve in the short term, intervention by the judiciary was most unlikely to provide a more effective remedy than the long term operation of the market.[222] Worse still, unwarranted or misdirected government intervention could cause serious and lasting harm to economic efficiency.[223] Under the influence of the Chicago School, US antitrust agencies and courts of the Reagan Administration, in particular, dramatically reined in intervention in matters concerning unilateral conduct, and focused their

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[216] Ibid. See also Evans and Padilla, above n 213, 77.

[217] Posner, 'The Chicago School', above n 214, 927.

[218] Ibid 928.

[219] Easterbook, 'When is it Worthwhile?', above n 188, 353.

[220] Hovenkamp, 'Post-Chicago Antitrust', above n 153, 269.

[221] Ibid. See, eg, Easterbook, 'When is it Worthwhile?', above n 188, 347.

[222] Hovenkamp, 'Post-Chicago Antitrust', above n 153, 269.

[223] Easterbook, 'When is it Worthwhile?', above n 188, 349–50.

attention on cartels and large mergers.[224] But, as explained in the following section, the pendulum was to swing again.

VII. THE CONDUCT APPROACH

Currently, the weight of opinion lies between the two extremes just canvassed. It is generally accepted that firms with substantial market power may demonstrate superior efficiency and that, where they do not, markets are often self-correcting. Therefore competition laws do not prohibit the possession of a dominant position or substantial market power per se.

On the other hand, it is not generally accepted that single-firm market power should be left unregulated. Rather than address the size and power of dominant firms directly, the current view is that effective competition will prevail if the law prevents certain *conduct* by the dominant firm. In particular, the law should focus on conduct by dominant firms that excludes rivals not through superior efficiency, but by impairing or suppressing competition.[225]

A 'conduct' approach has long been adopted in the US. In *United States v Grinnell Corp*,[226] the Supreme Court held that unlawful monopolization consisted of two elements: '(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic

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[224] Ibid 350, 354. See also F M Scherer, 'Conservative Economics and Antitrust: A Variety of Influences' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antirust* (Oxford University Press, 2008) 36–7.

[225] See, eg, Joel B Dirlam and Alfred E Kahn, *Fair Competition: The Law and Economics of Antitrust Policy* (Cornell University Press, 1954) 28, referring to the 'deliberate impairment, misdirection, or suppression of competition'; Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1038, defining monopolistic conduct with reference to acts 'reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals'. This concept is explained in more detail in Part VIII below.

[226] 384 US 563 (1966).

accident.'[227] This has been interpreted to mean that the law requires proof of both monopoly power,[228] and exclusionary conduct.[229]

Similarly, in the EU, Article 102 of the *TFEU* prohibits not the mere possession of a dominant position, but the abuse of that position, examples of which are listed in the article itself.[230] The European Commission has targeted exclusionary conduct under Article 102, referring to conduct by which 'undertakings which hold a dominant position … exclude their competitors by other means than competing on the merits of the products or services they provide'.[231] In the EU, abuses also include 'exploitative' practices, explained further below.[232]

The Australian law against misuse of market power also requires proof of certain conduct on the part of the dominant firm. Section 46(1) of the *CCA* prohibits a corporation with a substantial degree of market power from 'taking advantage' of that power for certain purposes. In general terms, these proscribed purposes relate to the exclusion of rivals, or deterrence or prevention of competitive conduct by rivals.[233]

The determination to regulate unilateral conduct also finds support in modern economic theory. Since the 1980s, both Transaction Cost Economics ('TCE') and post-Chicago scholars have been 'kicking the tires' on some of the Chicago School theories and producing significant criticisms of the earlier assumptions and conclusions.[234]

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[227] 384 US 563, 570–1 (1966). Section 2 of the Sherman Act also prohibits 'attempted monopolization', which requires proof of certain conduct and likely effects, coupled with a lower market power threshold: see Hovenkamp, *Federal Antitrust Policy*, above n 3, 303–10.

[228] Explained in Part IX below.

[229] See *Berkley Photo Inc v Eastman Kodak Co*, 603 F 2d 263, 275 (2d Cir 1979): '[T]he firm must refrain at all times from conduct directed at smothering competition.'

[230] See the text of *TFEU* Art 102 in Chap 1(IV)(C) herein.

[231] *EC Guidance Paper*, above n 79, 7 [6].

[232] Jones and Sufrin, above n 118, 358–9.

[233] Explained in Chap 3 herein.

[234] Evans and Padilla, above n 213, 78–80. See also Crane and Hovenkamp, above n 46, 445–7.

Williamson brought the TCE approach to bear in this area, advocating a more aggressive approach to unilateral exclusionary conduct.[235] While the Chicago School argued that 'capital inexorably flows toward the lure of monopoly profits', Williamson highlighted 'the transactional impediments to the easy flow of capital toward monopoly profits'.[236] He explained that incumbent firms may enjoy certain 'first-mover advantages'.[237] Once the market has reached an advanced stage of development, there are contemporaneous cost differences between an established firm and would-be entrants.[238] 'To the extent that the prospective entrant's initial costs exceed the steady-state costs of established firms in the industry, a higher price to (steady-state) cost margin will be required to induce entry.'[239] Other conditions being equal, nontrivial transaction costs will inhibit entry. In these circumstances, unassisted market processes will be unlikely to correct the harm caused by substantial market power in a reasonable period of time.[240]

Post-Chicago theorists also have less confidence in markets than the Chicago School.[241] Post-Chicago scholars have often used game theory to challenge Chicago's 'impossibility theorems' (the claims that firms with monopoly power lack incentives to engage in certain unilateral anticompetitive practices),[242] explaining how dominant

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[235] Crane and Hovenkamp, above n 46, 445.

[236] Ibid 446.

[237] Williamson, above n 174, 216.

[238] Ibid 216–7.

[239] Ibid 217.

[240] Ibid 218.

[241] Unlike the Harvard School, the Chicago School and the Ordoliberals, post-Chicago theorists have 'no institutional locus', nor are they united by 'an elegant analytical structure or clear research agenda'. Rather they can be seen as 'clusters of scholars who, since the mid-1980s have been challenging the Chicago School's antitrust approach': Crane and Hovenkamp, above n 46, 446. See also Steven C Salop, 'Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (2008) 142–4.

[242] See Evans and Padilla, above n 213, 74.

firms can in fact adopt strategic behaviour to achieve anticompetitive ends.[243] Post-Chicago economics demonstrate that 'markets are much more varied and complex than Chicago theorists were willing to admit': thus 'the number and variety of anticompetitive practices are unknown and open ended'.[244]

In contrast to the work of Chicago Scholars, post-Chicago economists have developed a collection of 'possibility theorems'.[245] The theory of Raising Rivals' Costs ('RRC') provides a convincing explanation of certain exclusionary practices.[246] The Chicago School's 'single monopoly profit theorem' has also been challenged: leveraging a monopoly position may, in fact, increase monopoly profits under certain conditions.[247] Other post-Chicago literature has debunked the theory that firms have no incentive or ability to engage in predatory pricing.[248]

According to both TCE and post-Chicago theorists, even though markets may tend to self-correct, economic theory suggests many reasons why they do not always do so within a reasonable time.[249] These arguments are borne out by the facts. Post-

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[243] Hovenkamp, 'Post-Chicago Antitrust', above n 153, 270–1: 'When information is not evenly balanced, anticompetitive strategic behaviour is possible. In the presence of specialized assets and economies of scale strategic pricing, even at prices significantly above cost, can be anticompetitive. Network externalities in some markets … can give dominant firms decisive advantages that enable them to defeat even superior technologies.'

[244] Ibid 268.

[245] Evans and Padilla, above n 213, 79.

[246] Hovenkamp, 'Post-Chicago Antitrust', above n 153, 337. See Thomas G Krattenmaker and Steven C Salop, 'Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price' (1986) 96 *Yale Law Journal* 209, 230–40.

[247] See Baker, 'Exclusion as Core', above n 4, 585–6. In the case of tying, this can be achieved where the tied market is subject to economies of scale, and the leveraging induces exit or deters entry in the tied market, giving rise to a secure monopoly in the tied market: Evans and Padilla, above n 213, 78, citing Michael D Whinston, 'Tying, Foreclosure, and Exclusion' (1990) 80 *American Economic Review* 837.

[248] Evans and Padilla, above n 213, 78, citing Patrick Bolton, Joseph F Brodley and Michael H Riordan, 'Predatory Pricing: Strategic Theory and Legal Policy' (2000) 88 *Georgetown Law Journal* 2239, 2250–1.

[249] Williamson, above n 174, 220, 233; Baker, 'Exclusion as Core', above n 4, 584.

Chicagoans point list examples from US case law of monopolies that have endured for decades.[250]

VIII. UNILATERAL ANTICOMPETITIVE CONDUCT

The theories explained by the TCE school and the Post-Chicago school, in particular, demonstrate that not all threats from substantial market power can be left to the self-correcting forces of the market. While some firms with substantial market power succeed by offering a better price or product, it is possible for firms to create, protect or extend market power through conduct which suppresses the rivalry of their competitors, without creating any, or any proportionate, benefit for consumers ('unilateral anticompetitive conduct').[251] Such conduct effectively blocks the self-correcting forces of the market, depriving consumers of innovative and superior offers from would-be challengers and reducing the pressure on the incumbent to improve its own offering.[252] It also wastes the resources of both the excluding firm and the excluded firm.[253]

One matter should be clarified here. A 'suppression' of rivalry does not occur simply because a rival loses a given sale or sales to the dominant firm. The better view is that the suppression of rivalry occurs when the dominant firm's conduct significantly impairs its rivals' ability and/or incentive to compete for future sales, or for sales other

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[250] Baker, 'Exclusion as Core', above n 4, 584; Jonathan M Jacobson, 'Towards a Consistent Antitrust Policy for Unilateral Conduct' (2009) *The Antitrust Source* 1, 2 <http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Feb09_Jacobson2_26f.authcheckdam.pdf >.

[251] See the definition of 'monopolistic conduct' by Herbert Hovenkamp explained in Chap 5 Part III(B) herein. For alternative concepts of anticompetitve conduct, see Eleanor M Fox, 'What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect' (2002) 70 *Antitrust Law Journal* 371.

[252] See Hovenkamp, *Antitrust Enterprise*, above n 80, 156; Baker, 'Exclusion as Core', above n 4, 559–62; Krattenmaker and Salop, above n 246, 213–4.

[253] See Richard Posner, 'The Social Costs of Monopoly and Regulation' (1975) 83 *Journal of Political Economy* 807, 807–8; Hovenkamp, *Federal Antitrust Policy*, above n 3, 21, 24–5.

than those captured directly by the dominant firm.[254] Bernheim and Heeb explain that this effect can be achieved in a number of ways, including by:

- reducing competitors' cash flow by limiting their ability to make profitable sales, while limiting their ability to raise funds on attractive terms,[255] thereby undermining their ability to invest in research and development and plant and equipment, and, in turn, their ability to offer competitive products in the future;[256]
- preventing competitors' products from gaining the extent of customer acceptance, or customer feedback, necessary to compete effectively;[257] or
- preventing competitors from gaining the scale and scope necessary to compete effectively.[258]

The economic theory regarding unilateral anticompetitive conduct is often explained with reference to certain categories of conduct, including predatory pricing; exclusive dealing; loyalty rebates; tying and bundling; refusals to deal; and non-price predation.[259] However, the actual form which unilateral anticompetitive conduct may take is limited only by the imaginations of dominant firms. The difficulty for antitrust authorities and courts is that unilateral anticompetitive conduct and vigorous competition may look

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[254] See B Douglas Bernheim and Randal Heeb, 'A Framework for the Economic Analysis of Exclusionary Conduct' in Roger D Blair and D Daniel Sokol (eds), 2 *The Oxford Handbook of International Antitrust Economics* (Oxford University Press, 2014) 4, 5–6, 26.

[255] Ibid 27 (citations omitted): 'Significantly, when outside investors are unaware that the rival's failure to generate profits results from anticompetitive exclusion (or are simply uncertain about the existence, continuation, and/or impact of anticompetitive conduct), they may conclude incorrectly that the company itself is at fault, that its business plan is ill-conceived, and that its prospects are therefore poor, even if it is, in fact, positioned to compete successfully on the merits. Accordingly, anticompetitive exclusion can leave a company cash-starved, dependent on costly sources of finance, and with limited ability to raise funds.'

[256] Ibid 26–7.

[257] Ibid 27.

[258] Ibid 27–8.

[259] See, eg, O'Donoghue and Padilla, above n 74, 239–40.

very similar in practice.[260] While the law should condemn and deter unilateral anticompetitive conduct, it should also avoid unduly hindering or deterring beneficial competitive activity by dominant firms, including the exclusion of rivals through superior efficiency or innovation.[261] Robust theoretical foundations are needed to distinguish aggressive, beneficial discounting from predatory pricing; efficiency-enhancing exclusivity arrangements from anticompetitive foreclosure; and procompetitive refusals to cooperate with rivals from inefficient, monopoly-preserving refusals to deal.

While post-Chicago theorists have convincingly demonstrated the 'messiness' of the world in contrast to the Chicago School's elegant but flawed conceptions, post-Chicago theories do not translate easily into rules that courts, and firms, can apply with confidence.[262] Beyond the question of which economic theory is 'correct',[263] lawmakers must create rules that can be understood by firms and administered by the relevant agencies and courts. A rule that identifies anticompetitive conduct with a great degree of accuracy may still be undesirable if it is inordinately costly or impracticable for the relevant authorities to apply.[264] Similarly, a highly accurate rule may be inappropriate if it makes it very difficult for firms and their advisers to predict in advance whether their proposed conduct will fall foul of the rule.

Having identified the threat of unilateral anticompetitive conduct, it is still necessary to construct administrable, cost-effective rules that identify and condemn anticompetitive

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[260] See William J Baumol et al, *Brief of Amici Curiae Economics Professors in Support of Respondent*, Submission in Verizon Communications Inc v Law Offices of Curtis V Trinko LLP, No 02-682, 25 July 2003, 4, stating that the challenge is to 'deter anticompetitive behaviour without undermining incentives for procompetitive pricing, production, investment and innovation', but that the difficulty in distinguishing these two types of conduct 'stems from the fact that they both are disadvantageous to rivals'.

[261] Niels, Jenkins and Kavanagh, above n 122, 16.

[262] Hovenkamp, 'Post-Chicago Antitrust', above n 153, 270–3; 278–9.

[263] It is a question of which economic theories are 'more nearly correct' since 'economic propositions are among the least provable of those addressed in the various sciences': Scherer, above n 224, 31.

[264] See Kovacic, above n 93, 36-38.

practices, and provide remedies likely to secure a better outcome for consumers than the operation of the market itself, without unduly hindering vigorous competition. The aim of this dissertation is to assess the effectiveness of the respective standards for unilateral anticompetitive conduct in achieving these goals.

A short note should be made about 'exploitative' conduct by dominant firms. Since market power refers to the power to increase price above the competitive level, it might be thought that unilateral conduct laws would target supracompetitive pricing by dominant firms. In fact, in some jurisdictions – for example, the EU and South Africa – unilateral conduct laws do prohibit such 'exploitative' conduct, or 'excessive pricing' on the part of dominant firms in general.[265] However, even in these jurisdictions, competition authorities rarely pursue excessive pricing cases, for the same reasons that prohibitions of exploitative conduct in general have not been adopted in other jurisdictions.[266] Mirroring the reasons for not prohibiting dominance per se, it is very difficult to define when a price becomes 'excessive' or 'exploitative'; high prices are often a socially useful reward for superior efficiency and innovation; and courts are not well-suited to the role of price regulators.[267] The focus of this dissertation is on exclusionary, as opposed to 'exploitative', unilateral conduct.

IX. SUBSTANTIAL MARKET POWER REQUIREMENT

Beyond the shared 'conduct' approach, unilateral conduct laws generally have another feature in common, namely they only apply to firms that possess a certain degree of market power.[268] As noted earlier, to an economist, 'market power' is the ability of a firm to exercise power over price.[269] While most firms in modern markets have some

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[265] See Jones and Sufrin, above n 118, 531–8; Philip J Sutherland and Katharine Kemp, *Competition Law of South Africa* (LexisNexis, 2005-) 7-36–7-49 [7.9].

[266] See Jones and Sufrin, above n 118, 531–2; Sutherland and Kemp, above n 265, 7-36–7-38 [7.9.1].

[267] See Jones and Sufrin, above n 118, 531–2.

[268] Elhauge and Geradin, above n 78, 271–5.

[269] See Kaplow and Shapiro, above n 121, 3; Edwards, above n 121, 157–8, 161. See also *Queensland Wire Industries* (1989) 167 CLR 177, 188 (Mason CJ and Wilson J).

ability to control the price they charge,[270] unilateral conduct laws generally only apply to firms with a substantial degree of market power. What does this mean, and why is such a requirement imposed?

In the US, under section 2 of the *Sherman Act*, the law against monopolisation applies to firms with 'monopoly power',[271] which has been defined to mean 'the power to control prices or exclude competition'.[272] This definition appears to extend the economic meaning of market power (power over price) by adding an alternative basis for finding that monopoly power exists, namely that the firm possesses 'the power to exclude'. However, there is a strong argument that 'monopoly power' should be regarded as the power to price above the competitive level (or reduce quality below the competitive level), and that a firm can price above the competitive level in one of two ways, either by restricting its own output or by restricting the output of its rivals.[273] In practice, US courts tend to infer market power from the dominant firm's market share, coupled with evidence of relatively high barriers to entry,[274] generally requiring a showing of both a market share above 50 percent and an ability to either influence marketwide prices or impose significant marketwide foreclosure that impairs rival efficiency.[275]

In the EU, Article 102 of the TFEU only applies to firms that possess a 'dominant position' in the relevant market,[276] which is defined as

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[270] Kaplow and Shapiro, above n 121, 3; Elhauge, above n 123, 330.

[271] See Phillip E Areeda and Herbert Hovenkamp, 3 *Antitrust Law* (3rd ed, 2008) 1 618, 66. This dissertation focuses on the offence of monopolisation under US law, as opposed to conspiracy to monopolize or attempted monopolization.

[272] *Eastman Kodak Co v Image Technical Services Inc*, 504 US 451, 481 (1992), quoting *United States v E I du Pont de Nemours & Co*, 351 US 377, 391 (1956).

[273] See Thomas G Krattenmaker, Robert H Lande and Steven C Salop, 'Monopoly Power and Market Power in Antitrust Law' (1987) 76 *Georgetown Law Journal* 241, 247–51.

[274] Elhauge and Geradin, above n 78, 283–4.

[275] Elhauge, above n 123, 257.

[276] See Jones and Sufrin, above n 118, 283.

> a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of its consumers.[277]

As with the US explanation of 'monopoly power' this definition appears to focus on both the ability to raise prices and the ability to exclude competition. However, as Elhauge and Geradin point out, recent EU cases have focused more on the firm's pricing discretion in line with the economic meaning of market power, stating that a firm essentially has a dominant position if it has the 'power to behave to an appreciable extent independently of [its] competitors or to gain an appreciable influence on the determination of prices without losing market share'.[278] In practice, the EU authorities generally infer dominance from the existence of high market shares and, to some extent, barriers to entry.[279] In essence, the EU case law establishes a presumption of dominance where a firm possesses a market share of at least 50 percent.[280]

In Australia, section 46(1) of the *CCA* is similarly limited in its application to corporations that possess a substantial degree of market power ('SMP'). The Act provides that, in determining whether a corporation possesses SMP, the court shall have regard to the extent to which the corporation is constrained by the conduct of its competitors, potential competitors, suppliers and customers in the relevant market.[281] It also clarifies that a corporation may possess SMP even though it does not substantially control the market or enjoy absolute freedom from constraint by the conduct of its

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[277] *Hoffmann-La Roche & Co AG v Commission of the European Communities* (85/76) [1979] ECR 461, [38].

[278] Elhauge and Geradin, above n 78, 285, citing *Gencor v Commission of the European Communities* (T-102/96) [1999] ECR II-753.

[279] See Jones and Sufrin, above n 118, 325.

[280] Ibid 328, citing *AKZO Chemie BV v Commission of the European Communities* (C-62/86) [1991] ECR I-3359, [60].

[281] *CCA* s 46(3).

competitors, potential competitors, suppliers and customers.[282] Otherwise the *CCA* provides no definition of, or concrete guidance about, when market power becomes 'substantial'. Rather, this is a question of fact in each case, requiring a 'large' or 'considerable' degree of power, but something *less* than 'monopoly or near monopoly power' or a position of substantial control.[283]

In contrast to the approaches taken in US and the EU, Australian courts have focused primarily on the height of barriers to entry in determining whether a corporation possesses SMP, with less consideration given to market shares or market share thresholds.[284] The High Court has referred to a firm with SMP as having power over price, or 'the ability … to raise prices above supply cost without rivals taking away customers in due time'.[285] In *Boral Besser Masonry Ltd v ACCC*, the majority of the High Court clarified that SMP could not be inferred from the ability to exclude a competitor alone.[286]

A further distinction should be noted between the SMP requirement in these jurisdictions. In both the EU and Australia, the unilateral conduct laws only apply to a firm that meets the SMP requirement *before*, or at the time, it engaged in the impugned conduct.[287] In the US, by contrast, section 2 of the *Sherman Act* will apply to a firm that did not possess ex ante monopoly power, if, by its exclusionary conduct, it gained monopoly power.[288] Section 2 also prohibits attempted monopolisation where a firm's

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[282] *CCA*, s 46(3C).

[283] *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 423 [136]–[137] (Gleeson CJ and Callinan J). See also Corones, above n 115, 132–50.

[284] See George A Hay and Rhonda L Smith, '"Why Can't a Woman Be More Like a Man?" – American and Australian Approaches to Exclusionary Conduct' (2007) *Monash University Law Review* 1099, 1117–8.

[285] *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 423 [136]–[137] (Gleeson CJ and Callinan J).

[286] Ibid 423 [136]–[147] (Gleeson CJ and Callinan J), 438–9 [186]–[188] (Gaudorn, Gummow and Hayne JJ), 474–5 [302]–[308] (McHugh J). See Edwards, above n 121, 157–8.

[287] See Elhauge and Geradin, above n 78, 272; Hay and Smith, above n 284, 1116–7.

[288] Ibid.

conduct creates a dangerous probability of monopoly power. The significance of this difference is explained further in Chapter 4 in particular.

Beyond these matters, this dissertation does not analyse the SMP requirement of unilateral conduct laws, but focuses on the standards proposed for the characterisation of unilateral conduct. For these purposes, it is assumed that the SMP requirements remain unchanged. Nonetheless, in assessing the various proposals for unilateral conduct standards, it is important to understand the *function* that the SMP requirement serves.

It is submitted that the SMP requirement in unilateral conduct laws acts as a screen. That is, it restricts government intervention to the unilateral anticompetitive conduct of those firms which are most *likely* to create an anticompetitive effect.[289] SMP is not an economic concept, but a legal construct which focuses on the substantiality of a firm's market power to determine whether the firm's conduct is worthy of scrutiny.[290]

Importantly, SMP is not a precise or definable degree of market power above which anticompetitive conduct becomes possible and below which all conduct is procompetitive. Rather, the SMP requirement acts as a filter, which is intended to ensure a more cost effective application of the law by focusing enforcement efforts on the range of conduct most likely to create anticompetitive effects.[291]

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[289] See Philip L Williams, 'Should an Effects Test Be Added to s46?' (Paper presented at the Competition Law Conference, Sydney, 24 May 2014) 2; Kaplow and Shapiro, above n 121, 101, 103; Hovenkamp, *Federal Antitrust Policy*, above n 3, 293; Elhauge, above n 123, 335.

[290] See Kaplow and Shapiro, above n 121, 20.

[291] If unilateral conduct laws applied to all firms, the costs of enforcement, compliance and litigation would be enormous. Such rules are therefore limited in their application to those firms that are most likely to succeed in causing harm through their unilateral acts - that is, firms that possess, in lawyers' terms, substantial market power. This threshold requirement filters out the myriad cases that might create little benefit to competition while imposing significant costs on authorities, plaintiffs and defendants. See Kaplow and Shapiro, above n 121, 101, 103; Williams, above n 289, 2.

It is possible, and even profitable, for firms with less-than-substantial market power to engage in anticompetitive conduct in certain circumstances.[292] As noted, in the US, the law of monopolisation extends liability to anticompetitive conduct by which a firm *acquires* monopoly power, in addition to anticompetitive conduct by which a firm maintains its monopoly power.[293] Further, Markovits has recently argued that, as a matter of economic theory, there is actually a weak correlation between a firm's pre-existing monopoly or market power and its ability to engage in anticompetitive conduct.[294]

Nonetheless, the current consensus is that firms with substantial market power are more likely to cause significant harm to the competitive process, and ultimately consumer welfare. Accordingly, the application of unilateral conduct laws is restricted to these firms, even though it may be possible for firms without substantial market power to achieve anticompetitive outcomes by their unilateral conduct.

X. CONCLUSION

To summarise, the possession of a monopoly position, or substantial market power, is acknowledged to pose certain threats to social welfare, and consumer welfare in particular. However, competition laws do not generally condemn the possession of such power alone. This is because the competitive process by which monopolies are created, defended and superseded is believed to produce redeeming benefits, which outweigh the potential harms.

Nonetheless, it is also possible for firms to achieve or maintain a monopoly position or substantial market power by another method – not by outcompeting their rivals, not by offering consumers a better product or service, but by preventing rivals from offering

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[292] See Gormsen, above n 77, 38, referring to post-Chicago scholarship, which indicates that market failures are not necessarily self-correcting and that firms can take advantage of imperfections to produce inefficient results *even in competitive markets*.

[293] Elhauge, above n 123, 331–2.

[294] Richard S Markovits, *Economics and the Interpretation and Application of US and EU Antitrust Law: Volume I* (Springer, 2014) chap 4, 528.

consumers a better product or service.[295] If a dominant firm can hamstring its rivals' attempts to compete, it can enjoy its position of power without creating any benefits for consumers. It can deprive consumers of the benefits of increased rivalry. In these circumstances, society suffers the harms inherent in the possession of substantial market power without enjoying any of its redeeming side effects. Unilateral conduct laws should therefore target this method of maintaining, prolonging or enhancing market power.

[295] Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1038.

CHAPTER 3: THE HISTORY AND OBJECTIVES OF UNILATERAL CONDUCT LEGISLATION IN AUSTRALIA

I. INTRODUCTION

Since 1906, the Australian government has made a number of attempts to enact unilateral conduct laws. The law against misuse of market power that applies in Australia today, namely section 46(1) of the *CCA*,[1] was shaped in part by the history of these earlier legislative attempts. Since its enactment in 1974, the provision has been criticised in respect of three distinctive features in particular:

(a) it does not permit an efficiency defence (or 'authorisation' of the conduct);[2]
(b) it does not take into account the effect of the impugned conduct on the relevant market;[3] and
(c) it depends on the dominant firm 'taking advantage of', or 'using', its market power to achieve its anticompetitive purpose.[4]

The debates surrounding the reviews of section 46(1) have produced substantial literature on how misuse of market power might be proved under the existing provision, and whether such proof is unreasonably difficult.[5] However, relatively little attention has been given to the origins of the provision and particularly its early

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[1] There are other provisions of the *CCA* which address unilateral anticompetitive conduct either incidentally, because such conduct is captured in their broader scope (eg s 47); or in respect of a specific industry (eg Pt XIB) or a specific type of unilateral conduct (eg s 46(1AA) or Pt IIIA), but this dissertation focuses on the treatment of unilateral conduct more generally under s 46(1).

[2] See, eg, Stephen Corones, 'The Characterisation of Conduct under Section 46 of the Trade Practices Act' (2002) 30 *Australian Business Law Review* 409, 414–20; Commonwealth, *Parliamentary Debates*, House of Representatives, 24 July 1974 (Bob Ellicott). The 'authorisation' process is explained in Part II(D) below.

[3] See, eg, Parliament of Australia, *The Trade Practices Act: Proposals for Change* (1984) ('*1984 Green Paper*'); Gaire Blunt and Jennifer Neale, 'The Development of Section 46 in Australia - *Melway* and its Likely Impact on Business' in Frances Hanks and Philip L Williams (ed), *Trade Practices Act: A Twenty-Five Year Stocktake* (Federation Press, 2001) 202, 207; Corones, 'The Characterisation of Conduct', above n 2, 409–13.

[4] See, eg, Ian Harper et al, *Competition Policy Review: Draft Report* (September 2014) 208–9 ('*Harper Draft Report*'); Blunt and Neale, above n 3, 207–8.

[5] See, eg, Corones, above n 2; Bill Reid, 'Section 46 - A New Approach' (2010) 38 *Australian Business Law Review* 41; Rhonda L Smith and David K Round, 'Do Deep Pockets Have a Place in Competition Analysis?' (2012) 40 *Australian Business Law Review* 348.

legislative history. An understanding of these origins, it is argued, is essential to understanding the law against misuse of market power in Australia. As Robert Bork cautioned antitrust lawyers 25 years ago:

> The less we know of how ideas actually took root and grew, the more apt we are to accept them unquestioningly, as inevitable features of the world in which we move.[6]

The aim of this chapter is to uncover the 'roots' of section 46(1), in an attempt to understand the design of the current provision and the means by which it distinguishes procompetitive from anticompetitive conduct. It gives particular attention to the origins of the three features outlined above. This analysis makes reference to the legislative history of the provision's immediate (identical) predecessor, section 46(1) of the *Trade Practices Act 1974* (Cth) ('*TPA*'). At times, however, the trail leads back even further, and so reference is also made to the *Australian Industries Preservation Act 1906* (Cth); the work of Sir Garfield Barwick in proposing new competition legislation for Australia in the 1960s; and the *Trade Practices Act 1965* (Cth). A closer look at this history creates a picture, not of a cohesive scheme targeted at the object of the provision, but of an ad hoc approach shaped in significant respects by inattention, inadvertence and superseded theories.

This chapter is in three parts. Part II outlines the history of Australian legislation regulating unilateral anticompetitive conduct. Part III analyses the origins of the three most distinctive features of section 46(1), in its current form, in an attempt to identify the theoretical underpinnings of the Australian approach. Part IV lays the foundation for further analysis of the law against misuse of market power in Australia by explaining the objective of this law, namely the protection of the competitive process in the long term interests of consumers.

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[6] Robert Bork, *The Antitrust Paradox* (Basic Books, 1978) 15.

II. THE HISTORY OF UNILATERAL CONDUCT LEGISLATION IN AUSTRALIA

A. The Australian Industries Preservation Act 1906

1. An Australian Twist on an American Statute

The first proposal for legislation to address anticompetitive practices, including unilateral conduct, was presented to the Commonwealth Parliament in 1905 and, in largely the same form, in 1906.[7] The Australian Industries Preservation Bill 1906 (Cth) ('AIP Bill') was promoted by the then Attorney-General, Isaac Isaacs, and insofar as it concerned restrictive trade practices and unilateral conduct, it largely adopted the succinct prohibitions of 'contracts and combinations in restraint of trade' and 'monopolization' from the US *Sherman Act* ('the anticompetitive practice provisions').[8]

In spite of some significant opposition,[9] the *Australian Industries Preservation Act 1906* (Cth) ('*AIPA*') was enacted later that year. The enactment of the *AIPA* has sometimes been treated as an unremarkable and abortive attempt to introduce competition law in Australia,[10] and yet, in context, the passage of the provisions concerning anticompetitive practices was quite unusual. At this time, only two other countries had enacted legislation prohibiting anticompetitive practices, namely

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[7] A Bill was originally introduced as a matter of some urgency shortly before Christmas in 1905, but was allowed to lapse. A similar Bill was introduced six months later in 1906.

[8] In clauses 4 and 5, and clauses 7 and 8 respectively. Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 335–90 (Isaac Isaacs, Attorney-General). See Chap 2 Part II(A),(F), explaining the enactment of the *Sherman Act*.

[9] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 373 (James Hume Cook), arguing that it was in fact an 'Anti Competition Bill' aimed at the destruction of private enterprise; Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 387–90 (Edmund Lonsdale).

[10] See, eg, Trade Practices Act Review Committee, Parliament of Australia, *Report to The Minister for Business and Consumer Affairs* (1976) 7 ('*Swanson Report*'); House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989) 5 ('*Griffiths Report*'); Neville R Norman, *Trade Practices Regulation in Australia: An Analysis* (Australian Industries Development Association, 1976) 3.

Canada,[11] and the United States.[12] Competition legislation would not be introduced in the United Kingdom or Europe[13] until after the Second World War.[14] Australia's economy at the turn of the century was very small (with a population of only 4 million in 1906) and yet to be industrialized (in the sense of developing manufacturing of a heavy, complex and diversified kind).[15] And while Australians certainly observed the unfolding power struggle between the US government and the US 'trusts' with concern, Australia had not experienced abuses of a similar scale at the hands of its own dominant firms.[16]

Some explained the need for the anticompetitive practice provisions in terms of a pre-emptive strike against potential misuses of economic power, a move to 'kill the tiger while it is young',[17] and this appears to have been the rationale put forward by the Attorney-General himself. In his second reading speech, Isaacs stated:

> [I]t is necessary to see that [Australia's] manufacturing industries and its natural resources, which may easily be turned into secondary sources of production, are not stifled, perhaps in the very first years of the Commonwealth, by the power of numbers and the power of aggregated wealth wrongly used to the repression of honest individual effort properly directed.[18]

There were also concerns that a number of US trusts or combines might extend their reach and come to dominate in Australia.[19] It does seem, however, that the primary

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[11] *Prevention and Suppression of Combinations Formed in Restraint of Trade Act*, SC 1889.

[12] See Chap 2 Part II(A),(F), explaining the enactment of the *Sherman Act*.

[13] With the exception of Norway, which enacted a competition law in 1926: David Gerber, *Global Competition: Law, Markets and Globalization* (Oxford University Press, 2010) 165.

[14] Ibid 163–67.

[15] This kind of industrialisation would only begin in Australia around the time of World War I: P H Karmel and Maureen Brunt, *The Structure of the Australian Economy* (F W Cheshire, 1966) 88–9.

[16] See Geoffrey de Q Walker, *Australian Monopoly Law* (F W Cheshire, 1967) 18.

[17] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 370 (James Hume Cook, Hughes interjecting).

[18] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 376 (Isaac Isaacs, Attorney-General).

[19] Commonwealth, *Parliamentary Debates*, Senate, 14 June 1906, 248–50 (Sir William Lyne, Minister of Trade and Customs).

motivation for including the anticompetitive practice provisions in the *AIPA* was to seal a related political bargain.

To explain, the *AIPA* also included an 'anti-dumping law' that prohibited cheap imports, which were thought to threaten important Australian industries. This law was proposed at the request of a Mr H V McKay, the largest producer of harvesting machines in Australia.[20] After a falling out with American and Canadian harvester manufacturers with whom he had previously colluded, Mr McKay sought protection for his local harvester manufacturing business from lower-priced imports which were said to threaten the Australian industry, and its workers and customers alike.[21] To secure the passage of the anti-dumping law, the Government required the support of the Labour Party.[22] The Labour Party was, at this time, concerned with the power of monopolists, particularly in the tobacco industry and the sugar industry, and it advocated the nationalisation of these industries.[23] As a compromise, and no doubt to forestall the nationalisation alternative,[24] the Government included the anticompetitive practice provisions in the *AIPA*.[25]

While some have suggested that the Government was not motivated to actually enforce the anticompetitive practice provisions of the *AIPA* even at the outset,[26] it is difficult to doubt entirely the sincerity of the Attorney-General in his speeches on the Bill,[27] or later, as a judge of the High Court, in his eloquent and thorough 280-page

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[20] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 352–55 (William Johnson).

[21] See 'Manufacturers' Protection Association', *Chronicle* (Adelaide), 1 April 1905, 5; 'Farming Machinery: More About Prices', *The Register* (Adelaide), 28 April 1905, 4.

[22] The party was only formally named the 'Australian Labour Party' in 1908, and changed the spelling to the 'Australian Labor Party' in 1912.

[23] Commonwealth, *Parliamentary Debates*, House of Representatives, 14 December 1905, 7029–36 (John Watson).

[24] D J Stalley, 'Federal Control of Monopoly in Australia' (1958) *University of Queensland Law Journal* 258, 263.

[25] Commonwealth, *Parliamentary Debates*, Senate, 4 October 1906, 6040 (Hugh De Largie).

[26] Stalley, above n 24, 261–62.

[27] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 375–87 (Isaac Isaacs, Attorney-General).

judgment in the first case to interpret the anticompetitive practice provisions of the *AIPA*.[28] Concerns had also been raised about the power exercised by local undertakings, including the Colonial Sugar Refining Company, the shipping combines and the coal vend (a group of collieries acting in concert in the Newcastle region).[29]

As for the adoption of the American approach, it seems likely that the early Commonwealth legislators were keen to learn lessons from American federation and that they found in the *Sherman Act* a ready-made and apparently constitutionally valid law.[30] Sections 4 and 5 of the *AIPA* followed the lead of section 1 of the *Sherman Act*, prohibiting contracts and combinations in restraint of trade. The *AIPA* also addressed unilateral conduct, prohibiting 'monopolization' pursuant to section 7 (in respect of interstate trade) and pursuant to section 8 (in respect of certain corporations). Largely adopting the wording of section 2 of the *Sherman Act*, section 7 of the *AIPA* provided as follows:

> (1) Any person who monopolizes or attempts to monopolize, or combines or conspires with any other person to monopolize, any part of the trade or commerce with other countries or among the States, with intent to control, to the detriment of the public, the supply or price of any service, merchandise, or commodity, is guilty of an offence.
>
> • Penalty: Five hundred pounds.
>
> (2) Every contract made or entered into in contravention of this section shall be absolutely illegal and void.

Section 8 repeated this prohibition in respect of '[a]ny foreign corporation, or trading or financial corporation formed within the Commonwealth'. The Act did not define 'monopolization', a fact that was to prove critical in the application of this prohibition.[31] The *AIPA* also gave plaintiffs the right to claim treble damages from the

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[28] *R v Associated Northern Collieries* (1911) 14 CLR 387.

[29] Commonwealth, *Parliamentary Debates*, House of Representatives, 14 December 1905, 7029–36 (John Watson). See also Part II(A)(2) below.

[30] Stalley, above n 24, 263.

[31] See Part II(A)(2) below.

defendant if an infringement of any of these provisions was proved,[32] another feature adopted from the US legislation.[33]

Some aspects of the wording of these provisions should be noted. First, sections 7 and 8 were drafted to make reference to interstate trade and to corporations respectively, in an attempt to bring the provisions within the Commonwealth Parliament's limited powers to legislate.[34] Second, the provisions prohibited not only unilateral anticompetitive conduct but also multilateral conduct where a number of parties combined or conspired to 'monopolize'. These laws preceded the sharper lines drawn between horizontal, vertical and unilateral practices in modern competition policy.[35] Third, the Australian provision departed from the US provision by adding further elements of intent and detriment, by requiring that there be 'intent to control, to the detriment of the public'.[36] This modification was made because the Bill's promoters felt that the US statute went too far in condemning all 'trusts', and they wished to ensure that only monopolies that were detrimental to the public would be caught by the Australian legislation.[37] As will be seen, however, in its interpretation by the courts, this element was to prove fatal to the effectiveness of section 7.

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[32] *Australian Industries Preservation Act 1906* (Cth) s 11(1).

[33] Ironically (given the rarity of punitive damages awards under English and Australian common law) the treble damages remedy was actually an English invention. Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (Thomson Reuters, 4th ed, 2011) 720, states that the final proposal for treble damages under the *Sherman Act* was modeled largely on the English Statute of Monopolies which, since 1623, had provided that any person injured by a monopoly 'shall recover three times so much as the damages that he sustained by means or occasion of being so hindered …'.

[34] Reliance was placed on the trade and commerce power (*Constitution* s 51(1)) and the corporations power (*Constitution* s 51(XX)): Commonwealth, *Parliamentary Debates*, House of Representatives, 19 June 1906, 376–77 (Isaac Isaacs).

[35] See Chap 1 Part VI herein.

[36] Ibid 377–78.

[37] Ibid.

2. Enforcing the AIPA: the Coal Vend case

Context and Facts in the Coal Vend Case

The life of section 8 of the *AIPA* was brief: it was declared constitutionally invalid in 1909.[38] The following year, under the Fisher Labour administration, the first case under section 7 was brought. It came before Isaacs J himself, by then a judge of the High Court. This case, now known as the *Coal Vend case*,[39] was the first and the last section 7 claim to proceed to a final hearing.

The *Coal Vend case* did not actually involve any unilateral conduct. The claim under section 7 concerned a multilateral 'monopolization' by a number of colliery owners and shipping companies in New South Wales, which would nowadays be addressed as horizontal and vertical agreements and not as monopolization or misuse of market power.[40] But the case is important for present purposes because it explains the particularly high threshold that was set for the application of section 7, especially with regard to the defendants' intent.

In the *Coal Vend case*, substantially all of the colliery owners in the Newcastle and Maitland districts of New South Wales entered an agreement with each other in 1906.[41] The purpose of this agreement was to raise and maintain the price of coal.[42] There had been agreements on price between Newcastle collieries in earlier times, but this particular agreement was made in response to a period of intense price competition between the collieries, which had been initiated by a new colliery that

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[38] In *Huddart, Parker & Co Pty Ltd v Moorehead* (1909) 8 CLR 330, the High Court held that the power to make laws with respect to 'foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth' did not extend to controlling the operations of such corporations when lawfully engaged in domestic trade within the States, and accordingly ss 5 and 8 of the *AIPA* were beyond the constitutional power of the Commonwealth. These sections were repealed in 1909.

[39] *R v Associated Northern Collieries* (1911) 14 CLR 387 ('*Northern Collieries*').

[40] The Attorney-General in the *Coal Vend case* also alleged breach of s 4 of the AIPA, but this claim was rejected for largely the same reasons as the section 7 claim.

[41] *Northern Collieries* (1911) 14 CLR 387, 396–98, 437. There were 30 colliery owners in these districts and all but one were parties to the agreement.

[42] Ibid 396–98, 437.

commenced operations in the Maitland district in 1904.[43] The agreement between the colliery owners (known as the 'Vend') fixed the selling price of coal, restricted the output of each colliery to an allotment fixed under the agreement, and generally forbade the opening of new pits.[44] The Vend itself, however, was not the subject of the prosecution,[45] presumably because it operated only within New South Wales and section 7 only applied to interstate trade.

Rather the Crown's claim related to a further agreement between the members of the Vend, on the one hand, and four shipping companies, on the other, pursuant to which the shipping companies agreed to obtain all of their coal requirements for interstate trade from the Vend ('the shipping agreement').[46] The members of the Vend, in turn, promised to sell no coal for consumption interstate other than to the shipping companies.[47] The shipping agreement also set a maximum resale price for the coal.[48]

The Decision at First Instance: Isaacs J

At first instance, Isaacs J held that the defendants had infringed section 7, finding that, by their agreements, the colliery owners and the shipping companies had aimed to 'grasp into one huge hand the whole inter-State supply of Newcastle coal'.[49] With regard to section 7, His Honour described the concept of 'monopolization' under the AIPA in some detail. He explained that:

> [T]he legislation is not aimed at the share or proportion of trade which any person whether individual or corporation may acquire in the ordinary course of business. If by superiority of service or commodity, by lower prices more desirable terms or any of the

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[43] *Adelaide Steamship Co Ltd v R* (1912) 15 CLR 65, 82 ('*Adelaide Steamship*').

[44] Unless a firm's quota could not be met from its existing pits: *Attorney-General (Cth) v The Adelaide Steamship Co Ltd* (1913) 18 CLR 30, 41, 43 ('*Adelaide Steamship (Privy Council)*'). There was even provision for the Vend to make payments to members who sold less than their allotment 'as an inducement to the parties whose trade fell off not to increase it by under-selling or other act contrary to the spirit of this agreement': *Adelaide Steamship* (1912) 15 CLR 65, 87.

[45] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 46.

[46] *Northern Collieries* (1911) 14 CLR 387, 398, 424–26.

[47] Ibid 424–26.

[48] Ibid.

[49] Ibid 654.

> arts and inducements known to active rivalry, always consistent with healthy competition, and free from force or fraud, a trader attracts to himself the whole of the trade in any particular direction he does not offend against the law of monopoly. The field of opportunity is open to all; he has fairly used it and has succeeded. He has succeeded, not because he has silenced, but because he has outstripped his competitors, and because the public find it to their advantage to voluntarily accept his service in preference to that of others they might have; and should he abuse his opportunity by asking unduly high prices, or restricting facilities or otherwise, the field is as open as ever for competitors to offer and for the public to accept. At all events, up to that point, he has neither done or intended any harm to the community. But if not content with serving the public to the best of his ability, and letting consequences take care of themselves, he so *acts as to purposely concentrate in himself the existing means of public satisfaction in such a way and to such an extent as in the circumstances to prevent or destroy all reasonably effective competition, he does, within the meaning of the Statute, monopolise or attempt to monopolise*.[50]

His Honour later emphasised this last aspect, stating:

> In my opinion *the prevention or destruction of all reasonable and effective competition* – the natural commercial safeguard of the public – is at the root of the conception of monopoly within the meaning of the statute.[51]

As to the intention of the parties to the shipping agreement, he stated:

> I have no doubt, and I cannot imagine any doubt existing, that the intention of the defendants was to monopolise in the sense in which I have explained that term. They intended to efface competition in every form – competition of production … and competition of carriage.[52]

This elimination of competition was 'the main and the central object of the whole combination complained of' and not 'an indirect and subordinate injurious result from a primarily innocent scheme'.[53] As to the detriment to the public, his Honour

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[50] Ibid 653 (emphasis added).

[51] Ibid 654 (emphasis in original).

[52] Ibid 654.

[53] Ibid 655.

essentially focused on various harms to consumer welfare. The relevant detriment was found to consist of the excessive prices charged for Newcastle coal; the restricted choice of coal introduced by the Vend and made more effective by the shipping agreement; and shortages in the delivery of coal desired by customers.[54]

In considering the requirement in section 7 that the defendant monopolises 'with intent to control, to the detriment of the public, the supply or price of any service, merchandise, or commodity', Isaacs J found that the defendants had both an intent to monopolise,[55] and that their monopolisation had caused detriment to the public.[56] The defendants by their agreement intentionally prevented all effective competition, the public was thereby deprived of its 'commercial safeguard', actual detriment was found to occur and the defendants intended those natural or probable consequences of their acts.[57]

The Appellate Decisions

On appeal, the Full High Court took a dimmer view of the benefits of competition, and a more sympathetic view of the conduct of the defendant collieries and shipping companies.[58] The Court noted early in its reasoning that '[c]ut-throat competition is not now regarded as necessarily beneficial to the public'.[59] Rather the Court saw a trend in 'modern legislation' which recognized that combinations may actually work in the public interest.[60] The Vend was described by the Court in strikingly benign terms as 'a combination of coal owners who entered into mutual agreements for the purpose, not only of preventing unlimited and ruinous competition, but of fixing a definite basis for the hewing rate', the hewing rate being the wage paid to mine

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[54] Ibid 650, 625.

[55] Ibid 654.

[56] Ibid 650, 652, 474.

[57] Ibid 461–62, 654.

[58] *Adelaide Steamship* (1912) 15 CLR 65.

[59] Ibid 76.

[60] Ibid 76–77. It referred to the Trade Union Acts, the Wages Board Acts, customs laws and arbitration laws as examples of this trend.

workers.[61] At the time the agreement was made, 'all parties honestly believed … that the prosperity of the Newcastle and Maitland Districts was in danger, as well as their own individual interests, by reason of the excessive competition and unremunerative prices obtained for coal'.[62] The Vend was thus 'a lawful and even laudable transaction', which was intended to operate and did operate to the advantage of the public, notwithstanding that it was intended to operate and did operate to raise the price of coal.[63]

With regard to the shipping agreement, the Court held that, according to section 7, 'an agreement made to create a monopoly is not unlawful under the Act unless it is made with intent to cause detriment to the public'.[64] Importantly, the public in question was *not just consumers*, but the public at large, including the producers and workers.[65] The Court found that the parties to the shipping agreement did not possess a 'sinister intention' to cause detriment to the public, rather it was their intent to secure for the colliery owners 'a convenient and tolerably certain outlet for their coal in the inter-State market'.[66] Accordingly, there was no breach of section 7.

On appeal, the Privy Council was similarly sympathetic to the plight of the defendants.[67] Their Lordships noted that the Vend was intended to raise and maintain the price of coal and, to that end, the Vend included the colliery owners in the Maitland district, whose competition had 'proved so disastrous'.[68] It was found that:

> [N]either the vend agreement nor the shipping agreement taken separately, nor both agreements taken together as part of a single scheme, can raise any legitimate inference that any of the parties concerned … acted otherwise than with a view to

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[61] Ibid 82.

[62] Ibid 85.

[63] Ibid 91.

[64] Ibid 101.

[65] Ibid 72, 77.

[66] *Adelaide Steamship* (1912) 15 CLR 65, 93.

[67] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30.

[68] Ibid 43.

> their own advantage, or had any intention of raising prices or annihilating competition to the detriment of the public.[69]

In their Lordships' opinion, the Crown could not rely on 'the mere intention to raise prices' as proving an intention to injure the public.[70] Rather, it would be necessary to demonstrate an intention to charge 'excessive or unreasonable prices'.[71] The onus of proving that prices were unreasonable lay with the Crown and, in their Lordships' view, that onus had not been discharged.[72] Evidence of other kinds of detriment – including delays and shortages experienced by consumers of coal – were not relevant since no inference could be drawn from such evidence as to the intention of the parties in entering the agreements.[73] Similarly, evidence of the defendants applying pressure to collieries outside the Vend was irrelevant since this policy was not foreshadowed or contemplated in the agreement, nor was it the necessary outcome of the agreement.[74] Accordingly, the Crown's claim failed for lack of evidence of the requisite 'sinister intention'.[75]

Differences in Approach: Consumer Welfare and Monopolisation vs Total Welfare and Restraint of Trade

The key point of difference between the decision of Isaacs J and the decisions of the appeal courts, it is submitted, was their respective definitions of 'monopolisation'. As noted earlier, this term was not defined by the Act and so remained open to interpretation by the courts. Isaacs J defined monopolisation in economic terms, emphasising that it entailed 'the prevention or destruction of all reasonable and effective competition', thereby removing the commercial safeguard of the public. In

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[69] Ibid 52.

[70] Ibid 48.

[71] Ibid.

[72] Ibid 52-53.

[73] Ibid 53–54. At 53: Since the parties to the agreement 'could gain nothing by putting difficulties in the way of their own customers', their Lordships concluded that they could not have intended this detriment in entering the agreements.

[74] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 54.

[75] Ibid.

so reasoning, he gave priority to consumer welfare as the goal of the legislation. His reasoning also revealed concerns with economic freedom;[76] a distinction between vigorous competition and the suppression of rivalry in a market;[77] and the recognition that, in the absence of unilateral anticompetitive conduct, a market could self-correct where a firm exercised its market power to the detriment of consumers.[78]

The Full High Court and the Privy Council, on the other hand, both began with a detailed discussion on the common law of restraint of trade as the basis for defining 'monopolisation' under the Act.[79] As explained in Chapter 2, at common law, a contract in restraint of trade was only enforceable if it was 'reasonable both in reference to the interests of the parties and in reference to the interests of the public'.[80] Notwithstanding this reference to the public interest, however, the common law demonstrated an overwhelming concern with the reasonableness of the restraint as between the parties to the contract, and the general public interest in upholding the bargain made by the parties.[81] In fact, in the Privy Council, their Lordships stated that they were not aware of 'any case in which a restraint though reasonable in the interests of the parties has been held unenforceable because it involved some injury to the public'.[82] There had, however, been a suggestion in an earlier English case that this might occur if the restraint were calculated to create a 'pernicious monopoly, that is to say, a monopoly calculated to enhance prices to an unreasonable extent'.[83]

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[76] It was acceptable for a trader to attract the whole of a trade so long as he did so 'free from force or fraud' and so long as the 'field of opportunity is open to all': see n 50 above and accompanying text. See also Chap 2 Part III(D) herein on economic freedom as an objective of unilateral conduct laws.

[77] It was lawful for a trader to succeed 'not because he has silenced, but because he has outstripped his competitors': see n 50 above and accompanying text. See Chap 2 Part VIII on the 'suppression' of rivalry.

[78] '[S]hould he abuse his opportunity by asking unduly high prices, or restricting facilities or otherwise, the field is as open as ever for competitors to offer and for the public to accept': see n 50 above and accompanying text.

[79] *Adelaide Steamship* (1912) 15 CLR 65, 73-76; *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 31–35.

[80] See Chap 2 Part II(D) herein.

[81] Ibid. See also *Nordenfelt v Maxim Nordenfelt Co* [1894] AC 535, 565–7, 573.

[82] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 33.

[83] Ibid 33–5, citing *Maxim Nordenfelt Guns and Ammunition Company v Nordenfelt* [1893] 1 Ch 630.

While the Attorney-General urged the Privy Council to have regard to decisions of the US Supreme Court under the *Sherman Act* in interpreting the *AIPA*, the Privy Council held that these decisions were not 'of any real assistance' since, unlike the *Sherman Act*, the *AIPA* required proof of detriment to the public and sinister intention.[84] Their Lordships instead equated the concept of 'destructive monopoly' under the *AIPA* with the concept of 'pernicious monopoly' under the common law restraint of trade.[85] This reliance on the common law caused the appeal courts to focus on the interests of the parties to the restraint, namely the producers (and workers incidentally, as benefiting from the prosperity of the producers), at the expense of the interests of consumers.[86]

Further, the statements of the appeal courts concerning the necessary intention to cause detriment indicated that it would never suffice to show that the defendants purposely freed themselves from the constraints of competition, securing for themselves the 'quiet life' free from pressures to provide a better product or a lower price. Rather, plaintiffs would face the extremely difficult task of proving that the defendants had not only agreed to increase prices but to increase them to an 'excessive' level.

D J Stalley commented that it was unfortunate that this important test case concerned the coal mining industry, which, as in practically all coal producing countries, was affected by the difficult problems of over-capacity and declining demand due to competition from fuel substitutes.[87] Perhaps these extenuating circumstances provide some explanation for certain parts of the reasoning of the appeal courts, which so lacked foundation in logic as to give the appearance of naivety or willful blindness.[88] For example, the Privy Council expressed the view that it could not have been in the Vend's interests to charge unreasonably high prices because it was constrained in its

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[84] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 39–40.

[85] Ibid 37.

[86] The defendants had not raised prices to 'an unreasonable extent', nor had they 'acted otherwise than with a view to their own advantage': ibid 52.

[87] Stalley, above n 24, 288.

[88] See, eg, Stalley, above n 24, 284–88, for an economic analysis of the views of the appeal courts.

pricing by competition from outside the Vend.[89] At the same time, their Lordships disapproved of the practices engaged in by members of the Vend to prevent outsiders from competing with the Vend, but refused to take these exclusionary practices into account in their reasoning since they were not contemplated by the agreement.[90]

The ultimate impact of the *Coal Vend case* is discussed further below, but first it is worth noting a further development under the *AIPA*.

3. 'Strengthening' the *AIPA*

In 1910, while the *Coal Vend case* was still in its interlocutory stages, the Acting Prime Minister and Attorney-General, William Hughes, introduced a Bill to amend the *AIPA* with the aim of 'strengthening' the statute.[91] In the second reading speech, Hughes referred to Parliament's original intention in enacting the *AIPA* and the disappointing results since its enactment:

> The hope was then expressed that its effect would be to regulate and control the extreme operations of trusts, to suppress monopolies, and generally to enable the Legislature to exercise a paternal supervision and control over the financial monsters who in these days seem to multiply exceedingly in our commercial deep. The net effect of that Act so far has been nil.[92]

Although the judgments in the *Coal Vend case* had not yet been delivered, Hughes explained that the *AIPA* had been impossible to enforce in the vast majority of cases due to the difficulty in proving detriment to the public in the early stages of conduct and the extreme difficulty of proving intent.[93]

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[89] *Adelaide Steamship (Privy Council)* (1913) 18 CLR 30, 48.

[90] Ibid 53–54.

[91] Commonwealth, *Parliamentary Debates*, House of Representatives, 11 November 1910, 6038–43 (William Hughes, Acting Prime Minister and Attorney-General).

[92] Ibid 6038. See also Commonwealth, *Parliamentary Debates*, Senate, 15 November 1910, 6095 (George Pearce, second reading speech), stating that there had been 'fifteen or twenty inquiries into cases' but 'only two prosecutions, the final result of which was that two sections of the principal Act were declared by the High Court to be ultra vires of the Constitution'.

[93] Commonwealth, *Parliamentary Debates*, House of Representatives, 11 November 1910, 6096 (William Hughes, Acting Prime Minister and Attorney-General).

Hughes argued that the problem was that the *AIPA* was a 'weak imitation' of the *Sherman Act*, and that the current difficulties in enforcement could be alleviated if Australia followed the US position of requiring no proof of intent or public detriment.[94] Notwithstanding his rhetoric, Hughes acknowledged that if the Australian parliament prohibited *all* combines 'the whole country would be thrown into chaos', and, accordingly, the Bill added a defence in respect of the prohibition against contracts and combinations in restraint of trade where the defendant proved that the restraint was not unreasonable and not to the detriment of the public.[95]

Importantly, in respect of monopolisation, the amendment removed the need to prove intent or detriment to the public,[96] but it permitted no defence.[97] According to Hughes, when the Court construed the Act, '"monopoly" would be defined to be something very much more than a technical monopoly. It would have to be a monopoly whose volume was substantial, and whose operation would, in fact, threaten or endanger the public'.[98] It could not be claimed that, notwithstanding the existence of such a monopoly, it caused no detriment to the public.[99]

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[94] Ibid 6040–41.

[95] Ibid 6041–42. Indeed, Hughes still argued for the nationalization of monopolies: Commonwealth, *Parliamentary Debates*, House of Representatives, 18 October 1910, 6042 (William Hughes).

[96] *Australian Industries Preservation Act 1910* (Cth) s 4 deleted the words 'with intent to control, to the detriment of the public, the supply or price of any service, merchandise, or commodity' from the *AIPA* s 7. The amendment also made infringement of s 7 of the *AIPA* an indictable offence.

[97] Commonwealth, *Parliamentary Debates*, House of Representatives, 11 November 1910, 6057–58 (William Hughes, Acting Prime Minister and Attorney-General).

[98] Ibid. He went on to assure the House that he only intended to proceed in cases of 'such flagrant misuse or abuse of the trading opportunities … as creates, or might create, a dangerous condition of things'.

[99] According to one view, since the concept of monopoly required proof that the conduct excludes effective competition, 'to allow the defendant under section 7 to set up as an explanation that the monopoly is not to the detriment of the public would simply be to give him permission to rebut what the Crown has to prove': Commonwealth, *Parliamentary Debates*, House of Representatives, 11 November 1910, 6058 (Patrick Glynn). See also Commonwealth, *Parliamentary Debates*, House of Representatives, 11 November 1910, 6057 (Littleton Groom): 'The mere fact of a monopoly is taken to mean something injurious.'

4. The Fossilisation of the AIPA

In addition to the 1910 amendments to remove the requirements of intent and detriment from section 7, earlier amendments to the *AIPA* had prohibited other potentially unilateral conduct, particularly exclusive dealing[100] and improper refusals to sell,[101] with the aim of striking at monopolisation in its initial stages.[102] But, in spite of these attempts to make the *AIPA* more useful, no further cases in respect of unilateral conduct proceeded to a final hearing until the Act was repealed in 1966.

Given the events of the intervening years, there was, perhaps unsurprisingly, little focus on unilateral anticompetitive conduct. Faced with the immense uncertainty and contracting markets of the Depression, many businesses sought to protect themselves with restrictive trade practices and agreements, which were generally accepted as necessary and even desirable.[103] During the two World Wars, Australian industry was also subjected to extensive government regulation (including controls on prices and standards as well as compulsory rationing and zoning of market areas) in support of the war effort.[104] Government attention to anticompetitive behaviour, where it existed, tended to be directed at controlling prices during the war and post-war inflationary periods.[105]

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[100] *Australian Industries Preservation Act 1906* (Cth) s 7A, inserted by *Australian Industries Preservation Act 1909* (Cth) s 5.

[101] *Australian Industries Preservation Act 1906* (Cth) s 7B, inserted by *Australian Industries Preservation Act 1909* (Cth) s 5.

[102] These amendments implemented the recommendations of the *Royal Commission on Navigation* (1910) by declaring illegal practices shown to have been widely used in the formation of monopolies: Stalley, above n 24, 265.

[103] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 May 1965, 1654-55 (Billy Snedden, Attorney-General). See also, eg, *A-G (NSW) v Brickworks Pty Ltd* (1941) SR (NSW) 72, 77–81; Sir Garfield Barwick, 'Australian Proposals for the Control of Restrictive Trade Practices and Monopolies: Trade Practices in a Developing Economy' (Speech delivered as The G L Wood Memorial Lecture, University of Melbourne, 16 August 1963) 8–9; Alex Hunter, 'Restrictive Trade Practices and Monopolies in Australia' [1961] *Economic Record* 25, 38.

[104] Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3238–39 (Reginald Connor); Barwick, 'G L Wood Memorial Lecture', above n 103, 9; Hunter, above n 103, 25, 38.

[105] See, eg, *Necessary Commodities Control Act 1919* (NSW); *Profiteering Prevention Act 1920* (Qld); *Profiteering Prevention Act 1939* (WA); *Industrial Arbitration Act 1939* (NSW).

But even if the Crown had had any appetite for antitrust litigation in these circumstances, it was now clear that a strong case under section 7 would be a very rare specimen. First, proof of monopolisation would, in the words of Isaacs J, require 'the prevention or destruction of all reasonable and effective competition':[106] partial foreclosure of the market would not suffice. Second, notwithstanding the deletion of the requirement of intent and detriment in section 7, courts were likely to construe the concept of 'monopolisation', which remained undefined in the Act, as requiring an element of danger or injury to the public,[107] and the High Court had demonstrated a very marked reluctance to find these elements in the *Coal Vend case*.[108]

After the *Coal Vend case*, there were several failed attempts to amend the Constitution to permit the Commonwealth to legislate in respect of *intra*state trade practices.[109] However, there was never a constitutional issue concerning sections 4 and 7 of the *AIPA* – they validly prohibited combinations and monopolization in *inter*state trade – and there appear to have been a number of examples of interstate anticompetitive practices which could have been litigated under the existing provisions of the legislation.[110] It seems likely that section 7 remained unused due to a combination of the high threshold set by the *Coal Vend case* and a lack of political will. The Australian Labor Party ('ALP'), during this period, preferred to focus on nationalisation and government controls to counter aggregations of economic power, while non-labour groups also used their influence to oppose the use of competition legislation.[111] At the same time, there was no groundswell of support for such legislation from the Australian public. Perhaps because they had not been subjected to

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[106] *Northern Collieries* (1911) 14 CLR 387, 654.

[107] See n 98 and 99 above.

[108] See also Sir Garfield Barwick, 'Some aspects of Australian proposals for legislation for the control of restrictive trade practices and monopolies' (Paper presented at the 13th Legal Convention of the Law Council of Australia, Hobart, Tasmania, January 1963) 14.

[109] Referenda were held in 1913, 1919, 1926, and 1944 but on each occasion the power sought was denied to the Commonwealth: Stalley, above n 24, 258.

[110] Eg, Karmel and Brunt, above n 15, 96, list 24 types of product that were the subject of Australia-wide price agreements.

[111] Stalley, above n 24, 288; G de Q Walker, 'Competition Policy and the Corporation' in J P Nieuwenhuysen (ed), *Australian Trade Practices: Readings* (Croom Helm, 2nd ed, 1976) 17–18.

the dramatic exploits of 'robber barons', or 'trusts' in the mould of America's Standard Oil,[112] the Australian public retained a general apathy towards competition and its benefits well into the 1960s.[113]

In the period that the *AIPA* remained in force, some States also enacted legislation that addressed intrastate unilateral anticompetitive conduct. Queensland, for example, passed the *Profiteering Prevention Act 1920* (Qld), and New South Wales passed the *Monopolies Act 1923* (NSW),[114] both of which contained provisions in very similar terms to section 7 of the *AIPA*.[115] But, for similar reasons, litigated claims under these statutes were rare and met with very limited success in the courts.[116]

B. Sir Garfield Barwick's British Proposal

By the late 1950s, anticompetitive practices had become a pervasive feature of commercial life in Australia and, in some quarters, concerns began to be raised.[117] The cooperation between firms that served the country's aims during the Depression and the war years had since lingered and expanded, creating a vast web of restrictive practices linking whole industries.[118] Small traders struggled to gain membership of trade associations, without which they were denied supplies and/or customers.[119] Price-fixing between rivals was regarded as a normal aspect of 'orderly marketing' in

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[112] Walker, *Australian Monopoly Law*, above n 16, 18.

[113] Stalley, above n 24, 288.

[114] New South Wales had also earlier passed the *Industrial Disputes (Amendment) Act 1909* (NSW) to insert similar provisions in the *Industrial Disputes Act 1908* (NSW).

[115] These statutes were enacted after the 1910 amendments, but adopted the pre-1910 wording of the *AIPA* provisions, requiring 'intent to control, to the detriment of the public'.

[116] See, eg, *A-G (NSW) v Brickworks Pty Ltd* [1941] SR NSW 72, 83, 91 interpreting the *Monopolies Act 1923* (NSW) s 5 (including the requirement of 'intent to control, to the detriment of the public') and s 7 (which permitted a defence where the conduct was 'reasonably necessary for the maintenance of the industry'). See also Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law* (Kluwer Law International, 2003) 56.

[117] See, eg, Western Australia, Honorary Royal Commission on Restrictive Trade Practices and Legislation, *Report* (1958) ('*Report of the Western Australia Royal Commission*'); Barwick, 'G L Wood Memorial Lecture', above n 103.

[118] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 19 May 1965, 1655 (Billy Snedden, Attorney-General). See also Barwick, 'G L Wood Memorial Lecture', above n 103, 9.

[119] Barwick, 'G L Wood Memorial Lecture', above n 103, 2.

many markets.[120] Government requests for tender were met with such coordinated responses that, for example, nineteen firms could bid precisely £27,578 14s 2d for the same contract.[121]

There began a period of investigation into, and debate over, whether such practices were problematic,[122] and, if so, how the problem should be solved. There were royal commissions in Western Australia,[123] and later Tasmania,[124] aided by ground-breaking empirical studies by young researchers and economists.[125] But the most significant contribution to this process was made by the Commonwealth Attorney-General, Sir Garfield Barwick, and his department.[126]

Between 1960 and 1964, the Attorney-General's Department systematically documented reports of restrictive trade practices from around the country.[127] In response to a common view that there were no restrictive trade practices in Australia, or none that were harmful to the public, the Attorney-General's Department published

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[120] See, eg, *Report of the Western Australia Royal Commission*, above n 117, 13–15; Commonwealth, *Parliamentary Debates*, House of Representatives, 19 May 1965, 1654 (Billy Snedden, Attorney-General); Karmel and Brunt, above n 15, 94–96.

[121] Barwick, 'G L Wood Memorial Lecture', above n 103. The Comptroller of Stores for the West Australian Government Railways listed 45 articles which were 'non competitive as to price whenever tenders are called': *Report of the Western Australia Royal Commission*, above n 117, 15.

[122] At this time, there was some ambivalence about the likely effect of these practices, even among eminent economists. Karmel and Brunt, above n 15, 97–102, for instance, believed that the high concentration and restrictive practices that prevailed in Australian markets could well be offset by the rapid rate of growth the country was experiencing.

[123] See *Report of the Western Australia Royal Commission*, above n 117.

[124] Tasmania, Royal Commission on Prices and Restrictive Trade Practices in Tasmania, *Report* (1965).

[125] See Karmel and Brunt, above n 15, 95–97, citing R D Freeman, *Employers Associations in Victoria, 1840-1958* (B Com Thesis, University of Melbourne, 1959); P Cook, *Trade Associations in South Australia* (B Ec Thesis, University of Adelaide, 1961); Hunter, above n 103, 25–52.

[126] See Maureen Brunt, 'Lawyers and Competition Policy' in D Hambly and J Goldring (ed), *Australian Lawyers and Social Change* (The Law Book Co, 1976) 266, 266. For a more backhanded commendation, see Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3225 (Gough Whitlam): 'Nobody knew better than Sir Garfield Barwick the loopholes and the subterfuges of big business. No-one was better qualified to plug those loopholes and to ban those subterfuges. The best poachers, it was thought, often proved to be the best gamekeepers.'

[127] Barwick, 'G L Wood Memorial Lecture', above n 103, 2.

a list of some 32 types of restrictive trade practice, which had been brought to its notice, along with the possible harmful consequences of such practices.[128] The list included the following five types of unilateral conduct:

> 13. The supply by the manufacturer of a product on the condition that the reseller handles no one else's brand of that product, or that the reseller handles no other Australian brand of that product.
>
> 14. The supply by the manufacturer of a product on the condition that the reseller takes all his requirements of that product from that manufacturer, or on the condition that the reseller purchases a minimum quantity of that product from that manufacturer.
>
> 15. The supply by the manufacturer of a product on the condition that the reseller takes other products of that manufacturer – sometimes the manufacturer's "full line" of products – whether the reseller wants the other products or not; or the supply by the manufacturer on the condition that the reseller buys other products from other designated manufacturers.
>
> 16. The exacting of disproportionate discounts from manufacturers by a powerful reseller.
>
> …
>
> 18. The taking over or the buying out of all the existing businesses in an industry, sometimes after the adoption of exclusionary tactics, eg, the tying up of the available reseller outlets for the product concerned.[129]

These practices could be described in modern terms as exclusive dealing (including requirements contracts), full-line forcing, third-line forcing, buyer-induced price discrimination and anticompetitive mergers. Sir Garfield also noted the further potential practice of predatory pricing by a dominant organisation, which might temporarily reduce prices to a level which would force its rivals out of business and

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[128] Commonwealth Government, *Australian Proposals for Legislation for the Control of Restrictive Trade Practices and Monopolies* (undated) ('*Australian Proposals for Legislation*').

[129] Ibid 8–10.

thereafter leave the dominant firm to raise its prices to a level of its own choosing.[130] But there seem to have been no actual reports of unilateral predatory pricing.[131]

Economists also drew attention to the high degree of concentration in Australian markets by world standards, as well as the unusually common incidence of monopolies. Karmel and Brunt, for instance, stated that:

> It is commonplace of British and American textbooks that in modern economies single-firm monopoly is virtually non-existent; that is, it is a theoretical type which is a curiosity in practice. And yet in Australia in 1957-58 there were 14 important cases. These 14 cases of so-called 'old-fashioned monopoly' accounted for over 8 per cent of gross value added and over 5 per cent of employment in manufacturing; and far more important, it is apparent that these are basic industries occupying a strategic position in the economy.[132]

There were monopolies, or near-monopolies, in basic steel production, sugar refining, many chemicals, cigarettes, glass and certain paper products, among others.[133] Historically, Karmel and Brunt explained, economies of scale in relation to the size of the Australian market were such as to establish monopolistic and oligopolistic structures *ab initio*.[134] These original firms grew with their markets such that leading firms in a number of strategic industries had now established positions of 'virtually impregnable strength'.[135] While the usual response to such facts was that 'if we are to use modern techniques in an economy the size of Australia a high degree of monopoly is inevitable', Karmel and Brunt questioned whether *such* high

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[130] Barwick, 'G L Wood Memorial Lecture', above n 103, 8.

[131] *Australian Proposals for Legislation*, above n 128, 9, only listed reports of the 'combining of powerful sellers to undercut a competing seller', which could drive the competitor out of business.

[132] Karmel and Brunt, above n 15, 83–84.

[133] Ibid 58–59; Hunter, above n 103, 35–36. See also Commonwealth, *Parliamentary Debates*, House of Representatives, 30 November 1965, 3329 (William Hayden), quoting E Wheelwright of Sydney University.

[134] Karmel and Brunt, above n 15, 88–89.

[135] At least as far as conquest by domestic firms was concerned: ibid 65.

concentration as existed was necessary,[136] and pointed out that this degree of concentration was associated with the use of restrictive trade practices.[137]

The new focus on anticompetitive practices in Australia was no doubt influenced by international developments in competition law during the 1950s.[138] In this decade, new competition laws were enacted in numerous jurisdictions, including Great Britain,[139] Canada,[140] New Zealand,[141] South Africa,[142] West Germany,[143] and the European Common Market.[144] This trend, in itself, was no coincidence. While this is not the place to enter a discussion of all the influences at work on international competition legislation in the 1950s, one significant chain of influence can be recalled. In the post-war period, the US, now in a position of political and economic dominance, successfully pressured both Germany and the United Kingdom to enact competition legislation.[145] Antitrust was promoted by the US as a tool for democracy, peace and prosperity,[146] in the belief that economic concentration had fostered fascism and dictatorships in Germany, Italy and Japan.[147] In fact, in the case of Germany, the US required the enactment of competition legislation as part of the agreement to end its occupation of West Germany.[148] The competition law enacted in West Germany, in turn, influenced the competition laws adopted as part of the Treaty

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[136] Ibid 88–89.

[137] Ibid 96. See Chap 2 Part V herein, regarding the 'structuralist' views of the 'old' Harvard School.

[138] See, eg, *Report of the Western Australia Royal Commission*, above n 117.

[139] *Restrictive Trade Practices Act 1956* (UK); *Monopolies and Restrictive Trade Practices (Enquiry and Control) Act 1948* (UK).

[140] *Combines Investigation Act*, 1952-1960 (Canada).

[141] *Trade Practices Act 1958* (NZ).

[142] *Regulation of Monopolistic Conditions Act 1955* (South Africa).

[143] *Gesetz gegen Wettsbewerbsbeschrankungen* [Act Against Restraint on Competition] (Germany) 1957.

[144] Treaty of Rome 1957, Art 85, 86.

[145] Gerber, above n 13, 166.

[146] Ibid 153.

[147] Ibid 167–8.

[148] Ibid 168–9.

of Rome upon the formation of the European Economic Community in 1957.[149] While Britain took a very different approach to competition legislation to that of the US, it did enact competition laws in 1948 and 1956, and these statutes in turn influenced the New Zealand parliament.[150]

Sir Garfield Barwick undertook and published a comparative analysis of competition legislation from the United States, the United Kingdom, Canada, New Zealand and the European Common Market, and ultimately constructed a proposal for Australian legislation.[151] In contrast to the existing *AIPA*, Sir Garfield's proposal took a turn away from the US model of outright prohibition of restrictive trade practices.[152] Instead it largely followed the approach of the British legislation, creating a system of registration, and administrative examination of, such practices. Sir Garfield stated that this was an approach 'which does not take the American view that of necessity all reduction of competition is harmful' but rather 'leaves room for the view that a practice which does reduce competition may nonetheless not be harmful to the public interest'.[153] In this view he seems to have been influenced by the opinions of Professor Alex Hunter of the University of New South Wales, who had recently published an article arguing that the US attack on 'bigness' *per se* was inappropriate for small- and medium-sized economies such as Australia in which a considerable degree of concentration was necessary.[154] For this reason, Professor Hunter preferred

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[149] See Chap 2 II(G) herein.

[150] Barwick, 'Hobart LCA Convention', above n 108, 11–13.

[151] Barwick, 'Hobart LCA Convention', above n 108, 2–14. Barwick, 'G L Wood Memorial Lecture', above n 103, 13: 'All the western world has legislation to deal with restrictive practices; there is no novelty in Australia having such legislation; the oddity is that it has not.'

[152] Commonwealth, *Parliamentary Debates*, House of Representatives, 26 November 1965, 3302 (Malcolm Fraser): 'I think it is generally agreed that the American approach has been shown to be too much of a sledgehammer for our circumstances …'

[153] Barwick, 'Hobart LCA Convention', above n 108. See also Barwick, 'G L Wood Memorial Lecture', above n 103, 15.

[154] Hunter, above n 103, 37–39. Sir Garfield, who listed Hunter's work in his bibliography, stated that, particularly since some narrow markets in Australia made a considerable degree of concentration necessary, the US model 'with its root-and-branch attack on all forms of monopoly control' was inappropriate for Australia: Barwick, 'G L Wood Memorial Lecture', above n 103, 21.

the restraint of the 'pragmatic' UK approach to the 'dogmatic' US approach,[155] saying of US antitrust:

> What is all too frequently regarded as the archetype of anti-monopoly legislative control is in fact unique and not especially suitable for general use.[156]

This was certainly a justifiable view at the time. It is worth remembering that the US antitrust of the 1960s was not the restrained approach for which the nation became renowned in the last decades of the twentieth century. Rather, the plaintiff-friendly Warren Court of that era tended to be suspicious of firms and distrustful of markets,[157] particularly under the influence of the 'old' Harvard School.[158] US commentators have expressed the view that, in the 1950s and the 1960s, US courts often used antitrust to protect small businesses rather than competition, and found strategic behaviour to be anticompetitive without sufficient investigation.[159]

Sir Garfield explained his own proposal as an 'essentially pragmatic' approach, having 'its roots in the reaction of practical administrators to practices of the kind brought under notice rather than in general doctrinal considerations'.[160] Under this proposal, businesses would be required to register with a commission any agreement or practice which fell within the list of practices for registration under the

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[155] Hunter, above n 103, 40. Cf G de Q Walker, 'Competition Policy and the Corporation', above n 111, 10, who argued that the one of the reasons that Australia did 'almost nothing' about restrictive practices in the 1960s was that there was a tendency to see competition policy as a choice between the British and American techniques, about which there were 'monstrously inaccurate' perceptions in Australia (both as to the severity of the American system and the effectiveness of the British).

[156] Hunter, above n 103, 39.

[157] Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 1, 9.

[158] See Chap 2 Part V herein.

[159] Hovenkamp, *The Antitrust Enterprise*, above n 157, 1, 9. See also Jonathan B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 610.

[160] Barwick, 'G L Wood Memorial Lecture', above n 103, 3; Barwick, 'Hobart LCA Convention', above n 108, 2.

legislation.[161] These practices would be recorded in a secret register accessible only by the commission.[162]

If the registrar of the commission formed the view that any registered practice substantially reduced competition, the business would have an opportunity to prove before a specialist tribunal that the practice worked no public detriment or that it could otherwise be justified on one of 14 listed grounds, which included grounds relating to public safety, promotion of exports, efficiency gains and threat of serious unemployment. If the tribunal found that the practice substantially reduced competition and that it had not been proved to cause no detriment to the public or be otherwise justified, it would be removed from the register and a business that continued to carry on that practice would be liable to prosecution. This was the method for dealing with the bulk of restrictive trade practices under the proposal, but there was also a short list of practices which were regarded as so consistently harmful that they would be inexcusable: these practices would be outlawed and the business would have no opportunity to justify such behaviour.[163]

In the area of unilateral conduct, however, Sir Garfield's proposal substantially departed from the British approach. The British restrictive practices legislation made no provision with regard to unilateral conduct, leaving such matters to be considered administratively by the Monopolies Commission.[164] But Sir Garfield believed that

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[161] These practices would be unlawful unless registered. They included horizontal arrangements (such as price-fixing, boycotts and restrictions on ouput), as well as bilateral and unilateral practices (such as resale price maintenance, price discrimination, exclusive dealing and refusals to deal): Commonwealth, *Parliamentary Debates*, House of Representatives, 6 December 1962, 3104–13 (Gordon Freeth, Acting Attorney-General, reading a speech on behalf of Sir Garfield Barwick).

[162] All of the details of the proposal in this discussion are taken from the speech made by Freeth on 6 December 1962, except where otherwise indicated: ibid.

[163] Barwick, 'G L Wood Memorial Lecture', above n 103, 20.

[164] See Barwick, 'Hobart LCA Convention', above n 108, 11, 17, stating that the *Monopolies and Restrictive Trade Practices (Inquiry and Control) Act 1948* (UK) 'set up a Monopolies Commission to conduct investigations into monopolies and monopolistic practices. The Commission is, however, merely an advisory body which reports to the Board of Trade, leaving certain government departments to issue orders prohibiting monopolistic practices found by the Commission to be contrary to the public interest. In practice, however, few such orders have been made'.

certain unilateral conduct should be prohibited outright.[165] Under his proposal some types of unilateral conduct would be required to be registered according to the general scheme and would be open to justification,[166] but two types of unilateral conduct would be inexcusable, namely 'monopolisation' and 'persistent price cutting at a loss to drive a competitor out of business'.[167] Monopolisation would be 'defined, broadly speaking, as acquiring or using monopoly power with the intention of preventing a person from entering or expanding a business, or in a manner that is unreasonable and detrimental to consumers of goods or services. Monopoly power, for this purpose, will be defined as the power to fix, or influence substantially, the market price of any kind of goods or services, or to prevent persons entering or expanding businesses'.[168] Thus monopolisation was defined with reference to the economic concept of market power,[169] and with the objective of protecting the competitive process in the interests of consumers.[170]

Sir Garfield emphasised that this proposal was not final but that he hoped to seek the views of interested persons, and the public generally, before decisions were made on the ultimate form and content of the legislation.[171] To this end, Sir Garfield publicised

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[165] Barwick, 'Hobart LCA Convention', above n 108, 17. Commonwealth, *Parliamentary Debates*, House of Representatives, 6 December 1962, 3104 (Gordon Freeth, Acting Attorney-General, reading a speech on behalf of Sir Garfield Barwick) stated:

> The British legislation places major emphasis on combination, on agreement between two or more. The scheme I will outline covers bilateral and multilateral arrangements for restrictive action, which are probably the most common source of restrictive practices, but the scheme goes further and covers unilateral action of a restrictive kind taken by the individual. In this way, harmful actions by business undertakings or organizations which are large and powerful, or enjoy positions of advantage in the market, will be prevented.

[166] As under the New Zealand statute of that time, namely the Trade Practices Act 1958: Barwick, 'Hobart LCA Convention', above n 108, 11–12.

[167] Commonwealth, *Parliamentary Debates*, House of Representatives, 6 December 1962, 3107, 3112 (Gordon Freeth, Acting Attorney-General). At 3112: 'As to monopolization, the scheme will spell out our existing legislation, removing known deficiencies and accommodating it to the decisions of the courts, including the courts of the United States.'

[168] Commonwealth, *Parliamentary Debates*, House of Representatives, 6 December 1962, 3112 (Gordon Freeth, Acting Attorney-General, reading a speech on behalf of Sir Garfield Barwick).

[169] See Chap 2 Part III(E)(2) herein.

[170] See Chap 2 Part III(E) herein.

[171] Ibid 3113.

his proposals, and sought to encourage debate and feedback around them, through a number of public speeches in 1963.[172]

C. The Trade Practices Act 1965

In 1964, Sir Garfield Barwick was appointed as Chief Justice of the High Court of Australia, and the work of the Trade Practices Bill was passed on to the new Attorney-General, Billy Snedden. From this time, significant changes were made to Sir Garfield's original proposal, and the *Trade Practices Act 1965* (Cth) was ultimately passed to substantial criticism from commentators and politicians.[173] The Act was said to favour the Government's supporters in 'big business' by making practices only examinable rather than creating prohibitions backed by sanctions.[174] Members of the Opposition even claimed that the Government had only been motivated to enact the legislation so that it could repeal the existing *AIPA*.[175] The *AIPA*, at this point, had shown unexpected signs of life in a recent High Court decision,[176] and that Act would make businesses liable for treble damages upon proof of infringement.[177]

With regard to unilateral conduct, Barwick's original proposal to make monopolization and persistent price-cutting inexcusable was not adopted. Instead, any

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[172] See, eg, Barwick, 'Hobart LCA Convention', above n 108; Barwick, 'G L Wood Memorial Lecture', above n 103.

[173] See, eg, Geoffrey Walker, 'The Trade Practices Bill: The Need for More *Per Se* Rules' (1965) 39 *Australian Law Journal* 125; Maureen Brunt, 'Legislation in Search of an Objective' [1965] *The Economic Record* 357; Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3237-42 (Reginald Connor).

[174] Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3239 (Reginald Connor); Commonwealth, *Parliamentary Debates*, House of Representatives, 30 November 1965, 3342 (Edward Drury).

[175] Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3226 (Gough Whitlam).

[176] *Redfern v Dunlop Rubber Australia Ltd* (1964) 110 CLR 194.

[177] Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3226, and 1 December 1965, 3412–13 (Gough Whitlam). The Attorney-General refuted this claim, stating that the *AIPA* had not been retained because it proceeded on the basis of criminal liability, which led to uncertainty: Commonwealth, *Parliamentary Debates*, House of Representatives, 1 December 1965, 3419 (Billy Snedden, Attorney-General).

unilateral conduct that came within the definition of 'examinable practices' could only be examined by the Trade Practices Tribunal at the instance of the Trade Practices Commissioner (after consultation with the parties) and, if found to lessen competition, made the subject of an injunction.[178]

The *Trade Practices Act 1965* (Cth) ('the 1965 Act') continued to be criticised for the seven years that it, and its essentially identical successor,[179] were in force,[180] and it was derided by Sir Lionel Murphy as a 'paper tiger' when he introduced new competition legislation in 1974.[181] But in those years a number of factors improved the conditions for the reception of competition legislation in Australia. First, the constitutional challenges to the 1965 Act clarified that the Commonwealth Parliament was in fact empowered to legislate in respect of intrastate trade practices under the corporations power.[182] Second, the general attitudes of business people changed: businesses relinquished the long-held belief that price agreements were essential and began to accept that rivals should compete on price.[183] Third, the 1965 Act created specialised institutions to administer the competition laws.[184] The Tribunal continued to operate under subsequent legislation and the Commissioner was succeeded by a Trade Practices Commission, but importantly both authorities gained the respect of

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[178] Commonwealth, *Parliamentary Debates*, House of Representatives, 19 May 1965, 1657–59 (Billy Snedden, Attorney-General).

[179] In 1971, the 1965 Act was repealed and replaced by the *Restrictive Trade Practices Act 1971* (Cth) ('the 1971 Act'). The 1971 Act was in essentially the same terms as the 1965 Act, save that it remedied a problem with the validity of the 1965 Act identified in *Strickland v Rocla Concrete Pipes Ltd* (1971) 124 CLR 468 and added the prohibition of resale price maintenance. See Kerrie Round and Martin Shanahan, *From Protection to Competition: The Politics of Trade Practices Reform in Australia* (Federation Press, 2015) 183–4.

[180] The Act came into operation in September 1967 and the 1971 Act was repealed in 1974.

[181] Lionel Murphy, Attorney-General, 'The Trade Practices Legislation' (Speech delivered at a seminar sponsored by the Australian Association of National Advertisers, Sydney, 23 August 1974) 4.

[182] *Strickland v Rocla Concrete Pipes Ltd* (1971) 124 CLR 468. Further, in *R v Trade Practices Tribunal; Ex parte Tasmanian Breweries Pty Ltd* (1970) 123 CLR 361, the High Court held that the Trade Practices Tribunal did not exercise the judicial power of the Commonwealth in the exercise of its functions under the legislation. See Trade Practices Commissioner, *Annual Report 1973* (1973).

[183] Trade Practices Commissioner, *Annual Report 1974* (1974) [1.18] ('*Annual Report 1974*').

[184] Maureen Brunt, 'The Use of Economic Evidence in Antitrust Litigation: Australia' (1986) 14 *Australian Business Law Review* 261, 263.

interested parties during the operation of the 1965 Act.[185] Fourth, the unfolding operation of the 1965 Act (and the diminishing returns of examining practices on a case-by-case basis) convinced both sides of Parliament of the need for more effective competition legislation.[186]

During the time that the 1965 Act was in force many industry groups gave up their horizontal price-fixing agreements following investigation by the Commissioner, and the weight of business opinion gradually shifted to acknowledge that such agreements should be brought to an end.[187] But there was no comparable progress or convergence of opinions in respect of unilateral conduct, and this should come as little surprise. From the Commissioner's perspective, horizontal price agreements were centre stage: in a country where naked price-fixing between competitors was rife these were naturally the first and most important targets for the competition authority. In 1974, the Commissioner listed 54 cases that he had pursued over the previous six years. Only four of those cases concerned unilateral conduct.[188]

At the same time, it is quite likely that unilateral anticompetitive conduct was not a particularly prevalent feature of Australian markets in this period. After all, where firms can agree with their competitors to impose prices above the competitive level there is little reason for them to engage in risky, and often costly, unilateral strategies in an effort to eliminate rivals from the market so that they can charge prices above the competitive level.

D. Sir Lionel Murphy's Australian-American Hybrid: The Trade Practices Act 1974

In 1972, the ALP came to power for the first time in 23 years on a platform that included more effective competition legislation.[189] The ALP had been highly critical

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[185] See Brunt, 'Lawyers and Competition Policy', above n 126, 267.

[186] *Annual Report 1974*, above n 183, [1.7]-[1.8]; Norman, *Trade Practices Regulation*, above n 10, 5.

[187] *Annual Report 1974*, above n 183, [1.18].

[188] Ibid.

[189] See Commonwealth, *Parliamentary Debates*, Senate, 24 October 1973, 1417 (Ivor Greenwood).

of what it viewed as the under-deterrent, business-friendly statute of 1965,[190] and in 1972 it produced a proposal for legislation that was something of an Australian-American hybrid.[191]

The *Trade Practices Act of 1974* (Cth) ('*TPA*') created a Trade Practices Commission ('TPC') to replace the Trade Practices Commissioner, and the Trade Practices Tribunal became a body to review determinations by the TPC. Like the US legislation, the *TPA* prohibited a number of restrictive trade practices and agreements and made infringing corporations and officers liable to significant pecuniary penalties. But an Australian invention was added to the US model: firms that might otherwise infringe the Act could apply to the TPC for an 'authorisation' in respect of some potentially infringing conduct.[192] Such authorisation could be granted by the TPC where it was satisfied that the conduct was likely to result in 'a substantial benefit to the public, being a benefit that would not otherwise available, and that, in all the circumstances, … justifie[d] the granting of the authorisation'.[193]

Unilateral conduct was addressed by section 46(1) of the *TPA*, which provided that:

> A corporation that is in a position substantially to control a market for goods or services shall not take advantage of the power in relation to that market that it has by virtue of being in that position-
>
> (a) to eliminate or substantially to damage a competitor in that market or in another market;
>
> (b) to prevent the entry of a person into that market or into another market; or
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> (c) to deter or prevent a person from engaging in competitive behaviour in that market or in another market.

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[190] See nn 174, 175 above.

[191] See Commonwealth, *Parliamentary Debates*, House of Representatives, 7 November 1973, 2913–16 (Phillip Lynch).

[192] See Maureen Brunt, 'Australian and New Zealand Competition Law and Policy' in Barry Hawke (ed), *International Antitrust Law and Policy* (Transnational Juris Publications and Kluwer Law & Taxation, 1993) 135, explaining Australia's 'dual adjudication' system.

[193] *TPA* ss 88-90. See Brunt, 'The Use of Economic Evidence', above n 184, 265, noting that this authorisation procedure owed something to the British and EC approach to exemption.

Importantly, though, authorisations could *not* be granted for conduct that would otherwise infringe section 46(1).[194] This provision (and subsequent amendments to it) will now be analysed in an attempt to understand the legislative design and its underlying rationale.

III. THE LEGISLATIVE DESIGN OF SECTION 46

A. Introduction

As noted at the beginning of this chapter, the current Australian law against misuse of market power, embodied in section 46(1) of the *CCA*, has been criticised in three respects in particular:

- it does not permit a dominant firm to claim that conduct which would otherwise infringe section 46(1) nonetheless results in a net increase in consumer welfare, and should therefore be permitted or 'authorised';
- it does not take into account the effect that the impugned conduct has on competition in any market, but instead requires proof that a dominant firm has one of three proscribed purposes when it engages in the conduct; and
- it requires that a dominant firm, by engaging in the impugned conduct, 'takes advantage' of, or uses, its market power and not some other type of power.

These three features are analysed in this part. This analysis will focus on the underlying logic of section 46(1) in an attempt to understand the legislative design of the provision. An analysis of the case law under section 46(1) is undertaken in Chapter 4.

B. No Authorisation or Efficiency Defence

One way in which the Australian legislation might have distinguished between procompetitive unilateral conduct and anticompetitive unilateral conduct was by permitting a defence on the ground that the efficiency gains of the conduct

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[194] But s 46 did not prevent a corporation from engaging in conduct that did not constitute a contravention of ss 45, 47 and 50, by reason that an authorisation was in force in respect of the conduct: *TPA* s 46(4)(b).

outweighed any harm caused to the competitive process. A similar effect might have been achieved by using the authorisation mechanism which was incorporated in the *TPA*. As explained earlier,[195] in respect of most conduct that would otherwise infringe Part IV of the *TPA*, firms could apply to the TPC for an authorisation where the conduct would result in a substantial benefit to the public.

Practices that could be authorised included certain contracts, arrangements or understandings that substantially lessen competition; exclusionary provisions; secondary boycotts; exclusive dealing; and resale price maintenance.[196] But the power to authorise conduct was not extended to conduct that would otherwise infringe section 46, except insofar as the conduct in question was authorised in respect of another provision which was covered by the authorisation procedure.[197] This continues to be the position under the *CCA*,[198] although the Harper Report recently recommended that authorisation should be available in respect of section 46.[199] It is therefore useful to consider why section 46 matters were originally excluded from the authorisation process.

At the time the Trade Practices Bill was introduced in 1974, Senator Murphy explained this choice not to permit authorisation for certain conduct, stating that '[a]uthorizations are not available for practices that have been felt to be in their very nature so undesirable as to be incapable of justification in the public interest'.[200] This approach was consistent with, and possibly influenced by, Sir Garfield Barwick's earlier proposal that monopolization and persistent price-cutting should be treated as

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[195] See Part II(D) above.

[196] *CCA* ss 88–90.

[197] *TPA* s 46(4)(b).

[198] *CCA* s 46(6). Conduct which does not constitute a contravention of ss 45, 45B, 47, 49 and 50 by reason that an authorisation is in force does not contravene s 46(1).

[199] Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) 348 (Recommendation 30) ('*Harper Report*'). See the explanation of the Harper Proposal in Chap 5 Part VI herein.

[200] Murphy, above n 181, 7.

inexcusable,[201] and it may be useful to look to Sir Garfield Barwick's influences to understand the background to this position.

Sir Garfield's proposal not to permit monopolisation to be justified and excused was, at the outset, consistent with the differences in defences permitted under the existing law, namely the *AIPA*. As explained earlier, section 4(3) of the AIPA permitted a defence in respect of contracts and combinations in restraint of trade where the defendant could prove that its conduct was not to the detriment of the public or not unreasonable.[202] But Parliament chose not to allow a similar defence in respect of the monopolisation prohibition under the *AIPA*, believing that questions of detriment and intent would be considered as inherent elements of the prohibited conduct itself. Put another way, since detriment would necessarily be argued as an element of the offence, the defendant would have the opportunity to argue that its conduct was not in fact detrimental on the ground that it resulted in efficiency gains. Sir Garfield made reference to the consistency of his proposal with the *AIPA* defence in explaining his scheme.[203]

Sir Garfield's plan to allow some otherwise anticompetitive conduct to be justified on public interest grounds seems also to have been influenced by the new competition law of the European Community ('EC') and particularly the exemptions allowed under Article 85 of the Treaty of Rome[204] in respect of agreements and concerted practices.[205] In his analysis of the EC competition law, Sir Garfield referred to the fact that the prohibitions in Article 85 of the Treaty of Rome could be declared by the EC Commission to be inapplicable to an agreement or concerted practice which was registered with the Commission and which, in the opinion of the Commission, was

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[201] Whitlam, and later Murphy, both invoked Sir Garfield's name in support of their views. See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 2 December 1965, 3516-17 (Gough Whitlam); Commonwealth, *Parliamentary Debates*, Senate, 24 October 1973, 1413, and 10 April 1974, 891 (Lionel Murphy, Minister for Customs and Excise).

[202] See Part II(A)(3) above.

[203] Barwick, 'Hobart LCA Convention', above n 108, 20.

[204] *Treaty Establishing the European Economic Community*, opened for signature 25 March 1957, 298 UNTS 11 (entered into force 1 January 1958) ('Treaty of Rome').

[205] See Barwick, 'Hobart LCA Convention', above n 108, 13, referring to the exemptions permitted under the EC Treaty.

capable of justification according to the criterion in Article 85(3).[206] After referring to this mechanism, Sir Garfield noted by way of contrast that '[t]he unilateral practices to which article 86 [of the Treaty of Rome] applies are prohibited absolutely, and no opportunity is afforded for establishing the justification of such a practice'.[207] The position that Article 86, unlike Article 85, did not allow a dominant firm to obtain exemption for their abusive practices was confirmed in the EC case law,[208] and was sometimes explained in terms of the principle that dominant firms have a 'special responsibility' not to allow their conduct to impair genuine undistorted competition on the common market.[209] This precedent seems also to have influenced the creation of the authorisation mechanism under the 1974 statute.[210]

In 1974, during the debates on the Bill that was to become the *TPA*, the Opposition actually proposed that the Bill be amended to allow a corporation to seek authorisation for conduct that might otherwise infringe clause 46, arguing that cases would arise where corporations were in genuine doubt.[211] Senator Murphy opposed this amendment, arguing that Parliament should not risk giving the TPC the impression that it could condone the conduct of a monopolist where it 'abused' its power to 'destroy' competition.[212] As will be explained in more detail below, Senator

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[206] Ibid.

[207] Ibid.

[208] *Ahmed Saeed Flugreisen and Silver Line Reiseburo* (66/86) [1989] ECR 803, 848 [32]; *Compagnie maritime beige transports v Commission of the European Communities* (T-24/93 - T-26/93, T-28/93) [1996] ECR II-1201, II-1254 [152].

[209] *Atlantic Container Line v Commission of the European Communities* (T-191, T-212-214/98) [2003] ECR II-3275, II-3655 [1109], [1112].

[210] Brunt, 'The Use of Economic Evidence', above n 184, 265, noted that this authorisation procedure owed something to the British and EC approach to exemption.

[211] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 24 July 1974, 570 (Robert Ellicott); Commonwealth, *Parliamentary Debates*, Senate, 15 August 1974, 992–93 (Ivor Greenwood).

[212] Commonwealth, *Parliamentary Debates*, Senate, 15 August 1974, 993 (Lionel Murphy, Attorney-General):

> [I]f the power [to authorise conduct under section 46] is put in the legislation the Commission will think that it is expected to use the power, that it is expected to condone and preauthorize abuse of monopoly power to destroy competitors or to prevent the entry of competitors into the field or substantially to damage them or to engage in the other kind of conduct prohibited in the clause. So I

Murphy considered that clause 46 would only apply where a dominant corporation had actually been shown to have caused harm.[213] According to his concept, the prohibition would apply where a corporation actually achieved one of the three listed results, and he believed it would be wrong to then allow a corporation to justify such conduct.

The problem with each of these three reasons for not allowing authorisation, or an efficiency defence, under section 46 – the precedent set by the *AIPA*, the precedent set by the Treaty of Rome, and Senator Murphy's arguments that an infringing corporation has caused competitive harm – is that not one of them is current and relevant to section 46 as it stands. The position under the *AIPA* and Senator Murphy's arguments were both predicated on the assumption that the court would consider whether the defendant corporation had caused some public detriment or 'abused' its position in a way that caused harm. However, as explained further below, section 46(1) was interpreted by the courts, and amended by Parliament, so as to remove any suggestion that proof of actual harm or detriment was necessary. Thus the defendant is not given the opportunity to argue that its conduct in fact gave rise to benefits which offset any likely detriment.

With regard to the precedent set by the Treaty of Rome, any continuing reliance on this distinction under the law of the EU is out of date. In 2009, the European Commission published its 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings' ('*EC Guidance Paper*'), which acknowledges that an efficiency defence may be raised in respect of an abuse of dominance claim: dominant undertakings may justify their conduct on the grounds of efficiencies which are sufficient to ensure that there is no net harm to consumers.[214] While the Guidance

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must say that we think it would be wrong to include such an authorization power. It is quite different from the other provisions and it would start to distort the character of the legislation.

[213] See Part III(C)(1) below.

[214] Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 381–2, citing *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2, [30]–[31].

Paper itself does not have the force of law,[215] the EU courts also appear to have accepted that dominant undertakings' conduct *can* be justified by efficiencies.[216]

There is therefore an argument for permitting authorisation of conduct which would otherwise infringe section 46(1). As explained in more detail in Chapter 5, it is submitted that an efficiency defence, or authorisation procedure, would be a worthwhile (indeed necessary) complement if and when section 46(1) is amended incorporate an effects-based test in accordance with the Harper Proposal or otherwise.

Under the current provision, however, some have argued that if the dominant firm is engaging in efficient conduct it will not have one of the proscribed purposes.[217] Is a balancing of likely detriment against likely efficiency gains possible as part of the consideration of the purpose element of section 46(1) as it stands? The reason for the inclusion of the purpose element in section 46(1), and its usefulness in distinguishing between anticompetitive and precompetitive conduct, are considered in the following section.

C. Purpose, Not Effect

1. Senator Murphy's Concept: Proof of Effect, No Proof of Intent

From the very inception of the *TPA*, there was controversy over whether the test in section 46(1) should include an element of purpose. The wording of the section, as originally enacted, was ambiguous.[218] It prohibited a firm from taking advantage of its market power '*to* prevent the entry of a person into that market or into another market', for example. The word 'to' was used in this way at the beginning of each of

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[215] Ibid 276–79, explaining that the *EC Guidance Paper* explains the manner in which the Commission will determine which abuse of dominance claims warrant investigation and prosecution. See Chap 1 Part IV(C).

[216] Ibid 378–80, citing *British Airways plc v Commission of the European Communities* (C-95/04) [2007] ECR I-2331; *Microsoft Corp v Commission of the European Communities* (T-201/04) [2007] ECR II- 3601.

[217] See Trade Practices Consultative Committee, Parliament of Australia, *Small Business and the Trade Practices Act: Volume 1* (1979) 69 ('*Blunt Report*'); *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* ('*Melway'*) (2001) 205 CLR 1, 41, 45.

[218] *Swanson Report*, above n 10, 39.

paragraphs (a), (b) and (c). Did 'to' mean 'for the purpose of' achieving one of the three results, or 'with the effect that' one of the results was achieved?

Interestingly, in light of all that has followed, the 'father of the Bill', Senator Murphy, believed that the provision required proof of the *effect* of the corporation's conduct. During the debates on the Bill, he indicated that a plaintiff would need to prove that the defendant corporation had achieved one of the three-listed consequences in section 46(1).[219] According to Senator Murphy, a corporation would infringe section 46(1) where its conduct amounted to

> taking advantage of a monopoly position in order to damage a competitor – and you have to show that the damage has occurred – or to prevent a competitor from entering into the field. … Under this clause one has to show not only that the competitor is damaged or that the entry into competition is prevented but also that this has been done by the monopolist taking advantage of his monopoly position.[220]

Thus, in Senator Murphy's mind, the clause required proof of an effect.

During the debates on the Bill, the Opposition argued for an amendment to insert the word 'wilfully' in clause 46 and thereby to indicate that an element of intent or purpose was required.[221] In a refrain reminiscent of the arguments made on behalf of 'big business' interests to the Harper Panel,[222] Liberal senators in 1974 claimed that in the absence of this amendment, a corporation could be held to infringe in circumstances where its conduct had one of the three-listed results even though it had no intent to cause those results.[223] This, they said, would be an unfair outcome.[224] The

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[219] Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 927 (Lionel Murphy, Attorney-General).

[220] Ibid.

[221] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 24 July 1974, 586 (Robert Ellicott).

[222] See Chap 1 Part II herein.

[223] Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 926–27 (Ivor Greenwood).

[224] Ibid.

Government opposed the proposal to include an element of intent.[225] ALP senators argued that clause 46 would be rendered 'useless and ineffective'[226] and 'virtually unworkable'[227] if plaintiffs were required to prove the additional element of willfulness on the part of a corporation, particularly given the difficulties of proving corporate intent.

In the event, section 46 was passed without the addition of any element of 'wilfulness' or purpose. It retained its unqualified, ambiguous 'to'.

2. The Amendment and the Ongoing Debate: Purpose or Effect

The 1976 Swanson Commitment and 1977 'Purpose' Amendment

In 1975, the ALP Government was replaced by a Liberal-Country Party Government which 'came with a mandate to remove or soften any business regulations that did not seem necessary'.[228] Accordingly, in 1976, the Swanson Committee was appointed to consider the operation and effect of the *TPA*, including the certainty of its language; its effect on small businesses; and its application to conduct by employees, and employee or employer organisations.[229]

The Committee considered numerous submissions concerning section 46, including submissions that the provision should specify that intent was a necessary element and submissions that the provision should require proof of effect. The Swanson Committee stated in its report that it interpreted section 46 as requiring that the corporation had the *purpose* of achieving one of the three-listed results, and it recommended that the provision be amended to clarify that purpose was a necessary

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[225] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 24 July 1974, 587 (Keppel Enderby); Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 923 (Lionel Murphy, Attorney-General).

[226] Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 925 (Mervyn Everett).

[227] Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 930 (Lionel Murphy, Attorney-General). Specific intent was also avoided as an element of monopolisation in the 1965 Act due to the difficulty of proving intent: Commonwealth, *Parliamentary Debates*, House of Representatives, 25 November 1965, 3236 (Thomas Hughes).

[228] Neville R Norman, 'Progress Under Pressure: The Evolution of Antitrust Policy in Australia' (1994) 9 *Review of Industrial Organization* 527, 532.

[229] *Swanson Report*, above n 10, 1.

element.[230] With regard to effect, it rejected the inclusion of an effects test since it considered that it should not be necessary to wait until a corporation achieved one of the prescribed effects before proceedings could be brought.[231] Thus the Swanson Committee only expressly rejected a test that would require proof of 'purpose *plus* effect'. It did not consider an effects test as an alternative to purpose, or the option of 'likely effect', either of which would have overcome the objection which it raised.

The following year a number of amendments were made to the *TPA* with the enactment of the *Trade Practices Amendment Act 1977* (Cth). During the debates on the Bill, the attention of the Parliament was squarely focused on a separate, controversial and highly politicised matter, namely the proposed sections 45D and 45E, which were to extend the operation of the *TPA* to trade union activity. But the Act also repealed and replaced section 46 of the *TPA*.[232] The new provision largely remained in its previous form but the words 'for the purpose of' were added to section 46(1) immediately preceding the three-listed results. This amendment received only the briefest mention in the second reading speech, noting that it was 'to clarify that s 46 requires purposive conduct'.[233] There was no debate on the issue. There was no mention of the fact that in choosing the 'purpose' approach Parliament was opting away from an 'effects' approach.

Section 46(1) now read:

> A corporation that is in a position substantially to control a market for goods or services shall not take advantage of the power in relation to that market that it has by virtue of being in that position *for the purpose of*-
>
> (a) eliminating or substantially damaging a person, being a competitor in that market or in any other market of the corporation or of a body corporate related to the corporation;
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> (b) preventing the entry of a person into that market or into any other market; or

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[230] Ibid 40.

[231] Ibid.

[232] *Trade Practices Amendment Act 1977* (Cth) s 25.

[233] Commonwealth, *Parliamentary Debates*, House of Representatives, 8 December 1976, 3531–32 (John Howard, Minister for Business and Consumer Affairs).

(c) deterring or preventing a person from engaging in competitive conduct in that market or in any other market. (emphasis added)

The 1979 Blunt Committee

In 1979, the purpose issue arose again. The Blunt Committee was appointed to consider the effectiveness of the *TPA* and particularly its effectiveness in addressing the problems facing small businesses.[234] The TPC submitted to the Blunt Committee that section 46(1) should be amended to remove the purpose requirement. The Blunt Committee agreed with the TPC that the purpose element was very difficult to prove, but it nonetheless recommended that the existing wording be maintained.[235] It reasoned that this wording clarified that '[i]t is only purposive misuse of market power and not inadvertent conduct or efficiency inspired conduct that should be at risk'.[236] It thus made no direct finding about the appropriateness of an effects test, but considered that a firm's purpose was 'fundamental' in distinguishing between competitive and anticompetitive conduct.[237]

The 1984 Green Paper and the 1986 'Substantial Market Power' Amendment

In 1984, the matter was taken up by the then Attorney-General, Senator Gareth Evans. He released a Government Green Paper entitled 'The Trade Practices Act: Proposals for Change', which aimed to be a 'catalyst for public discussion' on proposals to amend the *TPA*. The Green Paper stated that difficulties had arisen from the inclusion of the purpose element in section 46(1): in particular, a corporation could take advantage of its market power to produce immediate and severe anticompetitive consequences in a market, but the difficulties inherent in proof of intent meant that such a corporation might escape liability.[238] The Green Paper proposed that the

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[234] *Blunt Report*, above n 217.

[235] Ibid 69.

[236] Ibid.

[237] Ibid.

[238] *1984 Green Paper*, above n 3, 8, citing the difficulties in proving corporate intent in *Trade Practices Commission v Tubemakers of Australia* (1983) ATPR 40-358.

section be amended to include the words 'or that has or is likely to have the effect' before the three-listed results.[239]

Following on from the 1984 Green Paper, the *TPA* was amended in 1986. As part of these amendments the threshold for the application of section 46 was lowered from 'substantial control of a market' to 'a substantial degree of market power',[240] but the proposed amendment to include an effects-based test in section 46 was not made. Instead a new section 46(7) was inserted to enable a court to infer the required purpose from corporation's conduct or other relevant circumstances.[241] That is, the provision now clarified that direct evidence of the corporation's purpose was not essential.

The Ongoing 'Effects Test' Debate

The usual version of history[242] from this point on is that an amendment to incorporate an effects-based test in section 46 was proposed on numerous occasions before various committees appointed to review the Australian competition legislation,[243] and

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[239] Ibid 8–9.

[240] *Trade Practices Revision Act 1986* (Cth) s 17; Commonwealth, *Parliamentary Debates*, House of Representatives, 19 March 1986, 1626 (Lionel Bowen, Attorney-General).

[241] Ibid.

[242] See, eg, Mitchell Landrigan, Anne Peters and Jason Soon, 'An Effects Test Under S 46 of the Trade Practices Act: Identifying the Real Effects' (2002) 9 *Competition and Consumer Law Journal* 258; House of Representatives Standing Committee on Economics, Finance and Public Administration, Parliament of Australia, *Competing Interests: Is There Balance? Review of the Australian Competition and Consumer Commission Annual Report 1999-2000* (2001) ('*Hawker Report*') 49; Trade Practices Act Review Committee, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act* (2003) ('*Dawson Report*') 82–3; Senate Legal and Constitutional References Committee, Parliament of Australia, *Inquiry into s 46 and s 50 of the Trade Practices Act 1974* (2002) ('*McKiernan Report*') 20.

[243] To date, the reports of 13 independent reviews and parliamentary inquiries, as well as a Green Paper, have considered the effectiveness of *TPA* s 46 and *CCA* s 46: *Swanson Report*, above n 10; *Blunt Report*, above n 217; *1984 Green Paper*, above n 3; *Griffiths Report*, above n 10; Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls* (1991) ('*Cooney Report*'); Committee of Review of the Application of the Trade Practices Act 1974, Parliament of Australia, *National Competition Policy* (1993) ('*Hilmer Report*'); House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Finding a Balance: Towards Fair Trading in Australia* (1997) ('*Reid Report*'); Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia's Retailing Sector*

that these committees consistently rejected (or did not recommend) the adoption of such a test, at least until the appointment of the Harper Panel.[244]

This version of events, however, is inaccurate in two respects. First, it misconstrues the reports of the committees, a number of which did not express any conclusions on an effects-based test.[245] Second, it assumes that there is some unitary form of 'effects test' to which the relevant submissions and committee reports refer. In fact, as explained below, there are two main types of effects-based tests which have been considered as part of these deliberations in Australia, namely the 'the section-46 results test' and 'the SLC test'.

The section-46 results test was the test most often considered by the earlier review committees, where they considered an effects test.[246] This proposal would simply insert the words 'or with the effect or likely effect' in the existing section 46(1) immediately before paragraphs (a) to (c). That is, a firm would infringe section 46 if its conduct had the effect, or likely effect, of achieving one of the three-listed results, in short, eliminating or substantially damaging a competitor; preventing entry in a market; or deterring or preventing a person from competing in a market. Such a test is not to be found in any jurisdiction outside Australia. The reason for this is that it

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(1999) ('*Baird Report*'); *Hawker Report*, above n 242; *McKiernan Report*, above n 242; *Dawson Report*, above n 242; Senate Economics References Committee, Parliament of Australia, *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* (2004) ('*Stephens Report*'); Senate Economics References Committee, Parliament of Australia, *The Impacts of Supermarket Price Decisions on the Dairy Industry* (2011) ('*Dairy Report*'); *Harper Report*, above 199.

[244] See *Dawson Report*, above n 242, 82: 'Given the number of times such proposals have been examined and rejected and given the ultimate recommendation of this Committee, it is undesirable that the introduction of an effects test should be further reconsidered in a periodic review of the Act.'

[245] Eg, the *Griffiths Report*, above n 10, 32, 40-41, stated that, given that the High Court had handed down its decision in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 ('*Queensland Wire Industries*') during the review, 'any major changes to the wording of the section would at this time be a retrograde step which could lead to renewed uncertainty'; the *Reid Report*, above n 243, reached no independent conclusion with regard to an effects test but merely made a one-line reference to the conclusion of the Hilmer Committee; the *Baird Report*, above n 243, xxiv, recommended that the section 46 issue be revisited in 3 years' time; the *McKiernan Report*, above n 242, decided not to reach a conclusion on section 46 since the Dawson Review was due to commence; and the *Dairy Report*, above n 243, recommended a further review of section 46.

[246] See, eg, *Cooney Report*, above n 243, 96; *Dawson Report*, above n 242, 81; *Hawker Report*, above n 242, 49.

represents little more than the convenience of adding seven words to the existing provision. This convenience, however, would result in the capture of a very broad range of conduct, including competitive conduct. For instance, efficient practices, such as the development of a superior product or service, frequently result in substantial damage to a competitor or even the elimination of a competitor, but these practices clearly should not be prohibited. For this reason, it has, unsurprisingly, proved difficult to gain general support for the section-46 results test.[247]

The second test, namely the SLC test, would condemn conduct which had the effect, likely effect or purpose of substantially lessening competition in the relevant market. The SLC test was proposed on a number of occasions and was expressly considered by three committees, namely the Hilmer Committee in 1993; the Dawson Committee in 2003; and the Harper Panel in 2015.[248]

Earlier committees considering the SLC test expressed the view that, in the context of section 46(1), the SLC test would capture conduct that merely injures a dominant firm's rivals. Thus the Hilmer Committee stated:

> The TPC proposed that unilateral conduct should be prohibited if it has the effect of substantially lessening competition. Such a test would not, in the Committee's view, constitute an improvement on the current test. It does not address the central issue of how to distinguish between socially detrimental and socially beneficial conduct. As the High Court observed, the very essence of the competitive process is conduct which is aimed at injuring competitors. A firm that succeeds in aggressive competitive conduct may drive other firms from the market and achieve a position of pre-eminence for an extended period. It does not necessarily follow, however, that the competitive process will be damaged by the conduct or that the potential for competition will be diminished, even if the immediate manifestations of the successful competitive conduct may suggest it. Firms should be encouraged to compete aggressively by taking advantage of new and superior products, greater efficiency and innovation. There is a serious risk of deterring such

[247] See, eg, *Cooney Report*, above n 243, 96.

[248] *Hilmer Report*, above n 243; *Dawson Report*, above n 242; *Harper Report*, above 199.

> conduct by too broad a prohibition of unilateral conduct. The Committee takes the view that an effects test is too broad in this regard.[249]

Similarly, the Dawson Committee seemed to equate a substantial lessening of competition with the mere removal of a competitor or competitors, stating:

> An alternative to [the section-46 results test] proposed by the ACCC is … the amendment of section 46 to prohibit a corporation that has a substantial degree of market power from taking advantage of that power with the effect or likely effect of substantially lessening competition in a market.
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> However, such an amendment would only serve to exacerbate the difficulties identified above in relation to the ACCC's proposed amendment. It would change the focus of section 46 from that of conduct with a proscribed purpose to that of conduct with a proscribed effect, the effect being the substantial lessening of competition. Since the effect of legitimate competitive activities may result in the lessening of competition in a market, the section, as amended would be likely to catch pro-competitive as well as anti-competitive conduct.[250]

In contrast to the earlier committees, in 2015, the Harper Panel expressed the view that the incorporation of the SLC test in section 46(1) 'would enable the courts to assess whether the conduct is harmful to the competitive process'.[251] In particular:

> The proper application of the 'substantial lessening of competition' test is to consider how the conduct in question affects the competitive process – in other words, whether the conduct prevents or hinders the process of rivalry between businesses seeking to satisfy consumer requirements.[252]

The Panel also argued that this test in section 46(1) would bring the benefit of consistency since it is the test used in several other provisions in Part IV.[253] The Harper Proposal, and its recent adoption by the Cabinet, were outlined in Chapter

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[249] *Hilmer Report*, above n 243, 70–71.

[250] *Dawson Report*, above n 242, 85.

[251] *Harper Report*, above 199, 341.

[252] Ibid.

[253] Eg, *TPA* ss 45 and 47.

1.[254] The effectiveness of the Harper Proposal in addressing unilateral anticompetitive conduct, as well as its potential error costs and deterrence of procompetitive conduct by dominant firms, are considered in Chapter 5.

3. Purpose to Distinguish Between Competitive and Anticompetitive Conduct

It is clear from the foregoing discussion that the purpose element was not part of the original design of section 46(1), and it was subsequently preferred over an effects-based test based on a contentious assessment of the impact of such a test. But might the purpose test nonetheless prove useful in distinguishing between anticompetitive conduct and aggressive competition?

At the outset, a purpose test does lack some logical appeal in this role. Given that section 46 aims to promote competition,[255] liability based on the firm's subjective purpose,[256] rather than on any demonstration of harm or likely harm to competition, seems unlikely to capture the intended target of the prohibition. As Corones has stated:

> If the policy objective of s 46 is the promotion of competition, then liability should only arise when the conduct is likely to cause economic harm. Competition is a process of rivalry; it involves aggressive and ruthless behaviour which damages competitors. The essential characteristic of s 46 should be an evaluation of the effect or likely effect of the respondent's conduct on competition in the light of the structure of the relevant market. The purpose requirement impedes this evaluation by requiring the court to focus on the subjective purpose existing in the mind of the actor instead.[257]

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[254] See further Chap 5 Part VI herein.

[255] *Queensland Wire Industries* (1989) 167 CLR 177, 191; *Melway* (2003) 215 CLR 374, 411.

[256] As explained in Chap 6 Part III(D) herein, 'purpose' under s 46(1) has been interpreted as a reference to the corporation's subjective purpose.

[257] Corones, 'The Characterisation of Conduct', above n 2, 412.

Further, the objectives of section 46 are economic,[258] but, as the Government acknowledged in a different context, '[r]eliance on a "purpose test" alone risks a focus on the perceived morality of conduct rather than its economic effect'.[259]

Some have contended that these weaknesses in the purpose test are mitigated by the fact that, pursuant to section 46(7) (inserted by the 1986 amendment), courts may infer the existence of a proscribed purpose from the circumstances of the conduct. Thus the Productivity Commission has argued that:

> Section 46(7) is a relatively powerful addition to section 46 because it would allow a judge to discount obviously artificial claims of innocent intention if the more credible explanation of the behaviour was an underlying intention to act anticompetitively … Courts are permitted under the present section 46 to go beyond a mere statement of innocent purpose to an assessment of the credibility of such statements.[260]

The common law did already permit courts to draw inferences concerning intent from a defendant's conduct, and, in 1986, Senator Evans explained that this amendment did not represent 'any new adventure so far as legal principle is concerned', but was intended to capture 'the spirit of the existing law whereby purpose may be inferred from conduct'.[261] But it had been necessary, Senator Evans said, to clarify that such inferences could be drawn because there was an existing view in the business community that purpose could only be proved by direct evidence, particularly since a particular decision[262] in which the court had refused to draw an inference of purpose from the defendant's conduct.[263] However, he stressed that 'the *effect* of particular corporate conduct, that is to say, in terms of the elimination of a competitor or

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[258] *Queensland Wire Industries* (1989) 167 CLR 177, 194.

[259] See Explanatory Memorandum, Trade Practices Amendment (Telecommunications) Bill 1996 (Cth), regarding the proposed s 151AJ.

[260] Productivity Commission, Submission No 125 to the Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, July 2002, 9.

[261] Commonwealth, *Parliamentary Debates*, Senate, 13 March 1986, 936–37 (Gareth Evans, Minister for Resources and Energy).

[262] Re *Trade Practices Commission v CSBP & Farmers Limited* (1980) 53 FLR 135.

[263] Commonwealth, *Parliamentary Debates*, Senate, 13 March 1986, 943 (Gareth Evans, Minister for Resources and Energy); Commonwealth, *Parliamentary Debates*, Senate, 29 April 1986, 1987 (Gareth Evans, Minister for Resources and Energy).

something of that kind, will not be of itself enough to attract the inference of a breach of section 46'.[264] Rather, if a proscribed purpose could be inferred from the defendant's conduct, giving rise to a prima facie reason for supposing that there is some breach of section 46, the defendant would then bear the evidentiary onus of advancing some explanation for the conduct in question.[265]

Others have followed similar reasoning in explaining how the purpose element assists in differentiating legitimate from anticompetitive conduct.[266] They argue that if the dominant firm's conduct is efficient, then its purpose in engaging in the conduct is to achieve such efficiency and not one of the anticompetitive results listed in section 46(1). As Kirby J stated in his minority judgment in *Melway*:

> For the purposes of s 46 of the Act, arguments about the character of the use of market power are to be considered, if at all, in the classification of the 'purpose' of the impugned corporation.[267]

And in the case before the court, his Honour found that:

> [The corporation's] 'purpose' was not some competitive or efficiency-driven purpose that could withstand examination.[268]

The problem with this view is that it assumes that these purposes are mutually exclusive: that is, if the firm has an efficiency-driven purpose, it has no proscribed purpose. However, most commercial conduct will have more than one purpose and, to fall foul of section 46, a proscribed purpose need only be *one* of the dominant firm's

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[264] Commonwealth, *Parliamentary Debates*, Senate, 13 March 1986, 938 (Gareth Evans, Minister for Resources and Energy).

[265] Ibid 943.

[266] See, eg, *Melway* (2001) 205 CLR 1, 41, 45; *Dawson Report*, above n 242, 79–80. Landrigan, Peters and Soon, above n 242, 13 n 42, go so far as to suggest that 'the "purpose" test in s 46, which, in divining purpose, allows a firm to point to efficiencies as support for its pleaded "real" purpose, serves as a sort of costless "mini authorisation" process'.

[267] *Melway* (2001) 205 CLR 1, 45. At 41: 'It is in identifying that 'purpose', and not in characterizing the act as "tak[ing] advantage", that the debates about proscribed, or permissible, conduct by a dominant market player arise.'

[268] Ibid 45.

purposes, albeit a substantial one.[269] The proscribed purposes in section 46 are broadly worded, including the purpose of damaging one's competitor. If a firm's substantial purposes in engaging in certain conduct include both damaging a competitor and improving the product it offers, the legislation does not permit a court to weigh these substantial purposes against each other. Rather, according to section 4F, the purpose element will have been proved. For these reasons, of itself, the current purpose requirement is not a reliable tool for detecting anticompetitive behaviour.

4. The Original Rationale for the Purpose Element

The original rationale advanced in support of the inclusion of the purpose element, however, was somewhat more modest. Early advocates were chiefly concerned with achieving fairness for defendant firms. What would happen, they asked, if a firm merely improved its production efficiency such that rivals, who could not sell as cheaply, were damaged or eliminated?[270] What if a monopolist made a genuine reduction in its prices and thereby prejudiced its competitor?[271] A firm should not, they argued, be made liable for the unintended consequences of its behaviour in the market.[272]

The Swanson Committee in 1976 noted the concern of some 'who believe that their normal and proper competitive conduct might be proscribed by the section' and indicated that, in its view, the wording of section 46 imported an element of intent.[273] When the provision was amended in 1977 to include the words 'for the purpose of', in his second reading speech, the Minister for Business and Consumer Affairs, John

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[269] *CCA* s 4F(1)(b).

[270] Commonwealth, *Parliamentary Debates,* Senate, 14 August 1974, 926 (Ivor Greenwood)

[271] Ibid 922.

[272] Ibid 926; Commonwealth, *Parliamentary Debates,* Senate, 14 August 1974, 924–25 (Reginald Wright).

[273] *Swanson Report*, above n 10, 40.

Howard, merely noted that the amendment 'makes it clear that only purposive conduct by a market dominating concern comes within the prohibition'.[274]

Leaving to one side the question whether, in its operation, the purpose element under the current provision has worked to ensure fairness for defendants or whether it has resulted in unfairness to plaintiffs,[275] with regard to the design of the provision, it seems that the purpose element was not intended as the primary mechanism by which anticompetitive behaviour would be identified. On the other hand, it is possible that the purpose element combines with the requirement that a firm 'takes advantage' of its market power to draw the line between competitive and anticompetitive conduct. This possibility is now considered.

D. Why 'Take Advantage' of Market Power?

One of the most distinctive features of section 46(1) is that it only applies where a corporation 'takes advantage of its substantial degree of market power'. This approach implies that the only competitively significant threat posed by the dominant firm is that it may 'use' its market power, and not, for example, that it might use any other means at its disposal to maintain or increase its existing market power,[276] or that it might engage in conduct the negative effect of which is amplified by its market power.

In the US and the EU, by comparison, it is not necessary to show that the firm used its market power to achieve the relevant anticompetitive effect.[277] In the US, the

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[274] Commonwealth, *Parliamentary Debates*, House of Representatives, 8 December 1976, 3531–32 (John Howard, Minister for Business and Consumer Affairs).

[275] See, eg, Australian Competition and Consumer Commission, Submission No 56 to the Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, 2 July 2002, 80–81, 88, regarding the consequences of the purpose requirement.

[276] Put another way, market power may provide the *incentive* to engage in conduct while some other power (for instance, financial power) provides the *ability* to engage in that conduct: Rhonda L Smith and David K Round, 'Do Deep Pockets Have a Place in Competition Analysis?' (2012) 40 *Australian Business Law Review* 348, 350.

[277] See Spencer Weber Waller, Jeffry M Cross, J Douglas Richards and Maurice E Stucke, 'Use of Dominance, Unlawful Conduct, and Causation Under Section 36 of the New Zealand Commerce Act: A US Perspective' (2012) 18 *New Zealand Business Law Quarterly* 333; Hedvig Schmidt, 'Market

monopolisation offence focuses on the effect or likely effect of the firm's conduct: that is, whether the firm's conduct is reasonably capable of creating, enlarging or prolonging its market power by impairing the opportunities of rivals.[278] In the EU, Jones and Sufrin explain, the relevance of the dominant firm's conduct is in the magnitude of its effect rather than in the means used:

> [T]he dominant undertaking does not need to be *using* its dominance to commit the abuse. However, it is the fact that the undertaking is dominant that renders its behaviour abusive. The dominance means that the behaviour has effects which the behaviour of a non-dominant undertaking would not have.[279]

Thus, in the EU, the courts have explained that the dominant firm has a 'special responsibility not to allow its conduct to impair genuine undistorted competition' in the relevant market.[280]

If one turns to the Australian legislative history in search of the rationale for restricting liability to situations where the corporation 'takes advantage' of its market power, the theoretical underpinnings are elusive. In fact, it seems possible that the distinction was the inadvertent result of Parliamentarians 'tidying' the legislative drafting of an earlier statute.

The choice of the words 'take advantage' was not the subject of any significant explanation or debate at the time that the *TPA* was passed in 1974. It seems likely that the phrase was adopted from the 1965 Act, in which the monopolisation provision referred to a person in a dominant position who 'takes advantage of that position'.[281] But an interesting fact emerges from the parliamentary debates on the Bill that

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Power - The Root of All Evil?' in Ariel Ezrachi (ed), *Research Handbook on International Competition Law* (Edward Elgar, 2013) 369, 377–84.

[278] Hovenkamp, *Federal Antitrust Policy*, above n 33, 298.

[279] Jones and Sufrin, above n 214, 366 (emphasis in original, citations omitted). Cf Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart Publishing, 2nd ed, 2013) 262–63, arguing that it is not accurate to say that a causal link between the dominance and the abuse is 'entirely irrelevant under Article 102 TFEU'.

[280] *NV Nederlandsche Banden-Industrie Michelin v Commission of the European Communities* (322/81) [1983] ECR 3461, 3464 [10].

[281] *Trade Practices Act 1965* (Cth) s 37.

became the 1965 Act. The monopolisation clause of the Bill, clause 37, was originally drafted to include a situation where the dominant firm had the purpose of 'maintaining' its dominant position.[282] In its original form, the 1965 Bill provided:

> (1) For the purposes of this Act, a person engages in monopolization if, being in a dominant position in a line of trade or commerce in Australia or in a part of Australia –
> (a) by virtue of, *or for the purpose of maintaining*, his dominant position –
>
> (i) he does an act or thing intended or calculated to result in competitors, or possible competitors, being prevented from, or restricted or prejudiced in, obtaining supplies of goods or services or opportunities of marketing goods or making services available; or
> (ii) he engages in price-cutting with the object of substantially damaging the business of a competitor or preventing a possible competitor from entering into competition; or
> (b) he *takes advantage of his dominant position* in fixing or determining his prices or other terms or conditions of dealing.[283]

In this respect, the clause was similar to the British legislation, which had so influenced the drafters of the 1965 Bill, and which required the British Monopolies Commission to investigate 'things which are done by [a monopolist] as a result of, *or for the purpose of preserving* [its monopoly]'.[284]

However, in 1965, during the debates in the House of Representatives, the Attorney-General moved that clause 37 be amended to remove the words 'by virtue of, or for the purpose of maintaining, his dominant position' and to use instead the words 'takes advantage of his dominant position' from paragraph (b) to condition each of the

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[282] Commonwealth, *Parliamentary Debates*, House of Representatives, 3 December 1965, 3594 (Billy Snedden, Attorney-General).

[283] Ibid (emphasis added).

[284] *Monopolies and Restrictive Trade Practices (Inquiry and Control) Act 1948* (UK) c 66, s 6 (emphasis added).

categories of conduct.[285] The only explanation the Attorney-General offered for this change was as follows:

> [C]lause 37 covers three specific classes of conduct. The two classes covered by existing clause 37(1)(a) are qualified by the introductory words "by virtue of, or for the purpose of maintaining his dominant position", while the corresponding qualification of the class covered by section 37(1)(b) is that the person concerned "takes advantage of his dominant position". Under the proposed amendment, these distinctions between the qualifications that are applicable to particular classes of monopolization conduct are removed. Whatever class is involved, it will be necessary that the person concerned "takes advantage of" his dominant position. The phrase "takes advantage of a dominant position" appropriately describes the basic ingredient of the Government's conception of monopolisation, and possible confusion will be avoided by dropping the other phrases to which I have referred.[286]

There was no debate on this point, nor was there any acknowledgement that the removal of the 'maintenance' alternative had any significance for the operation of the provision,[287] although, as will be seen in the discussion of the *Rural Press* case, this amendment would become very significant.[288]

Perhaps the most useful explanation for the choice of the 'take advantage' wording can be found in Senator Murphy's statements in a different context, namely in making arguments as to why an element of purpose or intent should not be included in section 46(1). In this context, he explained that:

> A monopolist is not prevented from competing as well as he is able – for example, by taking advantage of economies of scale, developing new products or otherwise making full use of such skills as he has or protecting his patent rights in respect of an invention. In doing these things he is not taking

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[285] Commonwealth, *Parliamentary Debates*, House of Representatives, 2 December 1965, 3594–95 (Billy Snedden, Attorney-General).

[286] Commonwealth, *Parliamentary Debates*, House of Representatives, 24 November 1965, 3109 (Billy Snedden, Attorney-General).

[287] In the Second Reading Speech, Snedden did state that '… monopolisation has been defined for the purposes of the Bill so as not to embrace mere expansion in size' but 'the taking of improper advantage of a dominant position in a market': Commonwealth, *Parliamentary Debates*, House of Representatives, 19 May 1965, 1656 (Billy Snedden, Attorney-General).

[288] See Chap 4 Part VI(E) herein.

> advantage of the monopolistic power. He is just using ordinary skills, whether they are described as competitive skills or other skills.[289]

In Senator Murphy's view, therefore, it was the 'taking advantage' element that permitted the court to distinguish between 'ordinary' competitive behaviour and anticompetitive conduct. A firm that engages in efficiency-enhancing conduct would not be taking advantage of its market power, because even a firm without market power would engage in efficient conduct.

When pressed further with the suggestion that, without an element of intent, clause 46 could condemn competitive behaviour along with anticompetitive, Senator Murphy quoted from the 1911 judgment in the *Coal Vend case*,[290] which he said answered the concerns put forward by the Opposition.[291] He quoted Isaacs J as follows:

> [T]he legislation is not aimed at the share or proportion of trade which any person whether individual or corporation may acquire in the ordinary course of business. If by superiority of service or commodity, by lower prices, more desirable terms or any of the arts and inducements known to active rivalry, always consistent with healthy competition, and free from force or fraud, a trader attracts to himself the whole of the trade in any particular direction he does not offend against the law of monopoly. The field of opportunity is open to all; he has fairly used it and has succeeded. He has succeeded not because he has silenced but because he has outstripped his competitors, and because the public find it to their advantage to voluntarily accept his service in preference to that of others they might have … But if not content with serving the public to the best of his ability, and letting consequences take care of themselves, he *so acts as to purposely concentrate in himself the existing means of public satisfaction in such a way and to such an extent as in the circumstances to prevent or destroy all reasonably effective competition*, he does, within the meaning of the statute, monopolise or attempt to monopolise. …[292]

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[289] Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 923 (Lionel Murphy, Attorney-General).

[290] See Part II(A)(2) above.

[291] Ibid 929.

[292] Ibid (emphasis added).

The legislation to which Isaacs J referred, namely the *AIPA*, did not require a plaintiff to prove that the defendant had used, or taken advantage of, its market power to prove monopolisation. Rather the *AIPA* required proof of the detriment caused by the defendant's conduct. Isaacs J sought to distinguish normal competitive behaviour from conduct that had the effect of preventing or destroying all reasonably effective competition. Senator Murphy, in turn, was at pains to explain that innovative and competitive practices would not be condemned by the *TPA*. However, it seems that he was not explaining, or perhaps even conscious of, the implicit choice to permit conduct that maintained market power by exclusionary means other than taking advantage of market power.[293]

In fact, in its interpretation by the courts, the 'take advantage' requirement has been taken to mean that a dominant firm can engage in conduct which has the sole purpose and effect of suppressing rivalry in a market and thereby preserving its substantial market power, so long as it uses its financial resources, for example, to engage in the conduct.[294] This element of section 46(1) is explained in detail in the following chapter.

IV. THE OBJECTIVES OF SECTION 46(1)

One further matter requires clarification before a proper evaluation of the competing standards for unilateral anticompetitive conduct can be made. That is, it is necessary to clarify the legislative objective of section 46(1). It is submitted that the objective of provision is to protect the competitive process, in the interests of consumer welfare in particular.

The objects clause in section 2 of the *CCA* actually refers to a broader range of goals, stating that the purpose of the Act is 'to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer

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[293] At the time the *TPA* was enacted, commentators seemed similarly unaware of this implication. See, eg, Robert Baxt and Maureen Brunt, 'The Murphy Trade Practices Bill: Admirable Objectives, Inadequate Means' (1974) 2 *Australian Business Law Review* 3, 19, stating that s 46 was concerned with the 'misuse *or augmentation*' of market power (emphasis added).

[294] See the discussion of *Rural Press Ltd v ACCC* (2003) 216 CLR 53 ('*Rural Press*') in Chap 4 Part VI(E) herein.

protection'.[295] Perhaps the reference to 'the welfare of Australians' in general, and the promotion of 'fair trading', have encouraged some politicians and lobby groups in the belief that at least one of the objects of section 46(1) is to protect small businesses from harm which they might suffer as a result of the market activities of larger, more powerful businesses.[296] The language of the provision – referring to 'misuse of market power'; 'taking advantage' and 'damage' to competitors – also lends itself to the rhetoric of small business protection. In fact, in 2007, Senator Barnaby Joyce succeeded in securing the passage of the 'Birdsville Amendment' which added the plainly protectionist section 46(1AA), a provision that would condemn businesses with a 'substantial market share' from engaging in low pricing in the absence of evidence of any generally recognised form of predation.[297]

However, notwithstanding the rhetoric, the High Court of Australia has made it clear that the object of section 46(1) is to protect the competitive process, particularly in the interests of consumers.[298] To be sure, the interests of consumers and small businesses will often coincide, and may be protected by the same judicial intervention, where a dominant firm engages in conduct which preserves or enhances its market power by suppressing rivalry. But this does not mean that small business protection should be elevated to a goal in itself under section 46(1).[299] To do so would make the provision unjustifiably broad in its application and an instrument for the reduction, rather than protection, of economic efficiency and consumer welfare.

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[295] *CCA* s 2.

[296] See Gaire Blunt and Jennifer Neale, 'The Development of Section 46 in Australia – *Melway* and its Likely Impact on Business' in Frances Hanks and Philip Williams (eds), *Trade Practices Act: A Twenty-Five Year Stocktake* (Federation Press, 2001) 202, 202–5.

[297] See Stephen Corones, 'Sections 46(1) and 46(1AA) of the TPA: The Struggle of the Small Against the Large' (2009) 37 *Australian Business Law Review* 110

[298] *Queensland Wire Industries* 167 CLR 177, 191 (per Mason CJ and Wilson J); 194 (Deane J); *Rural Press* (2003) 216 CLR 53, 94 [100], 101 [125] (per Kirby J). See Blunt and Neale, above n 296, 205–7.

[299] See Stephen Corones, 'Section 46 of the Trade Practices Act: Boral, the Dawson Committee and the Protection of Small Business' (2003) 31 *Australian Business Law Review* 210, arguing that s 46 should not be used to protect small business competitors, since this is contrary to the established objective of promoting competition and economic efficiency for the benefit of consumers.

A dominant firm *will* cause detriment to small firms if and when the dominant firm succeeds in drawing consumers away through an offering which the consumers find more valuable than that of the small firms.[300] But competition law should not prevent this type of detriment. In the absence of any potential harm to consumer welfare, there is no logical limit to the protection of small business interests from the competitive activity of dominant firms.[301] If Australians are concerned about these types of harm to small business, it is submitted that those concerns should be addressed by other measures – including fiscal measures – and not by competition law.[302]

The focus of the misuse of market power prohibition may also be distinguished from the broader focus of the authorisation provisions, discussed earlier in this chapter, with the latter specifically requiring administrative consideration and balancing of a range of public interest, or 'total welfare', factors.[303]

V. CONCLUSION

Section 46(1) was originally conceived as a prohibition directed at conduct by a dominant firm which was not 'normal competitive behaviour' and which had an exclusionary effect. By 2015, it had become, by serial legislative tinkering, a prohibition directed at exclusionary purpose and dependent upon the dominant firm taking advantage of, or using, its market power to engage in the impugned conduct. While the objective of section 46(1) is the protection of the competitive process in the interests of consumers, this 'taking advantage' requirement focuses the court's attention on whether the impugned conduct was profitable because of the firm's substantial market power, rather than on the likely impact of the conduct on the competitive process. An examination of the history and rationale of section 46(1) does not create a picture of a cohesive scheme targeted at the object of the provision. The impression instead is of a collection of legislative artifacts, brought together by ad hoc

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[300] See the discussion of the economic freedom objective in Chap 2 Part III(D) herein.

[301] Although conduct that meets the requirements of 'unconscionability' may be regulated by unconscionable conduct laws: see, eg, *Australian Consumer Law* Part 2-2.

[302] See Hovenkamp, *Antitrust Enterprise*, above n 157, 44–5.

[303] Cf *Qantas Airways Ltd* (2005) ATPR ¶42-065, 42,871–75, referring to the modified 'total welfare' standard in authorisation cases.

adjustments, since guarded in the interests of preserving an alleged certainty in the status quo.

CHAPTER 4: A COMPARATIVE ANALYSIS OF PROFIT-FOCUSED TESTS FOR UNILATERAL ANTICOMPETITIVE CONDUCT

I. INTRODUCTION

As noted in earlier chapters, in 2015, the Harper Panel has recommended substantial changes to s 46(1) of the *CCA*,[1] and the government has announced its intention to adopt those changes.[2] One critical recommendation by the Harper Panel was to remove the requirement that the relevant firm 'take advantage' of its substantial market power and replace it with a requirement that the firm's conduct has the purpose, effect or likely effect of 'substantially lessening competition' in the market.[3]

In response to the Harper Panel's recommendation and the government's subsequent announcement, some commentators have argued that the 'take advantage' element in s 46(1) is in fact an essential part of the prohibition against misuse of market power, which is well understood and fulfills the function of distinguishing procompetitive conduct from anticompetitive conduct.[4] Others contend the 'take advantage' element has been under-inclusive in its reach, and the subject of inconsistent and uncertain judicial interpretation.[5]

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[1] Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) 335–47 ('*Harper Report*').

[2] See Malcolm Turnbull, Scott Morrison and Kelly O'Dwyer, 'Fixing Competition Policy to Drive Economic Growth and Jobs' (Joint Media Release, 16 March 2016) <http://kmo.ministers.treasury.gov.au/media-release/024-2016/>.

[3] *Harper Report*, above n 1, 344–5.

[4] See, eg, Marianna Papapakis, 'Harper "Effects Test" Will Hurt Business; Lawyers', *Australian Financial Review* (online), 31 March 2015 <http://www.afr.com/business/legal/harpers-effects-test-will-hurt-business-lawyers-20150401-1mbnle>; Graeme Samuel and Stephen King, 'Let Companies Compete and Consumers Take the Gains', *Australian Financial Review* (online), 7 April 2015 <http://www.afr.com/opinion/columnists/let-companies-compete-and-consumers-take-the-gains-20150407-1mfsxn>. The Business Council of Australia argues that the 'take advantage' requirement is 'well understood' and 'plays a critical role in connecting the conduct of a business with its market power': Business Council of Australia, Submission to the Competition Policy Review Panel, *Submission on the Competition Policy Review Draft Report*, November 2014, 15–16.

[5] See, eg, ACCC, Submission to the Competition Policy Review Panel, *Reinvigorating Australia's Competition Policy*, 25 June 2014, 78–80; Stephen Corones, Submission to the Competition Policy Review Panel, *Competition Policy Review Committee Submission*, 8 October 2014, 7–10.

The interpretation of the 'take advantage' requirement has been the subject of ongoing commentary and doctrinal analysis over the decades.[6] This chapter proposes a new framework for understanding and assessing the performance of this method of characterising unilateral anticompetitive conduct. It does so by placing the 'take advantage' standard in the broader context of the international debate concerning optimal standards for the characterisation of unilateral anticompetitive conduct. In particular, it contends that the 'take advantage' requirement is a 'profit-focused' test for unilateral conduct, which can be compared with other profit-focused tests — such as the 'profit sacrifice' and 'no economic sense' tests — proposed in the United States for the characterisation of unilateral anticompetitive conduct.[7]

Part II of this chapter describes a category of 'profit-focused' tests for unilateral anticompetitive conduct, which consider how the conduct was profitable for the dominant firm, rather than attempting to assess the impact of the conduct on the relevant market. Part III outlines the evolution of profit-focused tests in the US, beginning with several 'profit sacrifice' tests suggested for the identification of predatory conduct in the 1970s, and ultimately leading to proposals in the early years of the 21st century that a profit-focused test should be used to identify unilateral anticompetitive conduct more generally.

In Part IV, it is argued that, in spite of its numerous guises, the Australian 'take advantage' test is also a profit-focused test, which shares some features with those proposed by commentators in the US. However, the 'take advantage' test also differs from the US profit-focused tests in important respects and Part V provides a

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[6] See above n 4; Margaret Brock, 'Section 46 of the *Trade Practices Act* — Has the High Court Made a "U-Turn" on "Taking Advantage"?' (2005) 33 *Australian Business Law Review* 327; Justice John Middleton, 'The *Trade Practices Legislation Amendment Act 2008* (Cth) and s 46 of the *Trade Practices Act 1974* (Cth) — Will Anything Really Change?' (Speech delivered at the Twentieth Annual Workshop of the Competition Law and Policy Institute of New Zealand, Auckland, 7–8 August 2009); Bill Reid, 'Section 46 — A New Approach' (2010) 38 *Australian Business Law Review* 41; Rhonda L Smith and David K Round, 'Do Deep Pockets Have a Place in Competition Analysis?' (2012) 40 *Australian Business Law Review* 348.

[7] See A Douglas Melamed, 'Exclusionary Conduct under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal' (2005) 20 *Berkeley Technology Law Journal* 1247; Gregory J Werden, 'Identifying Exclusionary Conduct under Section 2: The "No Economic Sense" Test' (2006) 73 *Antitrust Law Journal* 413.

comparative analysis of these tests. This comparison is extended in Parts V and VI, which examine the likely errors under, and the certainty and 'administrability' of, the respective tests. While US profit-focused tests are acknowledged to err on the side of under-inclusiveness, it is submitted that, in its application, the Australian 'take advantage' test has ultimately been both less certain and less inclusive than its US counterparts. As a result, the provision has failed to capture significant instances of unilateral anticompetitive conduct.

II. UNILATERAL ANTICOMPETITIVE CONDUCT AND PROFIT-FOCUSED TESTS

As explained in Chapter 2, competition laws generally permit a firm to possess a dominant position, or substantial market power, in a market.[8] In Australia, a firm is considered to possess a substantial degree of market power if it has the ability to behave persistently in a manner unconstrained by its competitors, suppliers or customers, including the ability to price above competitive levels.[9] One of the reasons that most jurisdictions tolerate the mere possession of substantial market power is that dominant firms often acquire and preserve such power through superior efficiency, or 'competition on the merits', thereby increasing social welfare.[10]

While some firms with substantial market power succeed by offering a better price or product, it is possible for firms to create, protect or extend market power through conduct which suppresses the rivalry of their competitors, without creating any, or any proportionate, benefit for consumers ('unilateral anticompetitive conduct').[11] Unilateral anticompetitive conduct laws are intended to prevent practices such as these, without unduly hindering beneficial competitive activity.[12]

Some courts and commentators have attempted to distinguish unilateral anticompetitive conduct from vigorous competition by focusing on why the conduct

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[8] See Chap 2 Parts V, VIII herein.

[9] See Chap 2 Part IX herein.

[10] See Chap 2 Part V herein.

[11] See Chap 2 Pt VIII herein.

[12] Ibid.

in question was profitable for the dominant firm.[13] In particular, they highlight the connection between the firm's market power and the profitability of the relevant conduct for the firm.[14] In this chapter, such tests for unilateral anticompetitive conduct are referred to as 'profit-focused' tests. They may be distinguished from tests that focus on the effect of the dominant firm's conduct on the competitive process in the relevant market(s), and ultimately consumer welfare, sometimes referred to as 'effects-based' tests.[15] Effects-based tests depend on an accurate analysis of the likely impact of the impugned conduct in the relevant market(s). Profit-focused tests concentrate attention on the impact of the conduct on the firm undertaking the conduct, to determine *how* the firm profited, or was likely to profit, from the conduct.

As explained in Parts III–V, these profit-focused tests attempt to delineate acceptable and unacceptable methods of profit-seeking; to distinguish between those means that would be employed 'in the normal course of competition',[16] and those that would not. In short, they rely on the premise that exclusionary conduct[17] which generates profit that is dependent on the firm's market power[18] is not 'competition on the merits' or

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[13] See, eg, Phillip Areeda and Donald F Turner, 'Predatory Pricing and Related Practices under Section 2 of the *Sherman Act*' (1975) 88 *Harvard Law Review* 697; Robert H Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, 1978) 144; Janusz A Ordover and Robert D Willig, 'An Economic Definition of Predation: Pricing and Product Innovation' (1981) 91 *Yale Law Journal* 8; Mark R Patterson, 'The Sacrifice of Profits in Non-Price Predation' (2003) 18(1) *Antitrust* 37; Melamed, above n 7; Werden, above n 7. See case law discussion in Part III(D) below.

[14] To be clear, these courts and commentators do not focus on the economic profit of the firm (let alone its accounting profit) as an indication of the *existence* of market power. Rather, they consider how the firm's profit is likely to be affected by the impugned conduct, and particularly the relationship between that profit and the firm's market power, in assessing whether that conduct should be regarded as anticompetitive.

[15] See, eg, Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311. Chap 5 provides a comparative analysis of several 'effects-based' tests for unilateral anticompetitive conduct.

[16] Bork, above n 13, 144, referred to 'a deliberate seeking of market power through means that would not be employed in the normal course of competition'.

[17] That is, conduct that damages, or deters competitive responses by rivals, as opposed to purely 'exploitative' conduct, such as charging higher prices to consumers.

[18] As explained in Part V below, the Australian 'take advantage' test takes a slightly different approach to the US profit-focused tests, giving consideration to whether the conduct would be profitable in the absence of *ex ante* possession of substantial market power, as opposed to whether it would be profitable in the absence of the *resulting* preserved or enhanced market power.

'legitimate' competition. Conduct that would be profitable in the absence of such power should be regarded as legitimate competition, and protected as such.[19]

In the US, profit-focused tests gained attention in the 1970s as a means of identifying certain limited categories of anticompetitive behaviour.[20] Later, some US courts and commentators attempted to expand these tests from their limited application to specific categories of conduct to a general standard for unilateral anticompetitive conduct; from a sufficient condition for the existence of anticompetitive behaviour to a necessary condition for liability.[21] However, this expansion of profit-focused tests has generally been opposed in the US on the basis that they would be under-inclusive as a general standard for unilateral anticompetitive conduct.[22]

In Australia, to establish a misuse of market power under section 46(1) of the *CCA*, it is necessary for an applicant to prove that the firm in question possessed a substantial degree of market power; that it 'took advantage' of that power; and that it did so for one of the three proscribed purposes. The 'take advantage' element is intended to play a central role in distinguishing between vigorous, efficiency-enhancing competition and anticompetitive conduct.[23]

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[19] See William J Baumol et al, 'Brief of Amici Curiae Economics Professors in Support of Respondent', Submission in *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP*, No 02-682, 25 July 2003, 7, stating that the 'sacrifice test' (explained in Part III(C) below) 'is intended to protect ordinary business conduct, even that of an alleged monopolist, because profit-driven conduct by firms (apart from conduct that is only profit-maximizing because it harms competition) can, in most circumstances, be expected to promote overall social welfare'.

[20] See, eg, Areeda and Turner, above n 13; Part III below.

[21] See Jonathan M Jacobson and Scott A Sher, '"No Economic Sense" Makes No Sense for Exclusive Dealing' (2006) 73 *Antitrust Law Journal* 779, 781–6; Testimony of Aaron Edlin, *Academic Testimony on Unilateral Conduct before the US Dept of Justice and Federal Trade Commission Hearings* (January 2007) 27, 29–30, <http://works.bepress.com/cgi/viewcontent.cgi?article=1064&context=aaron_edlin>.

[22] See, eg, Baumol et al, above n 19; Salop, above n 15; Jacobson and Sher, above n 21; US Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the* Sherman Act (2008) 39–43, <http://www.usdoj.gov/atr/public/reports/236681.htm> ('*US Department of Justice Report on Single-Firm Conduct*').

[23] See Chap 3 Part III(D) above.

The 'take advantage' standard has not been explained as a profit-focused test of the kind described here. However, in this chapter, it will be argued that the 'take advantage' element bears a number of similarities to the profit-focused tests advocated in the US. As with those tests, Australian courts considering the 'take advantage' element have focused on the profitability of the conduct for the dominant firm, rather than on the effect of the conduct on the competitive process. As with the US tests, the focus is on the relationship between the likely profitability of the conduct for the dominant firm and the firm's market power. In particular, the Australian courts have assessed the likely profitability of the impugned conduct for a firm with substantial market power and for a firm without substantial market power (often referred to as the 'counterfactual'), in deciding whether the respondent has taken advantage of its market power.[24]

However, while the Australian courts have generally, as a matter of fact, considered the profitability of the impugned conduct in this way, the application of the 'take advantage' test has been attended by some confusion and inconsistency. A key cause of this uncertainty, it is submitted, is that the courts have repeatedly asked whether the impugned conduct would be *possible* without market power,[25] while in fact basing decisions on whether the conduct would be *profitable* in the absence of market power.[26] Particularly since the judgment of the High Court majority in *Rural Press Ltd v ACCC* ('*Rural Press*'),[27] there has been confusion about whether it is necessary to demonstrate that a firm without substantial market power would not profit from the impugned conduct, or whether it must be shown that such a firm could not (or could not 'afford' to) engage in similar conduct. As will be seen, the discrepancy between these approaches has had important implications for the Australian law on misuse of market power.

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[24] See Part III(B) below.

[25] The potential qualification that the conduct in question should not be possible for a *profit-maximising* firm without substantial market power is considered in Part VII(C) below.

[26] As explained in Part IV(B) below.

[27] (2003) 216 CLR 53.

III. PROFIT-FOCUSED TESTS IN THE UNITED STATES

A. The Areeda-Turner Test for Predatory Pricing

Perhaps the best known and most influential profit-focused test is that proposed by Phillip Areeda and Donald Turner in their seminal article on predatory pricing in 1975.[28] Predatory pricing is one example of unilateral anticompetitive conduct, or 'monopolization', which is prohibited under section 2 of the US *Sherman Act*.[29] Areeda and Turner acknowledged that, according to the classical explanation of the concept, predatory pricing occurs where a firm sacrifices some short-term profits by charging low prices, in order to earn later monopoly profits after it has caused rivals to exit.[30] Given the assumption that all firms seek to maximise their profits, a firm that is observed to *sacrifice* profits in the short-term raises the suspicion that it ultimately intends to maximise its profits by preventing rivals from competing in the longer term.[31] However, Areeda and Turner sought to provide a more precise definition of predatory pricing and, in particular, to identify a price-cost benchmark below which predation could be safely assumed.

The authors considered the significance of a firm pricing above and below various cost benchmarks. They emphasised that the fact that a firm aims to deter rivals and enhance its market power is not determinative.[32] Nor is it sufficient that the firm sacrifices profits to achieve this result.[33] A dominant firm might sacrifice some revenue by reducing its price, while still pricing above its average costs. Areeda and

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[28] Areeda and Turner, above n 13.

[29] 15 USC §§ 1–7 (1890) ('*Sherman Act*').

[30] Ibid 698.

[31] According to Baumol et al, above n 19, 5, such profit-sacrificing behaviour is conduct which 'would not be undertaken by a rational firm management unless it can be expected to reduce competition in the market'. See also Werden, above n 7, 422–3 n 37, quoting Lawrence Anthony Sullivan, *Antitrust* (West Publishing Company, 1977) 113.

[32] Areeda and Turner, above n 13, 704–5. Melamed, above n 7, 1256, contends that the profit sacrifice tests embody 'a somewhat Schumpeterian intuition that courts and commentators have repeatedly expressed — the idea that firms are entitled to reap the fruits of their "skill, foresight and industry," even if those fruits include market power' (citations omitted).

[33] Areeda and Turner, above n 13, 704.

Turner believed that such behaviour should be regarded as competition on the merits, akin to successful innovation or superior products or services.[34] These are practices that are likely to be 'an equally or more profitable choice quite apart from any exclusionary effects' that they might have.[35] Accordingly, such conduct is likely to be efficient because the exclusion of competitive constraints is not the sole source of profit from the conduct.[36]

If, on the other hand, a dominant firm prices below marginal cost, Areeda and Turner pointed out that the firm is both making a private loss and wasting social resources, since the marginal costs of production exceed the value of what is produced.[37] Pricing below marginal cost also greatly increases the probability that competitors will be excluded for reasons unrelated to the superior efficiency of the monopolist,[38] because even an equally efficient competitor would need to operate at a loss to compete with the monopolist. For these reasons, Areeda and Turner concluded that a monopolist that sacrifices profits by pricing below marginal cost, or average variable cost,[39] should be presumed to have engaged in predatory pricing.[40]

Importantly, Areeda and Turner confined this test to predatory pricing conduct, and indicated that the test was intentionally constructed to apply to a relatively narrow range of pricing to avoid deterring competitive price cuts.[41] But similar tests would soon be proposed to cover broader categories of conduct.

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[34] Ibid 705–6. Other commentators have since contended that prices above average variable cost ('AVC') can, in fact, be predatory. See, eg, Aaron S Edlin, 'Stopping Above-Cost Predatory Pricing' (2002) 111 *Yale Law Journal* 941.

[35] Areeda and Turner, above n 13, 722.

[36] Areeda and Turner also considered it to be relevant that such pricing would only exclude inefficient rivals, arguing that inefficient rivals should not be protected on the speculative possibility that they might otherwise have improved the outcomes of competition in the market: ibid 705–6.

[37] Ibid 712. It would be 'a misuse of *capital* resources to devote them to a less profitable pursuit' (emphasis in original): at 723.

[38] Ibid 712.

[39] Given the difficulty of calculating marginal cost, AVC was recognised as a reasonable surrogate for marginal cost: ibid 716–18.

[40] Ibid 712.

[41] Jacobson and Sher, above n 21, 782.

B. Bork's Definition of Exclusionary Conduct

In 1978, Robert Bork described exclusionary practices, for the purpose of s 2 of the *Sherman Act*, as practices that would not be profit-maximising for the dominant firm but for the expectation that such practices would drive out, or discipline, competitors.[42] Elhauge claims that Bork drew on the underlying reasoning of the predatory pricing standard, but attempted to 'generalize it into a global standard for determining what conduct meets the exclusionary conduct element of the monopolization test'.[43]

In his revolutionary polemic, *The Antitrust Paradox*, Bork recognised that the traditional concept of predation 'clearly contains an element of wrongful or specific intent, of a deliberate seeking of market power through means that would not be employed in the normal course of competition'.[44] But Bork sought a more precise definition. He proposed the following:

> Predation may be defined, provisionally, as a firm's deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing except for the expectation either that (1) rivals will be driven from the market, leaving the predator with a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behaviour the predator finds inconvenient or threatening. Since these results are detrimental to consumer welfare, predation is not to be classed as superior efficiency.[45]

According to Bork, then, predatory conduct is conduct that would not maximise profits in the absence of its anticipated effect of excluding competitive behaviour by rivals, and thereby entrenching the market power of the predatory firm. Such conduct

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[42] Bork, above n 13, 144.

[43] Einer Elhauge, 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 269.

[44] Bork, above n 13, 144. Bork's used 'predation' to refer to the element of exclusionary conduct under s 2 of the *Sherman Act*: *Neumann v Reinforced Earth Co*, 786 F 2d 424, 427 (DC Cir, 1986).

[45] Ibid.

is not independently profitable behaviour that *happens* also to exclude some rivals, but behaviour that would not be selected by the dominant firm but for its anticipated effect of excluding or disciplining competitive behaviour.

Bork referred to the fact that the desired outcomes of such conduct are detrimental to consumer welfare. However, as with the Areeda-Turner test, Bork's test focuses on the objective intent of the firm engaging in the conduct, and that intent is inferred from the profitability of the conduct with and without the anticipated exclusionary effect.

C. Ordover and Willig's Profit Sacrifice Test

In 1981, economists Janusz Ordover and Robert Willig also used the concept of profit sacrifice as the foundation for a more general standard for predatory behaviour.[46] In an article that was to become highly influential, they 'proposed an economic definition of predation',[47] which they intended as a 'unifying, general, and open-ended standard' for predatory behaviour.[48] According to Ordover and Willig 'predatory behaviour is a response to a rival that sacrifices part of the profit that could be earned under competitive circumstances, were the rival to remain viable, in order to induce exit and gain consequent additional monopoly profit'.[49]

Like Areeda and Turner, and Bork, Ordover and Willig held that the relevant question is not whether the practice causes a rival's exit per se, but whether '*the practice would not be profitable without the additional monopoly power resulting from the exit*'.[50] Actions by an incumbent that cause damage to a rival, or even cause a rival to exit, should not automatically be condemned as predatory: the fact that one firm is more efficient than another will mean that some firms fail, even in a competitive

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[46] Ordover and Willig, above n 13, 13–14, 52. The predatory behaviour to which Ordover and Willig referred extended beyond predatory pricing, including, eg, predatory product innovations.

[47] Ibid 52.

[48] Ibid 14.

[49] Ibid 9–10 (citations omitted).

[50] Ibid 9 (emphasis added).

market.[51] The proposed standard would not penalise the incumbent for 'legitimate competitive responses' such as these.[52]

To this extent, the proposed standard was similar to those proposed by earlier commentators. But Ordover and Willig went further in their consideration of the relevant counterfactual: that is, the hypothetical scenario in which, absent the exclusion of competition, the conduct would not maximise the dominant firm's profits. Ordover and Willig explained that, 'if there exists an alternative action, less damaging to the rival, that yields to the incumbent a higher level of profit', the firm is sacrificing profit to engage in the conduct.[53]

Importantly, Ordover and Willig stipulated that the question whether the firm had sacrificed profits in this way must be assessed with reference to 'competitive circumstances': that is, 'the profitability of the incumbent's actual and alternative responses should be assessed on the assumption that the rival reacts to them in a competitive fashion.'[54] This stipulation was critical to the authors' method of distinguishing predatory conduct from efficient competition. Profits that a firm can derive while its rivals continue to impose the same level of competitive constraint must result from the superior efficiency of the incumbent and not simply from the preservation or enhancement of the incumbent's monopoly power.

The counterfactual proposed by Ordover and Willig has been criticised for its complexity and the likely practical difficulty in implementing the test.[55] However, Ordover and Willig emphasised that their proposed definition of predation was not

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[51] Ibid 13.

[52] Ibid 10.

[53] Ibid 42. 'The existence of such an alternative action indicates that the firm's actual action was motivated by the desire for the monopoly profits attendant on the exit of the rival': at 13.

[54] Ibid 10.

[55] See, eg, Geoff Edwards, 'The Perennial Problem of Predatory Pricing: A Comparison and Appraisal of Predatory Pricing Laws and Recent Predation Cases in the United States and Australia' (2002) 30 *Australian Business Law Review* 170, 186–90.

itself a workable test for predatory practices, but that it provided a general and open-ended standard from which workable tests could be derived.[56]

D. Profit Sacrifice in the US Case Law

The use of profit-focused tests, or at least profit-focused reasoning, has also been evident in the US case law on monopolisation under section 2 of the *Sherman Act*, especially in predatory pricing cases. Thus, in *Matsushita Electric Industrial Co Ltd v Zenith Radio Corp* ('*Matsushita*'),[57] the US Supreme Court endorsed, in general terms, the below-cost pricing requirement advocated by Areeda and Turner.[58] The Court stated that an 'agreement to price below the competitive level requires the conspirators to forgo profits that free competition would offer them' in the hope of obtaining 'later monopoly profits'.[59]

Again, in *Brooke Group Ltd v Brown & Williamson Tobacco Corp*,[60] the Supreme Court held that predatory pricing requires proof of the dominant firm pricing below-cost, as well as a 'reasonable prospect' or a 'dangerous probability', of the firm recouping its investment in below-cost prices.[61] The Court held that there must be proof of pricing 'below an appropriate measure of its rival's costs',[62] although it did not specify what that measure should be. Later, in *United States v AMR Corp*,[63] in determining whether prices had fallen below an 'appropriate measure of cost', the

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[56] Ordover and Willig, above n 13, 14–15, 52. For example, '[i]n the case of single product firms, the standard suggests a number of [cost-based] tests [for predatory pricing] akin to those proposed by Areeda and Turner': at 15, citing Areeda and Turner, above n 13. When considering potentially predatory product innovations, it would be necessary to ask whether the costs incurred in bringing the new product to market could be recouped through profits on the new product if the firm's rival continued to be viable: at 28.

[57] 475 US 574 (1986).

[58] Jacobson and Sher, above n 21, 783 quoting *Matsushita*, 475 US 574, 589, 594 (1986).

[59] *Matsushita*, 475 US 574, 588–9 (1986).

[60] 509 US 209 (1993).

[61] Ibid 224.

[62] Ibid 222.

[63] 140 F Supp 2d 1141 (D Kan, 2001).

District Court of Kansas applied the Areeda-Turner test, using average variable cost as a proxy for marginal cost.[64]

But the US courts have also made occasional reference to the manner in which exclusionary conduct becomes profitable in cases that do not involve predatory pricing. In *William Inglis & Sons Baking Co v ITT Continental Baking Company Inc*, for instance, the Ninth Circuit Court explained that, in order to violate s 2 of the *Sherman Act*, conduct 'must be such that its anticipated benefits were dependent upon its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power'.[65]

Aspen Skiing Co v Aspen Highlands Skiing Corp[66] did not concern a predatory practice, but a firm's refusal to deal by terminating a joint venture in the provision of ski lift passes. Nonetheless, the Supreme Court noted that the defendant 'elected to forgo . . . short-run benefits because it was more interested in reducing competition in the Aspen market over the long run'.[67] Later advocates of profit-focused tests have relied on this passage in support of their arguments, while other commentators have asserted that the Court in *Aspen* in fact relied on an effects-based test.[68] In the subsequent case of *Neumann v Reinforced Earth Co*, Bork J also stipulated a profit-focused test for monopolisation,[69] outlining much the same definition of predation as he had put forward in *The Antitrust Paradox*.[70]

In 2003, the Antitrust Division of the US Department of Justice made reference to these cases in proposing a new 'screen' for monopolisation cases under s 2 of the *Sherman Act*.[71] The Antitrust Division stated that it often found it useful, in the

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[64] Ibid 98–103. See also *Cargill Inc v Monfort of Colorado Inc,* 479 US 104, 122 n 17 (1986).

[65] 668 F 2d 1014, 1030 (9th Cir, 1981).

[66] 472 US 585 (1985).

[67] Ibid 608.

[68] Patterson, above n 13, 39; Testimony of Aaron Edlin, above n 21, 30–7.

[69] 786 F 2d 424, 427 (DC Cir, 1986).

[70] Bork, above n 13, 144. See Part III(B) above.

[71] R Hewitt Pate, 'The Common Law Approach and Improving Standards for Analyzing Single Firm Conduct' (Paper presented at the Thirtieth Annual Conference on International Antitrust Law and

context of monopolisation claims, to ask whether the impugned conduct 'would make economic sense for the defendant but for its elimination or lessening of competition'[72] (the 'but for' test), a test which bears a strong resemblance to that proposed by Bork.[73]

The Antitrust Division advocated its 'but for' standard in a number of enforcement actions around that time.[74] In one of these cases, namely *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP* ('*Trinko*'),[75] the Supreme Court held that the defendant's alleged failure to share its telecommunications network with a rival did not infringe s 2 of the *Sherman Act*.[76] The Court distinguished *Trinko* from the earlier, successful refusal to deal claim in *Aspen Skiing*, on the basis that a key element of the liability finding in *Aspen Skiing* was the defendant's 'willingness to forsake short-term profits to achieve an anticompetitive end'.[77] In this way, the Court highlighted the importance of profit sacrifice in monopolisation claims beyond predatory pricing. The Antitrust Division, for its part, regarded this decision as an implicit endorsement of its 'but for' standard.[78]

Policy, Fordham Corporate Law Institute, New York, 23 October 2003) <http://www.usdoj.gov/atr/public/speeches/202724.htm> 8.

[72] Ibid.

[73] See Part III(B) above.

[74] Including *United States v Microsoft Corp*, 253 F 3d 34 (DC Cir, 2001) ('*Microsoft*'). See also Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner, *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP*, 540 US 398 (2004) (No 02–682), 15.

[75] 540 US 398 (2004).

[76] Ibid 409. In *Trinko*, Ordover and Willig, together with other prominent economics professors, filed a Brief of Amici Curiae, in which they vigorously opposed the application of their 'profit sacrifice' test as a general standard in all monopolisation cases, on the ground that it would be under-inclusive in this role: Baumol et al, above n 19, 6, 16, 18. This is explained further in Part VI(A) below.

[77] *Trinko*, 540 US 398, 409 (2004). See also *Covad Communications Co v Bell Atlantic Corp*, 398 F 3d 666, 675–6 (DC Cir, 2005). Testimony of Aaron Edlin, above n 21, 31–3 argues that such claims are 'revisionist' and that the Supreme Court in *Aspen Skiing* actually conducted an effects-based analysis.

[78] J Bruce McDonald, 'Antitrust Division Update: *Trinko* and *Microsoft*' (Speech delivered at the Houston Bar Association, Antitrust and Trade Regulation Section, 8 April 2004) 11.

E. US Proposals for a Profit-Focused Test for Unilateral Conduct Generally

In the wake of the Antitrust Division's arguments for a monopolisation screen, and the Supreme Court's comments in *Trinko*, some antitrust commentators began to advocate the use of similar profit-focused tests for general unilateral anticompetitive conduct claims.[79] There was, at this time, vigorous debate over what kind of test might be adopted as a universal standard for unilateral anticompetitive conduct.[80] While some, following the dicta of the DC Circuit in *Microsoft*,[81] proposed a test that considered the net effect of the conduct on competition in the relevant market(s),[82] others claimed that a test that focused on the likely source of the dominant firm's gain would provide greater predictability and 'administrability', while reducing error costs.

Douglas Melamed proposed a profit sacrifice test as a general test for unilateral anticompetitive conduct, but he explained that his test varied from the profit sacrifice concept familiar in predation cases in which it was necessary to identify 'a short-term sacrifice in search of a long-term, anticompetitive payoff'.[83] The test proposed by Melamed did not involve this temporal dimension. Instead, according to Melamed's formulation:

> the sacrifice test asks whether the allegedly anticompetitive conduct would be profitable for the defendant and would make good business sense even if

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[79] See, eg, Patterson, above n 13, 37–8. There had, however, been some earlier advocacy for this approach: see, eg, Thomas A Piraino Jr, 'Identifying Monopolists' Illegal Conduct Under the *Sherman Act*' (2000) 75 *New York University Law Review* 809, 846.

[80] There was also debate concerning the appropriate tests for unilateral anticompetitive conduct in the EU, including consideration of profit-focused tests: see, eg, Philip Marsden, 'Exclusionary Abuses and the Justice of "Competition on the Merits"' in Ioannis Lianos and Ioannis Kokkoris (eds), *The Reform of EC Competition Law: New Challenges* (Kluwer Law International, 2010) 411, 411–418; John Vickers, 'Abuse of Market Power' (2005) 115 *Economic Journal* 244, 253–6.

[81] 253 F 3d 34, 58–9 (DC Cir, 2001).

[82] See, eg, Salop, above n 15. The 'burden-shifting' approach outlined by the DC Circuit in *Microsoft* is explained in Chap 5 Part III(C) herein.

[83] Melamed, above n 7, 1255, citing Einer Elhauge 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 292–3.

> it did not exclude rivals and thereby create or preserve market power for the defendant. If so, the conduct is lawful. If not — if the conduct would be unprofitable but for the exclusion of rivals and the resulting market power — it is anticompetitive.[84]

If the conduct would not be profitable for the firm in the absence of the resulting preservation or enhancement of market power, it should be regarded as anticompetitive.

The test proposed by Melamed examined the costs and benefits of the conduct for the defendant to determine whether the conduct would be profitable in the absence of an exclusionary effect. He compared the incremental costs of the conduct[85] with the benefits resulting from the conduct (including variable cost savings, revenues from additional units sold, increased revenues from quality improvements, and increased demand). The relevant benefits did *not* include 'the ability to charge higher prices or to shift the variable cost curve downward'[86] as a result of the conduct's exclusionary effect, since these would be benefits derived from maintaining or augmenting market power.[87]

Importantly, 'conduct [would] fail the sacrifice test only if it [generated] incremental costs for the defendant that [*exceeded*] the incremental revenues or cost savings'.[88] As with the earlier tests, this test considered the likely source of the dominant firm's gain in order to make an inference about the firm's intent in engaging in the conduct. As Melamed explained, the test condemns 'only conduct that makes no sense apart from exclusion and resulting market power' and thereby 'ensures that the antitrust laws

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[84] Ibid.

[85] Being the costs (including opportunity costs) that the defendant would not incur but for the conduct.

[86] Melamed, above n 7, 1256 (eg because of a diminished need to provide customer services).

[87] Ibid.

[88] Ibid (emphasis added).

condemn only conduct from which an anticompetitive intent can unambiguously be inferred'.[89]

At around the same time that Melamed published his proposal, Gregory Werden proposed a slightly different version of a profit sacrifice test, which he labeled the 'no economic sense' test.[90] According to Werden's formulation, the court should ask 'whether challenged conduct would have been expected to be profitable apart from any gains that conduct may produce through eliminating competition'.[91] 'If conduct allegedly [creates or maintains] a monopoly [by its] tendency to exclude existing [or potential] competitors, the test is whether the conduct likely would have been profitable if [those] competitors were not excluded and monopoly was not created [or maintained]'.[92] The 'no economic sense' test therefore 'requires consideration of both the gains from the … conduct, apart from [those] that stem from eliminating competition, and the costs of undertaking the conduct'.[93]

While Werden's test is clearly very similar to that proposed by Melamed, it differs in one important aspect. Melamed's test would only be satisfied if the incremental costs of the conduct *exceeded* the incremental revenues from the conduct in the absence of any increase in market power. According to Werden's test, on the other hand, it is not crucial to demonstrate that the conduct would result in an incremental loss in the absence of any exclusionary effect, but only that the conduct would not create a profit absent such an effect.[94] This has particular relevance in cases of 'cheap' exclusion, as explained further in Part VI(D) below.

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[89] Ibid 1257. See also Piraino, above n 79, 826, 845, arguing that courts should focus on the 'substantive competitive purpose' of the impugned conduct.

[90] Werden, above n 7, 413.

[91] Ibid 414.

[92] Ibid 415.

[93] Ibid 416.

[94] Ibid 425.

IV. AUSTRALIA'S PROFIT-FOCUSED 'TAKE ADVANTAGE' TEST

A. Introduction

In Australia, the 'take advantage' test under s 46(1) of the *CCA* has not been explained with reference to the profit-focused tests proposed in the US antitrust commentary. In fact, until recently, Australian courts have not generally used the language of 'profitability' to explain the operation of the 'take advantage' test.[95] However, in this part it will be argued that, from the time of the first High Court decision under s 46(1), the 'take advantage' test has generally functioned as a profit-focused test, which shares a number of features with those put forward in the US antitrust commentary and cases. These similarities, as well as some important differences, will be explained in Part V. First, however, it is necessary to describe how the 'take advantage' test focuses on the profitability of the relevant conduct for the dominant firm.

At the outset, the 'take advantage' element in s 46(1) was intended to play a central role in distinguishing vigorous competition from anticompetitive conduct. As explained by the Attorney-General, Senator Lionel Murphy, in 1974, a firm that uses its superior skills to create a better product, or that takes advantage of economies of scale, is not taking advantage of its market power and does not thereby infringe s 46(1).[96] In a number of cases, the courts have also distinguished conduct that represents superior efficiency from conduct by which a firm takes advantage of its market power.[97]

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[95] The first Australian case to expressly refer to the profitability of the conduct under the 'take advantage' element was *ACCC v Cement Australia Pty Ltd* (2013) 310 ALR 165, 509 [1899] ('*Cement Australia*'), explained further in Part VII(C) below.

[96] See Chap 3 Part III(D).

[97] See, eg, *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 202 (Dawson J) ('*Queensland Wire Industries*'). In *Boral* (2003) 215 CLR 374, 465 [280], quoting *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1, 27 [67] ('*Melway*'), McHugh J stated that a dominant firm that has succeeded through superior efficiency would not contravene s 46(1), as such a firm 'has not "taken advantage of" its market power. It has not sought to act in a manner "free from the constraints of competition"'.

The question whether the dominant firm has taken advantage of its substantial market power is therefore intended to draw a line between anticompetitive conduct (which harms the competitive process) and vigorous competition (which creates real value for society).[98] But how exactly does the 'take advantage' element aid the courts in making this distinction?

B. The Meaning of the 'Take Advantage' Element

1. The Seminal Decision: Queensland Wire Industries

In the first case to come before the High Court under s 46(1), the Court provided substantial guidance on the meaning of the 'take advantage' element. The case, *Queensland Wire Industries*,[99] concerned an allegation that BHP had taken advantage of its position of control in the market for steel products.[100] In particular, BHP had constructively refused to supply a certain steel product, Y-bar, to Queensland Wire Industries. The reason for this refusal was that BHP used the entire supply of Y-bar to produce star pickets, which it sold as a monopolist in a downstream market, and it did not wish to supply Y-bar to any firm that might compete with it in the market for the supply of star pickets.[101]

Mason CJ and Wilson J held that the question whether a firm has 'taken advantage' of its position of control in a market requires no hostile intent on the part of the defendant but simply asks whether the firm 'has *used* that power'.[102] Their Honours explained their finding that BHP had in fact taken advantage of, or used, its position of control as follows:

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[98] See Trade Practices Consultative Committee, Parliament of Australia, *Small Business and the Trade Practices Act* (1979) vol 1, 69.

[99] (1989) 167 CLR 177.

[100] *TPA* s 46(1) originally referred to 'a corporation that is in a position substantially to control a market', but was amended in 1986 to refer to 'a corporation that has a substantial degree of power in a market': *Trade Practices Revision Act 1986* (Cth) s 17.

[101] *Queensland Wire Industries* (1989) 167 CLR 177, 182–5.

[102] Ibid 191 (Mason CJ and Wilson J) (emphasis added).

> It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power — in other words, if it were operating in a competitive market — it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor.[103]

Dawson J found that BHP had taken advantage of its market power on similar grounds:

> [BHP] used [its] power in a manner made possible only by the absence of competitive conditions. Inferences in this regard can be drawn from the fact that BHP could not have refused to supply Y-bar to QWI if it had been subject to competition in the supply of that product. … If there had been a competitor supplying Y-bar, BHP's refusal to supply it to QWI would have eroded its position in the steel products market without protecting AWI's position in the fencing materials market.[104]

In respect of the 'take advantage' question, Toohey J asked: 'Is BHP refusing to supply Y-bar because of its dominant power (due to the absence of competitors) in the steel products market?'[105] His Honour answered the question in the affirmative, stating:

> The only reason why BHP is able to withhold Y-bar (while at the same time supplying all the other products from its rolling mills) is that it has no other competitor in the steel product market who can supply Y-bar. It has dominant power in the steel products market due to the absence of constraint. It is exercising that power which it has when it refuses to supply QWI with Y-bar at competitive prices …[106]

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[103] Ibid 192 (Mason CJ and Wilson J).

[104] Ibid 202–3 (Dawson J).

[105] Ibid 216 (Toohey J).

[106] Ibid.

As will be seen from the terms used in the passages above, the judgments in *Queensland Wire Industries* repeatedly used the language of possibility ('can afford';[107] 'made possible';[108] 'is able'[109]) to contrast the position of a firm with substantial control of a market, and the position of a firm in a competitive market. This language gives the appearance that their Honours were considering whether the firm would be *able* to engage in the impugned conduct with and without market power.[110]

However, on a closer reading, it is apparent that their Honours were referring not to the literal possibility of the firm engaging in the conduct, but to the relative profitability of the practice when adopted by firms with and without control of a market respectively. As Mason CJ and Wilson J stated, BHP could 'afford, *in a commercial sense*,'[111] to engage in the conduct only by virtue of its control of the market. It was not that BHP's control of the market made it possible for BHP to engage in the simple act of refusing to sell its product: that position could be adopted by any firm, regardless of its power or the level of competition in the market. The clear import of their Honours' statement was that BHP's control of the market meant that it was likely to profit from such conduct, whereas, in a competitive market, a firm would be likely to suffer a loss of profits if it engaged in the same conduct.

The explanation by Dawson J is even more explicit: in the absence of its market power, BHP's conduct 'would have eroded its position in the steel products market without protecting AWI's position in the fencing materials market'.[112] That is, it would have eroded its position in the upstream market without creating profit through the resulting preservation of its market power in the downstream market.[113] The

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[107] Ibid 192.

[108] Ibid 202.

[109] Ibid 216.

[110] See the discussion of the 'possibility' strand of reasoning in Part VII(C) below.

[111] *Queensland Wire Industries* (1989) 167 CLR 177, 192 (emphasis added).

[112] Ibid 202–3.

[113] Cf Brock, above n 6, 331, noting that Dawson J may have supported a higher threshold of impossibility without market power. However, Brock's arguments (and a number of courts that have relied on the judgment of Dawson J in *Queensland Wire Industries* (1989) 167 CLR 177) seem to

conduct was only profitable because the firm possessed market power and because the conduct in question preserved or enhanced that market power.

2. The Amendment: Section 46(6A)

In subsequent case law, Australian courts considering the 'take advantage' element have consistently referred to the principles enunciated in *Queensland Wire Industries*, while producing other explanations of the manner in which a firm can be said to take advantage of its market power.[114] However, in 2003, the High Court majority in *Rural Press Ltd v ACCC* ('*Rural Press*')[115] appeared to indicate that courts were constrained to the narrower question whether a firm without substantial market power 'could' engage in the impugned conduct.[116]

As a result of concerns regarding the *Rural Press* decision, the *CCA* was amended in 2008 to incorporate a new s 46(6A), which clarified the broader range of factors relevant to whether a firm has taken advantage of its market power.[117] Section 46(6A) provides:

> In determining for the purposes of this section whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:
>
> (a) whether the conduct was *materially facilitated by* the corporation's substantial degree of power in the market;
>
> (b) whether the corporation engaged in the conduct *in reliance on* its substantial degree of power in the market;

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overlook this particular aspect of his Honour's explanation. See, eg, *Australian Competition and Consumer Commission v Boral Ltd* (1999) 166 ALR 410, 440 [157]; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, 144 [60].

[114] See the cases analysed in Part IV(B)(3)(5) below.

[115] (2003) 216 CLR 53

[116] Ibid 74–8 [49]–[56]. The *Rural Press* decision is explained in detail in Part VI(E) below.

[117] *Trade Practices Legislation Amendment Act 2008* (Cth) sch 1 item 5, amending *Trade Practices Act 1974* (Cth); Commonwealth, *Parliamentary Debates*, House of Representatives, 26 June 2008, 6030–1 (Chris Bowen, Minister for Competition Policy and Consumer Affairs). See the explanation of these concerns following the *Rural Press* decision in Part VI(E) below.

(c) whether it is likely that the corporation *would have engaged in the conduct if it did not have* a substantial degree of power in the market;

(d) whether the conduct is *otherwise related to* the corporation's substantial degree of power in the market.[118]

Sections 46(6A)(a)–(c) are derived from the case law on 'taking advantage', as described below.[119] Sub-section (d) appears to create a broader category, requiring only that the conduct be 'related to' the firm's market power.[120] As explained in the following discussion, each of these factors has been used to explain why the conduct in question would not be profitable for the firm if it did not possess substantial market power.

3. Conduct Unlikely in a Competitive Market

In *Dowling v Dalgety Australia Ltd*,[121] Lockhart J referred to the possibility of a firm engaging in the relevant unilateral conduct without market power, stating that, '[w]hat [s 46] discourages is conduct which would not be possible in a competitive market'.[122] However, his Honour determined that the 'central determinative question' in a case concerning the taking advantage of market power is: 'has the corporation exercised a right that it would be highly unlikely to exercise or could not afford for commercial reasons to exercise if the corporation was operating in a competitive market?'[123] The inference that a firm would be 'highly unlikely' to engage in the relevant conduct, or that it 'could not afford for commercial reasons' to engage in the conduct, must be based on the relative profitability of the conduct with and without a substantial degree of market power.

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[118] *CCA* s 46(6A) (emphasis added).

[119] See Part IV(B)(3)–(5) below.

[120] *CCA* s 46(6A)(d). See also Part VI(E) below; Middleton, above n 6. Cf Reid, above n 6.

[121] (1992) 34 FCR 109.

[122] Ibid 144.

[123] Ibid.

Similarly, in the later case of *Melway*,[124] Gleeson CJ, Gummow, Hayne and Callinan JJ considered the approach adopted in *Queensland Wire Industries*[125] and held that a majority asked 'how [the defendant] would have been likely to behave in a competitive market',[126] Their Honours went on to consider whether the dominant firm had denied itself sales (implicitly, whether it had foregone profit) by engaging in the relevant conduct and whether it had behaved similarly before it possessed market power.[127]

In *NT Power Generation Pty Ltd v Power and Water Authority* ('*PAWA*'),[128] the majority of the High Court commented that, if the defendant had been operating in a competitive market, 'it would be very unlikely that it would have been able to stand by and allow a competitor to supply' the service which it refused to supply as a dominant firm.[129] That is, in the absence of its market power, the firm would have been unlikely to sacrifice the profit that it could otherwise make by supplying its services to the customer in question.

4. Acting in Reliance Upon Market Power

In *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Pty Ltd* ('*Natwest*'),[130] French J emphasised the need for a causal connection between the alleged conduct and the firm's substantial market power, in establishing that a firm has taken advantage of its market power.[131] His Honour stated:

> There must be a causal connection between the conduct alleged and the market power pleaded such that it can be said that the conduct is a use of that power. In many cases the connection may be demonstrated by showing a

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[124] (2001) 205 CLR 1.

[125] Ibid 22 [47], 23 [52

[126] Ibid 23 [50].

[127] Ibid 26 [62].

[128] (2004) 219 CLR 90.

[129] Ibid 136 [124].

[130] (1992) 111 ALR 631.

[131] Ibid 637.

> reliance by the contravener upon its market power to insulate it from the sanctions that competition would ordinarily visit upon its conduct.[132]

The fact that conduct preserves or enhances a firm's substantial market power may make the relevant conduct profitable, whereas, in a competitive market, the same conduct would be sanctioned by a loss of profits, without offsetting profits from resulting market power. This factor could, for example, prove critical in some refusal to deal cases where a non-dominant firm attempting to act in the same way would be punished for its conduct by the normal competitive responses of other firms in the market, without any prospect of offsetting profits.

5. Conduct Materially Facilitated by Market Power

In the next case to come before the High Court under s 46(1), namely *Melway*,[133] the majority acknowledged that the language of 'possibility' might not always be apposite to the 'take advantage' question. Thus Gleeson CJ, Gummow, Hayne and Callinan JJ held:

> [I]n a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission … that s 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.[134]

How might it be demonstrated that a corporation's market power 'made it easier' for the corporation to act for the proscribed purpose? Their Honours went on to hold that:

> Freedom from competitive constraint might make it possible, or easier, to refuse supply and, if it does, refusal to supply would constitute taking advantage of market power. But it does not follow that because a firm in

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[132] Ibid 637.

[133] (2001) 205 CLR 1.

[134] Ibid 23 [51].

> fact enjoys freedom from competitive constraint, and in fact refuses to supply a particular person, there is a relevant connection between the freedom and the refusal. Presence of competitive constraint might be compatible with a similar refusal, especially if it is done to secure business advantages which would exist in a competitive environment.[135]

Of course, freedom from competitive constraint does not, literally, make it possible or easier for a firm to refuse to supply its products to another person. Rather, it changes the outcome of that act. In particular, it may mean that the refusal ultimately creates profits for the firm, whereas the same refusal would result in a loss of profits for the firm, without any offsetting profits from resulting market power, in the presence of competitive constraints.

On the other hand, as their Honours stated, if the practice is carried out 'to secure business advantages which would exist in a competitive environment',[136] there is no taking advantage of market power. This statement points to the relevant connection between the firm's substantial market power and the profitability of the conduct: if the conduct would create the same gains or profits for the firm in the presence of competitive constraints, it does not infringe.[137]

In *ACCC v Australian Safeway Stores Pty Ltd* ('*Safeway*'),[138] the Full Federal Court added to the explanation that a firm might take advantage of its substantial market power by conduct that is materially facilitated by that power. The impugned conduct was Safeway's decision to stop purchasing, or 'delete', the bread products of certain plant bakers. It was found that Safeway took this action to discipline the bakers in question for supplying discounted bread to independent retailers who competed with

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[135] Ibid 27 [67].

[136] Ibid.

[137] See also *Boral* (2003) 215 CLR 374, 464 (McHugh J), citing *Melway* (2001) 205 CLR 1, 21 [44], 27 [67] (Gleeson CJ, Gummow, Hayne and Callinan JJ):

> There must be a causal connection between the 'market power' and the conduct alleged to have breached s 46. Moreover, that conduct must have given the firm with market power some advantage that it would not have had in the absence of its substantial degree of market power.

[138] (2003) 129 FCR 339.

Safeway. In respect of the 'take advantage' question, Heerey and Sackville JJ found that '[a] firm without market power would not have pursued a policy of deletion because to do so would have produced harm for itself without any countervailing benefit'.[139] Further:

> In determining whether a corporation has taken advantage of its market power it is enough that the corporation's conduct has been 'materially facilitated' by the existence of its power. … As we have explained, there would have been no purpose in Safeway acting in this manner in a competitive market. On the contrary, had Safeway done so it would have inflicted economic harm on itself for no gain. Safeway's conduct … was therefore materially facilitated by the existence of its market power even though that same conduct would not have been 'absolutely impossible' without that power.[140]

This version of the 'take advantage' test can again be understood as focusing on the relative profitability of the conduct. If Safeway had deleted the bakers' products in a competitive market, it would have lost profits from the foregone bread sales without gaining any greater profits from preserving or enhancing its market power ('it would have inflicted economic harm on itself for no gain').[141] On the other hand, the same conduct was considered to be profitable in a situation where Safeway possessed substantial market power and was likely to preserve or enhance that power through its conduct.

V. COMPARISON OF PROFIT-FOCUSED TESTS

A. Profit Focus to Explain Objective Purpose

From the explanations of the 'take advantage' element in the case law, it can be seen that this test, like the US tests outlined in Part III above, is a test that generally focuses on the profit likely to be gained by a firm as a result of the impugned conduct,

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[139] Ibid 409 [330].

[140] Ibid 409 [333].

[141] Ibid.

as opposed to tests that focus on the impact of the conduct on the relevant market. In particular, each of these tests requires consideration of the likely source of the dominant firm's profit, and the relationship between the profit gained as a result of the conduct and the firm's market power.

These tests also appear to share a similar rationale for focusing on the connection between profit and market power: that is, this connection explains the objective *purpose* underlying the conduct in question, and particularly whether the conduct was designed to create profit only by suppressing the competitive responses of the dominant firm's rivals.[142] A concern with objective purpose can be discerned in earlier tests for predatory pricing, which may be regarded as the genesis of later profit-focused tests.[143] These tests for predatory pricing proceed from the assumption that all firms seek to maximize their profits. Given this assumption, a firm that is observed to *sacrifice* profits in the short term raises the suspicion that it is acting with the ultimate purpose of maximizing its profits by preventing rivals from competing in the longer term.[144]

Profit-focused tests apply this logic to competitive conduct more broadly. In Melamed's words, one of the benefits of his more general 'profit sacrifice' test is that

> by condemning only conduct that makes no sense apart from exclusion and resulting market power, the sacrifice test ensures that the antitrust laws

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[142] See, eg, Bork, above n 13, 144; Piraino, above n 79, 826, 845; Melamed, above n 7, 1257; Salop, above n 15, 354–7. See also Robertson, 'Primacy of "Purpose"– Part 1', above n 9, 104, noting that there is no doubt an element of purpose in 'taking advantage' of market power. In *Safeway* (2003) 129 FCR 339, 408 [329] (emphasis in original), Heerey and Sackville JJ stated:

> In our view, this analysis ignores the question of *why* Safeway engaged in the impugned conduct. This is not the same question as to whether one or more of the statutorily proscribed purposes existed. Before reaching that point it is necessary to look at not only what the firm did, but why the firm did it. That is why a business rationale for the conduct, independent of the question of market power, is relevant …

[143] See Salop, above n 15, 314–15.

[144] See Baumol et al, above n 19, 5; Werden, above n 7, 422–3 n 37, citing Lawrence Anthony Sullivan, *Antitrust* (West Publishing Company, 1977) 113.

> condemn only conduct from which *an anticompetitive intent can unambiguously be inferred*.[145]

As Lao describes the 'profit sacrifice' test:

> [B]usinesses do not generally engage in strategies that are unprofitable or otherwise contrary to their economic interests. Therefore, if a monopolist engages in an unprofitable refusal to deal, we assume that the firm has taken that course of action only because it believed and expected the refusal to increase barriers to competition, which would allow it to earn greater monopoly profits in the future. In other words, *the defendant's likely purpose* in refusing to deal *was not to enhance its own efficiency but to invest in future monopoly profits through excluding or disadvantaging its rivals*.[146]

But the relevant intent under profit-focused tests is not the firm's subjective intent. As Werden explains:

> In applying the no economic sense test, what matters are the objective economic considerations for a reasonable person, and not the state of mind of any particular decision maker. The test does not condemn conduct undertaken because of an unreasonable belief that the conduct would have an exclusionary effect. Nor does it condemn conduct because the decision maker did not clearly focus on, or even was unaware of, what were sound economic reasons for undertaking the conduct.[147]

Rather than focusing on the 'subjective motivation' for the conduct, the test asks 'whether the conduct would have been irrational but for any payoff from eliminating competition'.[148] The significance of the objective purpose rationale underlying profit-focused tests is analysed further in Chapter 6.

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[145] Melamed, above n 7, 1257.

[146] Marina Lao, 'Aspen Skiing and Trinko: Antitrust Intent and "Sacrifice"' (2006) 73 *Antitrust Law Journal* 171, 171, 187 (emphasis added).

[147] Werden, above n 7, 416–7 (emphasis added).

[148] Ibid 426.

Some have also argued that conduct which fails the profit-focused tests is necessarily detrimental to social welfare, since such conduct wastes social resources; excludes competitors who are equally efficient; and increases market power in the absence of superior efficiency.[149]

B. Relationship Between Market Power and Profit

Notwithstanding these common features of the tests considered here, the Australian 'take advantage' test diverges from the profit-focused tests proposed in the US in explaining the requisite relationship between market power and profit. While the US tests ask whether the conduct would make business sense in the absence of the *resulting* market power,[150] the 'take advantage' test asks whether the conduct would make sense in the absence of the firm's *ex ante possession* of substantial market power.

Werden's 'no economic sense' test, for instance, attempts to gauge whether the practice is only profitable due to the incremental market power which the practice creates or preserves. In contrast, the 'take advantage' test asks: if the firm did not possess substantial market power *before* it engaged in the conduct,[151] would it have been profitable for the firm to proceed with the conduct? This question is often answered by posing a hypothetical scenario in which a firm engages in the same conduct in a competitive market: the 'competitive market' counterfactual.[152] The US profit-focused tests do not make use of a 'competitive market' counterfactual, but ask whether the conduct would have remained profitable even if competition by rivals were not excluded or disciplined. That is, would the conduct have been profitable if it did not result in any 'ability to charge higher prices or to shift the variable cost curve

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[149] See Bork, above n 13, 144; Areeda and Turner, above n 13, 712, 723. See also Baumol et al, above n 19, 5.

[150] Melamed, above n 7, 1257.

[151] Or if the conduct occurred in a competitive market.

[152] See, eg, *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2011] NZLR 577, 602 [38]; *Cement Australia* (2013) 310 ALR 165, 509–10 [1900]–[1901].

downward (because, for example, of a diminished need to provide customer services) as a result of the exclusion of rivals'?[153]

In spite of this distinction, it is evident (if not expressly acknowledged) that resulting market power has also been relevant under the Australian 'take advantage' standard. It is submitted that the fact that the impugned conduct preserves or enhances market power explains *why* the conduct is profitable for the dominant firm while it would not be profitable for a firm in a competitive market. So, for example, in *Queensland Wire Industries*, Dawson J found that the dominant firm's refusal to deal would have resulted only in a loss of profits due to forgone sales for a firm in a competitive market, whereas, for the dominant firm, those lost profits would likely be offset by the resulting market power, namely the preservation of BHP's substantial market power in the fencing material market.[154] The important premise underlying the 'take advantage' test is that a firm without substantial market power will not generally have the ability to increase its market power if it engages in non-efficient, exclusionary acts.[155] Thus its business decisions will be shaped by the assumption that there could be no profit due to an increase in market power alone.

In this way, the fact that conduct is profitable due to its preservation or enhancement of market power is relevant under both the US profit-focused tests and the 'take advantage' test. Is the 'take advantage' test therefore, for practical purposes, equivalent to the US profit-focused tests? It is submitted that it is not. The reason for this is that the 'take advantage' test relies on the assumption that conduct that is profitable on the part of a firm without substantial market power is always

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[153] Melamed, above n 7, 1256.

[154] In another example, in *Boral* (2003) 215 CLR 374, 465 [280], McHugh J stated, obiter, that if a firm with substantial market power 'cuts prices below cost for a proscribed purpose with the intention of *later recouping its losses by using its market power* to charge supra-competitive prices, it has taken advantage of its market power to cut prices below cost to damage competitors' (emphasis added). The substantial market power does not make it possible for the firm to cut its prices below cost, rather the exclusionary effect of the below-cost pricing and the firm's *resulting* market power make this conduct profitable.

[155] Williams, 'Should an Effects Test Be Added to s 46?', above n 186, 2. See also Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (Thomson Reuters, 4th ed, 2011) 293.

competitive conduct, no matter the market conditions under which that conduct is in fact undertaken.[156]

Conduct that is profitable in the absence of substantial market power, so the reasoning goes, must be procompetitive. The 'take advantage' test, as it has been interpreted, depends on this premise. The US profit-focused tests do not make such an assumption. Instead of hypothesising a market in which the dominant firm does not possess substantial market power, the US tests hypothesise a situation in which the conduct does not exclude competitive behaviour.[157] As explained in Part VI below, this creates significant categories of error for the Australian test, which are not likely to arise under the US profit-focused tests.

VI. LIKELY ERRORS UNDER VARIOUS PROFIT-FOCUSED TESTS

A. Acknowledged Under-Inclusiveness of US Profit-Focused Tests

It is interesting to note that, in the US, proposals for a profit-focused test as a general standard for monopolisation have generally been put forward by those who advocate a very narrow prohibition of unilateral conduct. So, for example, the Antitrust Division suggested the broader application of the 'no economic sense' test during a period in which the Division was highly reluctant to initiate any monopolisation proceedings under s 2 of the *Sherman Act*.[158]

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[156] As Lockhart J stated in *Dowling v Dalgety Australia Ltd*, '[w]hat [section 46] discourages is conduct which would not be possible in a competitive market, *thereby promoting competitive conduct*': (1992) 34 FCR 109, 144 (emphasis added).

[157] The profits that a firm can derive while its rivals continue to impose the same level of competitive constraint must result from the superior efficiency of the incumbent and not simply from the preservation or enhancement of the incumbent's monopoly power. See Ordover and Willig, above n 13, 10.

[158] From 1993–2000, the Division 'brought seven civil cases predicated mainly on alleged *Sherman Act* Section 2 violations', whereas between 2000–2014, the Division filed one such case: William E Kovacic, 'Politics and Partisanship in US Federal Antitrust Enforcement' (2014) 79 *Antitrust Law Journal* 687, 688. See also Jonathan B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 607–9.

One of the key criticisms of Werden's 'no economic sense' test and Melamed's 'profit sacrifice' test is that they are under-inclusive.[159] In fact, Ordover and Willig, together with other prominent economics professors, have vigorously opposed the use of their 'profit sacrifice' test as a general standard in monopolisation cases, stating that, 'there undeniably are circumstances where business conduct can be damaging to the public welfare even though it passes the sacrifice test'.[160] Thus a requirement that such a test should be satisfied in all unilateral conduct cases 'could immunize from antitrust scrutiny a wide range of conduct that can only be viewed as reducing overall consumer welfare'.[161]

Even the Antitrust Division, while acknowledging the usefulness of these tests in some circumstances, ultimately declined to adopt a profit-focused test for all unilateral conduct cases.[162] In particular, it noted that these tests concentrate only on the impact of the impugned conduct on the dominant firm, and that firm's intentions, and may absolve some practices that have an anticompetitive impact on the relevant market(s) and ultimately consumer welfare.

While advocates of profit-focused tests argue that claims of under-inclusiveness are sometimes exaggerated,[163] they admit that their tests *are* under-inclusive. However, proponents argue both that their tests may be supplemented by other tests, and that an under-inclusive approach is justified.[164] In their view, the risk of firms engaging in unilateral anticompetitive conduct is relatively low and the cost of authorities incorrectly prohibiting conduct that is actually procompetitive is relatively high. It is often argued, for example, that, given that many US monopolisation claims will be

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[159] See, eg, Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 109, 115–116; Jacobson and Sher, above n 21, 781–6.

[160] Baumol et al, above n 19, 6.

[161] Ibid 16. Baumol et al go on to list instances of unilateral conduct not captured by the 'profit sacrifice' test, making particular reference to conduct that is otherwise unlawful, as well as 'cheap' exclusion in the form of patent fraud: at 18–20. 'Cheap' exclusion is explained in Part VI(D) below.

[162] *US Department of Justice Report on Single-Firm Conduct*, above n 22, 39–47.

[163] Melamed, above n 7, 1260–1; Werden, above n 7, 425–8.

[164] Werden, above n 7, 415.

heard by a jury, and that they may make a firm liable for treble damages, there is a high risk of an over-inclusive prohibition inhibiting aggressive but beneficial competition by dominant firms.[165] In these circumstances, some contend that policymakers ought to err on the side of under-inclusiveness in constructing rules against unilateral conduct.[166]

In Australia, section 46(1) claims are not heard by a jury and do not give rise to liability for treble damages, but, like the US tests, the provision does not depend on the effect of the impugned conduct on competition in the relevant market and ultimately consumer welfare. Further, the general prohibition of misuse of market power in section 46(1) cannot be supplemented with other standards in difficult cases, as proposed by Melamed and Werden,[167] at least not without substantial amendment to the legislation. On the other hand, unlike the position in the US, section 46(1) does not require proof that the conduct in question is reasonably capable of increasing monopoly power or lessening competition in the market. In this respect, at least, it might be argued that section 46(1) is more inclusive than profit-focused proposals from the US.

However, it is submitted that the 'take advantage' test, as interpreted by the Australian courts, absolves important instances of unilateral anticompetitive conduct, which US advocates of profit-focused tests would condemn. Three categories of such conduct are outlined in the following sections.

B. Conduct with Both Anticompetitive Effects and Efficiency Gains

One of the criticisms of profit-focused tests in general is that they may be under-inclusive where conduct gives rise to some gains resulting from improved efficiency, as well as gains resulting from increasing or augmenting market power.[168]

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[165] Ibid 432. See also Frank H Easterbrook, 'On Identifying Exclusionary Conduct' (1986) 61 *Notre Dame Law Review* 972; Frank H Easterbrook, 'When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?' (2003) *Columbian Business Law Review* 345.

[166] Werden, above n 7, 432.

[167] See Part VI(B) and (D) below.

[168] See, eg, Andrew I Gavil, 'Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 52–5; Salop, above n 15, 356, 361; Mark S Popofsky,

Commentators have argued that, in this respect, the 'no economic sense' test and its variants are particularly unhelpful in cases concerning tying and exclusive dealing.[169] These practices, they argue, will almost always have some efficiency justification — it will make at least some 'economic sense' — but by focusing solely on the internal costs and benefits of the conduct for the defendant, profit-focused tests may overlook the net harm caused by the conduct to the competitive process and consumer welfare.[170]

Proponents of profit-focused tests have adopted differing approaches to conduct that gives rise to gains from increased efficiency as well as gains from exclusionary effects. Werden recognises that his 'no economic sense' test may not be useful in these circumstances and acknowledges that a different type of test may be needed to assess such conduct.[171] He has acknowledged, in particular, that his test might not be feasible in circumstances where 'the conduct generates legitimate profits as well as profits from eliminating competition', as, for example, in some cases involving bundled rebates.[172]

Melamed, on the other hand, is confident that his 'profit sacrifice' test could address such practices. By weighing the incremental costs of the conduct against the incremental gains from the conduct,[173] Melamed claims to be able to identify conduct that depends upon an exclusionary effect for its profitability.[174] However, critics argue

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'Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules' (2006) 73 *Antitrust Law Journal* 435, 476.

[169] Jacobson and Sher, above n 21; Herbert J Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct' (Research Paper No 08-28, The University of Iowa College of Law, June 2008) 12. In Australia, exclusive dealing may also be addressed under *CCA* s 47.

[170] Jacobson and Sher, above n 21, 781, 784, 788–92; Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct', above n 169, 11–12.

[171] Werden, above n 7, 414.

[172] Ibid 421, citing *LePage's Inc v 3M,* 324 F 3d 141 (3rd Cir, 2003) in particular.

[173] Excluding any gains resulting from an increase in market power.

[174] Melamed, above n 7, 1255–7.

that, in practice, determining which gains arise from increases in efficiency and which gains result from an increase in market power may be near impossible.[175]

It is not entirely clear how the Australian 'take advantage' test addresses conduct that gives rise to both increased efficiency and increased market power from exclusionary effects. Some commentators have expressed the opinion that s 46(1) permits courts to take efficiency arguments into account since a firm that engages in economically efficient conduct does not take advantage of its market power:[176] conduct that is economically efficient, they say, is conduct that would be profitable in any market and there is therefore no causal connection between the market power and the conduct.[177]

This reasoning has also influenced the approach adopted in certain decisions on s 46(1). In particular, Heerey J in the Federal Court relied on this commentary in support of the view that the existence of a 'legitimate business reason'[178] for the impugned conduct necessarily points against a conclusion that the conduct constituted a taking advantage of market power, since the firm would engage in such practices to conduct its business more efficiently irrespective of its degree of market power. His Honour first adopted this approach in the dissenting judgment in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd*.[179] The same approach, referring to the 'business rationale' of the firm, was subsequently applied by his Honour at first instance in *Australian Competition and Consumer Commission v Boral Ltd*,[180] and by the majority of the Full Federal Court in *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd*.[181] Where the firm has a legitimate

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[175] See, eg, Salop, above n 15.

[176] Frances Hanks and Philip L Williams, 'Implications of the Decision of the High Court in *Queensland Wire*' (1990) 17 *Melbourne University Law Review* 437, 445.

[177] Philip Williams, 'The Counterfactual Test in s 46' (2013) 41 *Australian Business Law Review* 93, 97–8.

[178] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, 135 [25].

[179] (1999) 90 FCR 128, 135 [22]–[25], 136–7 [31]–[33].

[180] (1999) 166 ALR 410, 440 [158].

[181] (2003) 129 FCR 339, 408 [329] (Heerey and Sackville JJ). In *Cement Australia* (2013) 310 ALR 165, 508–10 [1896]–[1900], 510–11 [1904], Greenwood J took a similar approach, holding that, in determining whether a firm has taken advantage of its market power, regard must be had to any

business rationale for its conduct — so that even a firm without substantial market power would engage in similar conduct — it does not infringe s 46.

In this way, it appears that the courts consider that the existence of a 'legitimate business rationale' for the conduct in question may absolve the dominant firm, without the need for any weighing of profits derived from efficiency gains against profits derived from exclusionary effects alone. A business rationale is 'legitimate' if a firm without substantial market power would engage in similar conduct.[182] Once this much is proved, it is not necessary to investigate the extent of legitimate and illegitimate gains respectively, or to consider whether the conduct produces harm to the competitive process which is entirely disproportionate to the claimed efficiency gains.[183] Nor is it acknowledged that conduct undertaken by a dominant firm may have anticompetitive effects that are not present when the same conduct is undertaken by a non-dominant firm, as explained in the following section.

C. Conduct also Profitable for a Firm Without Substantial Market Power

The 'take advantage' test relies on the assumption that conduct that is profitable in a competitive market, or on the part of a firm without substantial market power, is procompetitive, no matter the market conditions in which that conduct is in fact undertaken.[184] In assessing this assumption, it is useful to have regard to the relevance of the 'substantial market power' requirement which is an element of most unilateral conduct rules.

'legitimate or ordinary business rationale informing the decision-making of the firm'. Cf *Boral* (2003) 215 CLR 374, 483, 500 [390], in which Kirby J argued '[t]o say that the impugned conduct was a rational business response is simply to beg the question'.

[182] Cf Elhauge, above n 43, 315–20, proposing a test which would absolve unilateral conduct that furthers monopoly power only as a result of an improvement in the dominant firm's own efficiency.

[183] See the discussion of unilateral conduct producing harms which are disproportionate to the resulting consumers' benefits in Hovenkamp, *Federal Antitrust Policy*, above n 155, 298, 300–1; Salop, above n 15, 323–6, 329–32. Cf *Pacific National (ACT) Ltd v Queensland Rail* [2006] FCA 91, 200–1 [1077]–[1079], where Jacobson J found that the existence of a 'business explanation' for the conduct meant that the firm had not taken advantage of its market power, apparently without the need to consider how or why the conduct was profitable for the firm.

[184] See *Harper Report*, above n 1, 339.

Unilateral conduct rules generally include a requirement that the defendant possess a 'significant' or 'substantial' degree of market power.[185] This is not because there is some definable level of market power above which firms become capable of anticompetitive conduct and below which all conduct is procompetitive. Rather, the market power requirement acts as an important screening device, which is intended to ensure a more cost effective application of the law by focusing enforcement efforts on the range of conduct *most likely* to create anticompetitive effects.[186]

In spite of the usefulness of the 'substantial market power' requirement as a screening device, it is possible for firms with less-than-substantial market power to profit from exclusionary conduct, particularly in cases of 'cheap' exclusion, as explained in the following section.[187] In the US, such conduct may even be condemned as monopolisation, since the law requires proof that the defendant possessed monopoly power *after* it engaged in the relevant conduct,[188] and not (as in Australia) *before* it engaged in the conduct. It is also possible for firms to engage in conduct that would be efficient in a competitive market, but which could have anticompetitive effects if adopted by a firm with substantial market power, as illustrated below.

Alan Devlin points out that, particularly in 'new economy' markets which display powerful network effects, it is now recognised that fringe firms may profit from conduct that was previously considered profitable only as a predatory strategy on the part of a dominant firm.[189] This has important implications for the 'take advantage' standard.

Consider the following example. The owner of a new and attractive technology plans to enter a market, which is characterised by direct network effects and dominated by

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[185] International Competition Network Unilateral Conduct Working Group, 'Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies' (Paper presented at the 6th Annual Conference of the ICN, Moscow, May 2007) 40, 59–60.

[186] See Chap 2 Part IX herein.

[187] See Part VI(D) below regarding 'cheap' exclusion.

[188] See Alan Devlin, 'Analyzing Monopoly Power Ex Ante' (2009) 5 *New York University Journal of Law and Business* 153.

[189] Ibid 180–3.

an incumbent with an objectively inferior, but widely adopted, product.[190] The incumbent enjoys a first-mover advantage. In this initial phase of its operations, it is rational for the entrant to price below cost to encourage sufficient, timely adoption of its product by consumers.[191] This is procompetitive conduct. The firm is offering consumers a superior product at a low price, and that product will become more valuable as the network grows.

Suppose that the entrant, having secured the necessary network and scale efficiencies, eventually achieves a dominant position and increases price to monopoly levels. This, in itself, is not cause for antitrust concern: a firm is generally considered to be entitled to the rewards of its superior performance and innovation. But what if a *new* rival later attempts to enter that market with a superior product? Should the now-dominant incumbent be permitted to drop its price below cost to deter competitive entry and protect its substantial market power?[192] The dominant firm would no longer be investing in establishing a network,[193] but in protecting its substantial market power.

The tests proposed by Melamed and Werden would condemn such conduct on the basis that the firm could only profit from the exclusionary effect of the conduct. But under Australia's 'take advantage' standard, the dominant firm would point out that it engaged in the very same below-cost pricing when it possessed minimal market power as a new entrant.[194] Its conduct cannot therefore be said to be taking advantage, or using, its current market power. The dominant incumbent should, on this basis, be

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[190] This illustration is derived from various scenarios suggested by Devlin: ibid 186.

[191] Ibid 186–9.

[192] A similar situation might arise if the firm initially entered the market by tying its new technology to an attractive complementary product, and later took up a similar tying practice in response to new entry.

[193] There are diminishing marginal network effects beyond a certain level of consumer acceptance: Devlin, above n 188, 187.

[194] One might argue that the actions of the dominant and non-dominant firms in this scenario are not similar since the firms acted with quite different purposes. However, in *Cement Australia* (2013) 310 ALR 165, 576–7 [2291]–[2296], Greenwood J found that the fact that a non-dominant entrant had engaged in 'similar' conduct to the dominant incumbent was 'powerful evidence' that the dominant incumbent had not taken advantage of its market power, apparently without regard to the fact that the incumbent monopolist acted with a different purpose to the potential rival.

free to engage in repeated predatory pricing to prevent any competitive entrant from obtaining the necessary network effects to enter the market.

The current 'take advantage' test effectively creates an irrebuttable presumption that conduct that would be profitable for a firm without substantial market power is efficient conduct, which should be protected from antitrust intervention, regardless of the actual impact of the conduct on the competitive process. This gives rise to significant errors under the 'take advantage' test, which are unlikely to occur under the US profit-focused tests.

D. 'Cheap' Exclusion

Profit-focused tests in general have been criticised for failing to capture 'cheap' exclusion.[195] Cheap exclusion is 'conduct that costs or risks little to the firm engaging in it, both in absolute terms and when compared to the gains (or potential for gains) it brings'.[196] While some unilateral anticompetitive conduct (such as predatory pricing) entails substantial costs and uncertain gains even for a dominant firm, cheap exclusion offers the attraction of very low costs and may involve little or no sacrifice of profits. Consider, for example, threats of predation made to deter the entry of a new rival;[197] abuse of standard-setting processes;[198] abuse of governmental processes;[199] 'fraudulent acquisition of a patent';[200] and 'gaming' of patent regulations to stall the

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[195] Salop, above n 15, 354–7; Baumol et al, above n 19, 18–9; Jacobson and Sher, above n 21, 784, 790–2; Elhauge, above n 43, 280–2; Gavil, above n 168, 56–7.

[196] Susan A Creighton et al, 'Cheap Exclusion' (2005) 72 *Antitrust Law Journal* 975, 977.

[197] Steven C Salop and R Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and *Microsoft*' (1999) 7 *George Mason Law Review* 617, 640. See also the discussion of *Rural Press* in section E below.

[198] See, eg, the *Unocal* case in William E Kovacic, US Federal Trade Commission, 'Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets' (Statement to the Subcommittee on Oversight and Investigations, US House of Representatives 22 May 2007) 10, <http://www.ftc.gov/sites/default/files/documents/one-stops/oil-and-gas/070522ftc_-initiatives_to_protect_competitive_petroleum_markets.pdf>.

[199] Bork, above n 13, 347–9.

[200] Jonathan B Baker, 'Exclusion as a Core Competition Concern' (2013) 78 *Antitrust Law Journal* 527, 553.

introduction of generic rivals.[201] Cheap exclusion is often also 'plain' exclusion,[202] meaning anticompetitive exclusion, which lacks any efficiency justification.[203]

Advocates of profit-focused tests have responded to the prospect of cheap exclusion in different ways. Melamed recognised that his profit sacrifice test might not capture certain cheap or plain exclusion.[204] However, he argued that it was not fatal to a test that it might not cover every instance of unilateral anticompetitive conduct. In particular, Melamed suggested that plain exclusion 'can be condemned as anticompetitive conduct without the need for a sacrifice test, market-wide balancing, or any other elaborate inquiry'.[205]

In one sense, Melamed has a point. There is substantial consensus that 'plain' exclusion should be condemned without the need for a detailed analysis of its actual or probable effects.[206] In short, such conduct is so lacking in any value to society that a less costly, truncated analysis is justifiable: there is a negligible risk that imposing liability in these cases will deter beneficial behaviour.[207] Other commentators have also set this type of exclusion apart, arguing that "plain" or 'naked' exclusion 'may be easily condemned without reference to any test for unreasonably exclusionary conduct'.[208] But it is submitted that this exceptional treatment of plain exclusion misses an important opportunity. It is precisely when all parties agree that 'of course'

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[201] Creighton et al, above n 196, 983–7.

[202] Ibid.

[203] This is 'behavior that unambiguously fails to enhance any party's efficiency, provides no benefits (short or long-term) to consumers, and in its economic effect produces only costs for the victims and wealth transfers to the firm(s) engaging in the conduct': ibid 982.

[204] Melamed, above n 7, 1260.

[205] Ibid. See also Patterson, above n 13, 42, who makes a similar suggestion, but also suggests ways in which 'cheap' exclusion may in fact sacrifice profits.

[206] See Nazzini, above n 75, 60–1, 101, 189–90; Popofsky, above n 168, 447-48, 464; A Douglas Melamed, Principal Deputy Assistant Attorney General, Antitrust Division, US Department of Justice, 'Exclusionary Vertical Agreements' (Remarks before the American Bar Association Section of Antitrust Law, Washington DC, 2 April 1998) <http://www.usdoj.gov/atr/public/speeches/1623.htm>.

[207] Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct', above n 169, 31.

[208] Thomas A Lambert, 'Defining Unreasonably Exclusionary Conduct: the 'Exclusion of a Competitive Rival' Approach' (2014) 92 *North Carolina Law Review* 1175, 1183.

such conduct should be condemned that we should enquire after the norm on which we rely. In this case, it is submitted that the unspoken norm is that a dominant firm should not be permitted to engage in conduct which, objectively assessed, has no purpose other than the suppression of rivalry to preserve market power: that is, conduct with an objective anticompetitive purpose. It would be a waste of resources to engage in an effects analysis of conduct with such a uniformly detrimental purpose. In Chapter 6 it is argued that this implicit norm should be recognized rather than dismissed for its obviousness.

In contrast to Melamed's concession, Werden claimed that cheap exclusion would be captured by his 'no economic sense' test. Since the 'no economic sense' test considers whether the conduct only creates a profit because of its exclusionary effect, regardless of whether it involves any short-run sacrifice, it may capture cheap exclusion with relative ease.[209]

But the situation is different in the case of the 'take advantage' test. Unlike Melamed's proposal, the 'take advantage' test must be satisfied in all cases in which unilateral anticompetitive conduct is alleged: there is no separate rule for plain exclusion. Further, unlike Werden's proposal, the 'take advantage' test does not, on its current interpretation, have regard to whether the conduct is only profitable because of its exclusionary effect.[210]

On the contrary, the requirement in the case law that the dominant firm be shown to have 'used' its market power has actually led some to the conclusion that s 46(1) does not cover some plainly anticompetitive conduct. For example, in *Natwest*, French J explained that '[t]here must be a causal connection between the conduct alleged and the [firm's] market power'.[211] His Honour gave the example that a corporation would not contravene s 46(1) by 'engag[ing] an arsonist to burn down its competitor's factory', since it could not be said that the corporation 'used' its market power to

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[209] Werden, above n 7, 425–8.

[210] See the argument in favour of this alternative interpretation in Katharine Kemp, 'The Case Against "French J's Arsonist"' (2015) 43 *Australian Business Law Review* 228.

[211] (1992) 111 ALR 631, 637.

engage in that conduct.[212] French J's 'arsonist' illustration has often been repeated in Australian and New Zealand cases and commentary to explain the requirement that a firm use its market power.[213] Yet this is an exclusionary act, without any efficiency justification, which enhances a dominant firm's market power.[214]

It might be argued against French J's arsonist illustration that, while some exclusionary conduct is inexpensive, no conduct is completely costless. That being the case, a profit-maximising firm with no market power would not engage in cheap exclusion, since it would have no prospect of recouping even the very low cost of such conduct in a highly competitive market.[215] However, Australian courts considering the 'take advantage' requirement have not compared the respondent's conduct with the conduct of a firm with *no* market power in a *highly* competitive market, but with the conduct of a firm with less-than-substantial market power.[216]

It is possible for firms with less-than-substantial market power to profit from cheap exclusionary strategies. Herbert Hovenkamp gives the example that 'even a relatively small oligopolist in a product differentiated market [might] profit from fraudulent patent infringement suits calculated to protect its particular product variation from close copying'.[217] Non-dominant firms have also engaged in deceptive behaviour in

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[212] Ibid.

[213] See, eg, *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, 133–4; *Optus Communications Pty Ltd v Telstra Corp Ltd* [1999] FCA 47 (1 February 1999) [9]; *BT Australasia Pty Ltd v New South Wales (No 12)* [1998] FCA 1101 (7 September 1998); Kathryn McMahon, 'Refusals to Supply by Corporations With Substantial Market Power' (1994) 22 *Australian Business Law Review* 7, 26; Rhonda L Smith and David K Round, 'Section 46: A Strategic Analysis of Boral' (2002) 30 *Australian Business Law Review* 202, 208; Brenda Marshall 'The Relevance of a Legitimate Business Rationale under Section 46 of the Trade Practices Act' (2003) 8 *Deakin Law Review* 49, 53; Williams, 'The Counterfactual Test in s 46', above n 177, 96.

[214] In fact, similar arson examples are often referred to by US commentators as illustrations of patently anticompetitive conduct: see, eg, Werden, above n 7, 426; Salop, above n 15, 315, 330.

[215] See Donald Robertson, 'Causal Concepts in Competition Law and Economics' (2001) 29 *Australian Business Law Review* 382, 401.

[216] As explained in Part IV(B).

[217] Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct', above n 169, 33.

the field of standard-setting in order to *acquire* monopoly power.[218] Some anticompetitive conduct may be profitable for both dominant and non-dominant firms. In Australia, the conduct of non-dominant firms is saved from scrutiny by the application of the substantial market power screen, as explained in the previous section, but this does not make the same conduct on the part of the dominant firm procompetitive.

E. 'Use of Financial Power'

The 'take advantage' test may also fail to capture exclusionary conduct which a firm could engage in, or could afford to engage in, by virtue of its *financial* power even in the absence of substantial market power. This was the essence of the reasoning of the High Court majority in *Rural Press*,[219] which is arguably an exception to the profit-focused approach generally taken by Australian courts in misuse of market power cases.

In this case, the defendants ('Rural Press') were found to be near-monopolists in the market for regional newspapers in a certain region of South Australia, the Murray Bridge area. When a newspaper from a neighbouring region began to make small incursions into the Murray Bridge area, Rural Press repeatedly threatened the new rival that it would introduce a new, free newspaper in the rival's primary region if it continued to compete in the Murray Bridge area, until, finally, the rival withdrew. The majority of the High Court found that Rural Press's conduct did not infringe s 46(1) because it did not take advantage of its market power. Rather Rural Press sought only to preserve or protect its market power by use of its substantial financial resources and local printing capacity, and this was not prohibited by s 46(1).[220]

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[218] See, eg, the *Unocal* case described by Kovacic, 'Market Forces, Competitive Dynamics, and Gasoline Prices', above n 198, 10–11.

[219] (2003) 216 CLR 53, 76 [51], [53].

[220] *Rural Press* (2003) 216 CLR 53, 76. This principle was recently emphasised in *Cement Australia* (2013) 310 ALR 165, 511 [1907], 574 [2278], 576–7, 666–7 [2680]–[2681].

Not surprisingly, this decision gave rise to some significant criticism.[221] According to this interpretation of s 46(1), Rural Press should be allowed to achieve a patently anticompetitive result – removing a new competitor, its only competitor, in order to preserve its monopoly – on the ground that it had not 'used' its market power in the process. This is conduct that would be captured by Werden's 'no economic sense' test, since the conduct only resulted in a 'positive pay-off' because of its exclusionary effect and the resulting preservation of Rural Press's monopoly. However, because a firm operating in a competitive market, but in possession of substantial financial resources, *could* engage in the same conduct, the majority found that it did not infringe s 46(1). This reasoning appeared to indicate a shift away from the earlier profit-focused approach to 'taking advantage', and towards a focus on whether a non-dominant firm could *afford* or absorb the cost of the conduct in question, having regard to its financial resources.

Following the decision in *Rural Press*, some expressed concern that the test enunciated by the majority set a higher threshold for infringement of s 46(1) (requiring the applicant to prove that a non-dominant firm *could* not engage in the same conduct) than the threshold set by earlier cases (requiring proof only that a non-dominant firm *would* not engage in the same conduct).[222] As a result of these concerns, the *CCA* was amended to include s 46(6A), which clarified that a court was entitled to have regard to a broader range of factors in determining whether the firm had taken advantage of its market power.[223]

Would the facts of *Rural Press* be treated differently today, particularly having regard to the broader category of conduct which is 'otherwise related to' the firm's substantial market power under s 46(6A)(d)? It might be argued, along the lines of the 'no economic sense' test, that a firm's conduct is 'otherwise related to' its substantial

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[221] See, eg, Stephen Corones, 'Has the High Court Crippled the Effectiveness of s 46 of the *Trade Practices Act*?' (2004) 32 *Australian Business Law Review* 142; Joshua S Gans, Rajat Sood and Philip L Williams, 'The Decision of the High Court in *Rural Press*: How the Literature on Credible Threats May Have Materially Facilitated a Better Decision' (2004) 32 *Australian Business Law Review* 337.

[222] See, eg, Stephen Corones, 'The Characterisation of Conduct under Section 46 of the Trade Practices Act' (2002) 30 *Australian Business Law Review* 409, 420; Brock, above n 6.

[223] See Part IV(B) above.

market power when it engages in conduct that is only profitable because it enhances that power and not because of any efficiency gains, *even if* it could 'afford' the cost of such conduct in a competitive market.[224] If the purpose of the 'take advantage' element is to distinguish between anticompetitive and competitive conduct, surely it should identify anticompetitive conduct where the dominant firm excludes competition to preserve or increase its market power without any efficiency justification.

However, some authorities appear to regard the 'market power versus other power' distinction as an overarching consideration, which must be considered in addition to the various methods of proving 'taking advantage'. As Greenwood J more recently expressed the principle in *Cement Australia*:

> there is nothing wrong, so far as s 46 of the *Trade Practices Act* is concerned, with taking *steps* to *preserve* market share and high … margins … *if* the preservation *conduct* does not involve a *method* which *uses* market power as *the* method of achieving the purpose.[225]

His Honour noted, in particular, that market power must be distinguished from financial power,[226] and ultimately found that certain actions by defendants in that case *could* be taken by a firm in a competitive market if it had sufficient financial resources to absorb the cost of taking the action.

In the same way, Bill Reid has argued that, notwithstanding the subsequent addition of the broader category of 'taking advantage' in s 46(6A)(d), the outcome in *Rural Press* would be the same today.[227] Section 46(6A)(d) is yet to be judicially

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[224] For a fuller explanation of this argument see Kemp, 'The Case Against "French J's Arsonist"', above n 210.

[225] *Cement Australia* (2013) 310 ALR 165, 574 [2278] (emphasis in original).

[226] Ibid 666 [2680].

[227] Reid, above n 6, 50.

considered,[228] but, if such views are accepted, s 46(1) will continue to permit instances of plainly anticompetitive conduct.

F. Over-inclusiveness of Some Profit-Focused Tests

While the most common criticism of profit-focused tests is that they tend to be under-inclusive, there is also an argument that some profit-focused tests are *over*-inclusive in respect of certain conduct. It is argued, for example, that the 'profit sacrifice' test would capture investments in a new factory or investments in research to create a patentable profit, because such conduct requires a sacrifice of short-run profits and depends on an increase in market power for its profitability.[229] At the same time, such conduct generally benefits consumers. But as Elhauge argues, '[d]elayed gratification is not an antitrust offense'.[230] Condemning such conduct under the 'profit sacrifice' test could have 'disastrous ex ante effects' on dominant firm incentives, and particularly dynamic efficiency.[231]

Interestingly, Werden contends that the 'no economic sense' test should not be applied to conduct which is generally socially beneficial such as 'improved product quality, energetic market penetration, successful research and development, cost-reducing innovations, and the like'.[232] Instead such conduct should be the subject of prudential safe harbours on the ground that it is 'overwhelmingly likely to enhance consumer welfare'.[233] But, as Elhauge argues, this approach fails to reveal precisely

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[228] *Cement Australia* (2013) 310 ALR 165 was decided under the previous *TPA* s 46(1), the conduct occurring before the *CCA* was enacted. In the more recent case of *Australian Competition and Consumer Commission v Pfizer Australia Pty Ltd* (2015) 323 ALR 429, 510 [295], 511 [303]–[304], Flick J found that, in certain respects, the respondent had taken advantage of its market power, since a firm without substantial market power could not, or, in another case, would not, engage in the same conduct. *CCA* s 46(6A)(d) was not considered.

[229] See, eg, *US Department of Justice Report on Single-Firm Conduct*, above n 22, 41; Elhauge, above n 43, 274–9.

[230] Elhauge, above n 43, 279.

[231] Ibid 275.

[232] Werden, above n 7, 419–20.

[233] Ibid.

what normative criteria determine when the profit-focused test would apply and when it would not. Instead it relies on implicit normative criteria.[234]

It is submitted that the implicit norm at work in these instances is the opposite of that mentioned above: that is, that a firm should be permitted to engage in conduct with the purpose of protecting or enhancing its market power by impairing the ability of its rivals to compete, if at the outset, and objectively assessed, that conduct had the purpose of creating benefits for consumer welfare which were at least proportionate to any consumer harm likely to be created by the exclusion. Antitrust's long-running concern with purpose, and the necessary distinction between acceptable and unacceptable antitrust purposes, are explained further in Chapter 6.

VII. CERTAINTY AND ADMINISTRABILITY

A. Claims of Greater Certainty and Administrability

One of the key claims made by proponents of profit-focused tests in the US is that these tests provide greater certainty for businesses in understanding the relevant rule, as well as a simpler and less costly analysis in the event of a litigated dispute.[235]

Even those who do not support profit-focused tests as a universal standard for unilateral anticompetitive conduct, still recognise that a profit-focused test can be valuable in identifying certain types of conduct, particularly predatory pricing and refusals to deal.[236]

But others contend that the usefulness of such tests extend beyond these categories, providing a sound policy choice in the interests of certainty and administrability. It might be ideal, they argue, given perfect information and unlimited resources, to have regard to all of the likely consequences of the conduct for the competitive process and consumer welfare, but given our less-than-ideal reality, a profit-focused test amounts

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[234] Elhauge, above n 43, 274–9.

[235] Werden, above n 7, 416; Patterson, above n 13, 43.

[236] Jacobson and Sher, above n 21, 781–3; Baumol et al, above n 19, 14–16, explain the circumstances in which a refusal to deal should be regarded as anticompetitive under the profit sacrifice test, but emphasise that it does not follow that conduct is *only* anticompetitive in these circumstances.

to a reasonable compromise.[237] In particular, it provides adjudicators with a test that is manageable to apply. It also provides businesses with a rule that requires information and understanding that they are likely to possess, namely the probability that certain conduct will be profitable and the likely cause of such profitability.[238] Similar arguments have been made in favour of the 'take advantage' test in Australia.[239]

One weakness in these arguments is that, as outlined in Part VI above, a profit-focused test requires various qualifications and/or supplementary tests to make it effective against all significant forms of unilateral anticompetitive conduct. These qualifications and additions erode the certainty claimed for the test as a universal standard.[240]

B. Difficulty in Constructing the Necessary Counterfactual

In addition to the uncertainty created by qualifications to profit-focused tests, the construction of the necessary counterfactuals may constitute a particularly difficult exercise for courts, potential plaintiffs, and firms attempting to comply with the unilateral conduct rule. Salop, for instance, argues that the 'no economic sense' and 'profit sacrifice' tests are not easy to administer, since they require the 'analysis of outcomes in a hypothetical world in which real-world market forces are assumed to be inoperative':[241] that is, would the same conduct have been profitable for the firm if it had not resulted in the exclusion or discipline of its rivals?

The Australian 'take advantage' element often requires the consideration of similar counterfactuals. In some cases, Australian courts have had regard to 'natural experiments' which provide evidence as to whether a firm would behave in the same

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[237] Melamed, above n 7, 1252, 1257, 1266.

[238] Ibid 1252, 1257.

[239] See, eg, Business Council of Australia, Submission to the Competition Policy Review, *Competition Policy Review Draft Report*, November 2014, 19; Rachel Trindade, Rhonda L Smith and Alexandra Merrett, 'Building Better Mousetraps: Harper's Re-Write of Section 46' (2014) 20 *State of Competition* 1, 3 <http://thestateofcompetition.com.au/wp-content/uploads/2014/10/TSoC-Issue-20-Harper-s46-effects-test.pdf>.

[240] Jacobson and Sher, above n 21, 785.

[241] Salop, above n 15, 352.

manner in a competitive market.[242] Evidence that a firm engaged in a similar practice before it obtained substantial market power, or in a market where it does not possess substantial market power, as well as evidence of the similar behaviour by non-dominant competitors,[243] has been taken to weigh in favour of a finding that a firm has not taken advantage of its market power. In the absence of such natural experiments, however, the consideration of whether a firm could profitably engage in the same conduct in a competitive market requires the court to construct a counterfactual in which the firm is confronted with competitive market conditions.

In *Melway*,[244] the High Court noted the difficulty of constructing such a counterfactual.[245] In particular, it acknowledged that it was not apparent exactly how competitive the hypothetical market should be.[246] Clearly it was not necessary to hypothesise a perfectly competitive market,[247] but what level of competition would suffice for these purposes?

The complexity of the task can be seen in the judgment of the New Zealand Supreme Court in *Commerce Commission v Telecom Corporation of New Zealand Ltd,*[248] which considered a claim under s 36 of the *Commerce Act 1984* (NZ), a provision with substantially the same wording as s 46(1). The Court stated that, in constructing the necessary counterfactual, one must:

> attribute to the hypothetical market, and [the hypothetical non-dominant firm], any special features which existed in the actual market other than those which gave rise to the dominance in the first place. This is done by stripping out or neutralising the features which gave rise to the dominance in the actual

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[242] See, eg, *Melway* (2001) 205 CLR 1.

[243] In *Cement Australia* (2013) 310 ALR 165, 576–7 [2291]–[2296], Greenwood J relied on the fact that a non-dominant entrant had engaged in 'similar' conduct to the dominant incumbent as evidence that the dominant incumbent had not taken advantage of its market power.

[244] (2001) 205 CLR 1.

[245] Ibid 23–5.

[246] Ibid.

[247] See the explanation of perfectly competitive markets in Chap 2 Part III(E) herein.

[248] [2010] 1 NZLR 577.

> market. … [while leaving in place] the essential features of the actual market which did *not* give rise to [the dominant firm's] dominance.[249]

In the recent *Cement Australia* case, Greenwood J approved this approach to the 'take advantage' requirement under s 46(1).[250]

The intricacy of the proposed task is evident. In fact, some US courts have said that such a standard is impossible to apply.[251] But whether it is impossible or only very difficult to construct this hypothetical competitive market and the firm's likely conduct within it, the complexity of the standard is liable to give rise to uncertainty both for dominant firms in planning their conduct and for potential plaintiffs considering whether to take action.[252]

C. Australia: Lack of Acknowledgement and Inconsistent Application

Another important difference between the Australian 'take advantage' test and the US tests is that the 'take advantage' test has not generally been *explained* as a test that focuses on the profitability of the conduct for the dominant firm. Instead, Australian courts have produced numerous explanations as to how a firm with substantial market power can be said to have taken advantage of that power, as outlined in Part IV(B) above.

If, as was argued earlier in this chapter, the Australian courts have in fact generally based their decisions on an assessment of whether the impugned conduct would be profitable in a competitive market, why has the 'take advantage' element not been

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[249] Ibid 602 [38], [40].

[250] *Cement Australia* (2013) 310 ALR 165, 509–10 [1900]–[1901]. The relevant counterfactual was a hypothetically competitive market in which all aspects or sources of Pozzolanic's substantial degree of market power are stripped away so as to neutralise its market power. In all other respects, the hypothetical market will reflect the circumstances of the actual market: at 509 [1900].

[251] Jeffrey M Cross et al, 'Use of Dominance, Unlawful Conduct, and Causation under Section 36 of New Zealand's *Commerce Act 1986*: A United States Perspective' (2012) 18 *New Zealand Business Law Quarterly* 333, 337, citing *Microsoft*, 253 F 3d 34, 79 (DC Cir, 2001).

[252] See ACCC, above n 5, 79–81.

consistently explained in this way? Why has it been necessary to construct a multitude of sub-tests to give content to the 'take advantage' test?

This state of affairs might be explained by the courts' discomfort in applying an expressly profit-focused test, having regard to the wording of s 46(1) as a whole. It will be recalled that the section provides that a firm with substantial market power 'shall not take advantage of that power … for the purpose of'[253] damaging a competitor,[254] excluding a competitor,[255] or excluding competitive behaviour.[256] If the courts were expressly to adopt a profit-focused test for 'taking advantage', the section might be read as requiring that a firm with substantial market power shall not *engage in conduct that is only profitable because it excludes competition* for the purpose of excluding competition. A more elegant interpretation of the provision is that a firm with substantial market power must not *engage in conduct that is only possible because of its substantial market power* for the purpose of excluding competition. The focus under this latter interpretation is on the source of the firm's power or capacity to engage in the conduct. If, then, in a competitive market, the defendant would lack the motivation to engage in the impugned conduct because it would be unlikely to profit from the exclusion, the defendant will nonetheless be absolved if it '*could* have acted in precisely the same way' in a competitive market.[257] This was the interpretation endorsed by the majority of the High Court in *Rural Press*.[258]

This ambiguity concerning the true nature of the 'take advantage' test has given rise to considerable uncertainty and inconsistency. On the one hand, the seminal decision in *Queensland Wire Industries*,[259] and numerous other cases[260], together with the

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[253] *CCA* s 46(1).

[254] Ibid s 46(1)(a).

[255] Ibid s 46(1)(b).

[256] Ibid s 46(1)(c).

[257] *Rural Press* (2003) 216 CLR 53, 75–7 (emphasis added).

[258] 'To reason that Rural Press and Bridge took advantage of market power because they would have been unlikely to have engaged in the conduct without the "commercial rationale" — the purpose — of protecting their market power is to confound purpose and taking advantage.': ibid 76 [51].

[259] (1989) 167 CLR 177.

[260] See the analysis of the case law in Part IV(B)(1)(5) above.

words of s 46(6A), point to the need to consider the relative profitability of the conduct for a firm with and without substantial market power. On the other hand, the same case law is littered with the language of 'possibility', and the judgment of the High Court majority in *Rural Press* emphatically distinguishes the case of a firm 'using' its substantial market power from the case of a firm 'using' its 'material and organisational assets' to protect or enhance that power.[261] The recent case of *Cement Australia* provides a pertinent example of the results of these inconsistencies.[262]

In *Cement Australia*,[263] the court actually made express mention of the relevance of the profitability of the conduct to the 'take advantage' element. At the outset, both of the parties in this case referred to the likely profitability of the relevant conduct for a firm with and without market power, in language reminiscent of Melamed and Werden's tests.[264] Thus the ACCC argued that:

> [The impugned conduct] made *no commercial sense* for anybody that did *not* have existing substantial market power in the downstream market because [the respondents] *could not recoup* the cost (including the opportunity costs) of the [conduct in the absence of market power]. Put more simply, for any corporation *without* substantial market power, the contract could only be anticipated to be *loss-making*.[265]

For the respondents' part, Greenwood J summarised the relevant evidence of Professor George Hay of Cornell University, the expert witness for the respondents, as follows:

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[261] *Rural Press* (2003) 216 CLR 53, 76 [51], [53].

[262] (2013) 310 ALR 165.

[263] Ibid.

[264] Ibid. Interestingly, in earlier cases under s 46(1), expert economists also relied on tests similar to those advanced by Melamed and Werden, although the courts had not adopted this language: see, eg, *Seven Network Ltd v News Ltd* (2007) ATPR (Digest) 46-274, 54695, 54714, where the applicant argued that the respondent's conduct 'made economic sense only on the footing that in the longer term [the respondent] would benefit by the removal of competition in the market in which it operated'.

[265] *Cement Australia* (2013) 310 ALR 165 508 [1894] (emphasis in original).

> The phrase 'taking advantage of market power' connotes anticompetitive conduct that would not be possible, or more precisely, would not be *profitable* for a firm *without* market power. Since a firm without market power could do almost anything that a firm with market power could do, if the firm without market power is willing to expend and lose a substantial amount of money, the proper inquiry is whether *only* a firm with substantial power could profitably engage in certain conduct.[266]

Greenwood J went on to hold that the relevant question was 'whether a profit maximising firm operating in a workably competitive market *could* in a commercial sense *profitably engage* in the conduct in question having regard to the business reasons identified'.[267] His Honour noted that expert evidence was relevant: to the factors that would, in principle, inform the decision-making of a person acting in a workably competitive market who is called upon to decide whether a profit maximising firm 'would behave' … in a similar way to the [dominant firm]'.[268]

These statements seemingly signaled an important clarification of the concept of 'taking advantage'. First, they appeared to reconcile the approach, in earlier cases, which focused on whether a firm without substantial market power 'would' engage in the conduct, with the question, bequeathed by the *Rural Press*[269] decision, whether such a firm 'could' engage in the same conduct. If the relevant firm is assumed to maximise its profits, then either test essentially asks the same question: would the impugned conduct be the profit-maximising choice for a firm without substantial market power? Second, these statements by Greenwood J appeared to confirm that the 'take advantage' test is a profit-focused test of the kind described in this article.[270]

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[266] Ibid 508 [1895] (emphasis in original).

[267] Ibid 509 [1899] (emphasis in original), or 'whether a firm profitably could have engaged in the conduct in question in the absence of a substantial degree of power in the relevant market': at 510 [1902].

[268] Ibid 515 [1927].

[269] (2003) 216 CLR 53.

[270] On its face, Greenwood J's test actually bears some resemblance to that advocated by Ordover and Willig: see Pt III(C) above. In determining 'whether a profit maximising firm operating in a workably competitive market *could* in a commercial sense *profitably engage* in the conduct', surely one must ask

However, while his Honour apparently put forward a profit-focused test for 'taking advantage', the factual analysis in the judgment gave little attention to the relative profitability of the conduct for a firm with and without substantial market power. For example, Greenwood J found that the defendant, by electing to extend a contract for the exclusive supply of an essential input, had incurred losses over a number years.[271] His Honour also found that the defendant believed at that time that, if a rival succeeded in obtaining access to the input and entering the market, the defendant's dominant position would be threatened and its profit margins would drop substantially.[272] The defendant sought to preserve its market power by denying rivals access to the necessary input.

Nonetheless, Greenwood J found that the defendant did not take advantage of its market power when it extended an exclusive supply agreement for the essential input. His Honour referred to the majority judgment in *Rural Press*,[273] and emphasised that a dominant firm was entitled to preserve its substantial market power, so long as it 'used' some other power, such as financial power, to do so.[274] Importantly, he found that the fact that the defendant in this case had the financial resources to 'absorb' or 'withstand' a deferral in revenues was 'not the expression of market power'.[275] A non-dominant firm 'could' have done the same.[276] His Honour did not indicate whether, or how, such conduct would be *profitable* for the firm without substantial market power.

Cement Australia is an example, it is submitted, of how the application of an apparently profit-focused standard, combined with persistent references to the 'possibility' of conduct on the part of a non-dominant firm, has resulted in uncertain, inconsistent and under-inclusive outcomes in Australian unilateral conduct cases.

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whether a firm in a competitive market would maximise its profit by engaging in the conduct in question: *Cement Australia* (2013) 310 ALR 165 508, 509 [1899] (emphasis in original).

[271] (2013) 310 ALR 165, 606–7 [2418].

[272] Ibid 665–6 [2673]–[2676], 738 [2971].

[273] Ibid 511 [1906]–[1907], 668–9 [2688], 671 [2693–2694].

[274] Ibid 574 [2278], 666–7 [2680]–[2681].

[275] Ibid 668–9 [2688].

[276] Ibid 668–9 [2687]–[2688].

VIII. CONCLUSION

The 'take advantage' element in s 46(1) of the *CCA* bears important similarities to the US profit-focused tests. In particular, it focuses on the profitability of the conduct for the impugned firm, rather than assessing the impact of the conduct on the relevant market. At the same time, the 'take advantage' test takes a slightly different approach to the US profit-focused tests, giving consideration to whether the conduct would be profitable in the absence of *ex ante* market power, as opposed to whether it would be profitable in the absence of the *resulting* market power.

Unlike the US tests, the Australian test relies on the assumption that any conduct that a firm without substantial market power can, or can profitably, engage in must be procompetitive when it is adopted by a firm with substantial market power. As a result, the 'take advantage' standard has absolved significant instances of unilateral anticompetitive conduct, even where near monopolists have adopted strategies to exclude rivals, and thereby protect their monopolies, without any plausible efficiency justification. Further, the failure of Australian courts to expressly acknowledge their application of a profit-focused test has led to uncertainty and confusion in the case law on 'taking advantage': the standard is not as well understood as its proponents claim.

Like its US counterparts, the 'take advantage' test is potentially a useful tool, which might be used to support a finding of unilateral anticompetitive conduct in some cases. In particular, these tests may explain a dominant firm's objective purpose in engaging in certain conduct, and whether it sought to profit only by suppressing the competitive responses of its rivals. However, as a general standard which must be satisfied in all unilateral conduct cases, the 'take advantage' test has been prone to uncertainty and demonstrably under-inclusive.

CHAPTER 5: A COMPARATIVE ANALYSIS OF EFFECTS-BASED TESTS FOR UNILATERAL ANTICOMPETITIVE CONDUCT

I. INTRODUCTION

Acknowledging the failings of the 'take advantage' test, the Australian government has announced its intention to amend section 46(1) of the *CCA* to remove the 'take advantage' requirement, and instead prohibit a corporation with substantial market power from engaging in conduct which has 'the purpose, or would have or be likely to have the effect, of substantially lessening competition',[1] in accordance with the recommendation of the Harper Panel.[2]

Given that unilateral conduct laws are intended to target dominant firm conduct which impairs the competitive process to the detriment of consumer welfare,[3] it does seem logical that legal tests for unilateral anticompetitive conduct should focus on the effect or likely effect of the dominant firm's conduct on the competitive process in the relevant market or markets.[4] Tests with such a focus have been referred to as 'effects-based tests'.[5] These tests, it is argued, ask 'the right question'.[6]

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[1] See Malcolm Turnbull, Scott Morrison and Kelly O'Dwyer, 'Fixing Competition Policy to Drive Economic Growth and Jobs' (Joint Media Release, 16 March 2016) <http://kmo.ministers.treasury.gov.au/media-release/024-2016/>.

[2] Ibid. See Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) 340–1, 344, 513 ('*Harper Report*').

[3] See Chap 2 Part III(E), Chap 3 Part IV herein.

[4] See, eg, Steven C Salop and R Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft' (1999) 7 *George Mason Law Review* 617; Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311; B Douglas Bernheim and Randal Heeb, 'A Framework for the Economic Analysis of Exclusionary Conduct' in Roger G Blair and D Daniel Sokol (eds), *The Oxford Handbook of International Antitrust Economics: Vol 2* (Oxford University Press, 2014); European Commission, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2, 9–11, [19]–[22] ('*EC Guidance Paper*').

[5] See, eg, James Kavanagh, Neil Marshall and Gunnar Niels, 'Reform of Article 82 EC – Can the Law and the Economics be Reconciled?' in Ariel Ezrachi (ed), *Article 82 EC: Reflections on Its Recent Evolution*

However, the logic of adopting an effects-based test for unilateral conduct depends on some important assumptions. Three key assumptions are:

(a) that firms, competition authorities and courts can reliably identify when given conduct harms, or is likely to harm, the competitive process and therefore consumers;

(b) that where conduct has such an effect, intervention by the state is likely to result in better outcomes for society, and consumers in particular, than the market would produce in the absence of such intervention; and

(c) that the presence of rules and remedies based on an effects-based test will, on balance, cause firms to engage in more behaviour which benefits consumers and less socially detrimental behaviour, than they would in the absence of such rules.

Opponents of effects-based tests argue against each of these assumptions. First, they say, it will often be the case that competition authorities and courts (let alone firms) simply cannot predict or discern the effects of single-firm conduct, at least without incurring costs that greatly exceed any benefit from intervention.[7] Firm behaviour, and market responses, are complex matters. While economic theory might offer some assistance in interpretation and prediction, the discipline is rife with nuance, conflicting views, and theories which cannot be usefully applied by generalist judges to real-world markets.[8] Further, the same practice may have *some* consequences which are detrimental to consumers and some which are beneficial for consumers, or it might benefit consumers in

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(Hart Publishing, 2009) 13; Damien Geradin, 'A Proposed Test for Separating Pro-competitive Conditional Rebates from Anti-competitive Ones' (2009) 32 *World Competition* 41.

[6] Salop, 'Flawed Profit-Sacrifice', above n 4, 313–4. See also Economic Advisory Group on Competition Policy, 'An Economic Approach to Article 82' (July 2005) 4.

[7] See, eg, Frank H Easterbrook, 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1, 41; Mark S Popofsky, 'Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules' (2006) 73 *Antitrust Law Journal* 435, 449–50; Mark R Patterson, 'The Sacrifice of Profits in Non-Price Predation' (2003) 18 *Antitrust* 37, 43.

[8] See, eg, *Barry Wright Corp v ITT Grinnell Corp*, 724 F 2d 227, 234 (1st Cir 1983).

one market while harming those in another. It is not apparent how such effects might be quantified or balanced against each other.[9] In short, an effects-based test might ask the right question, but it is a question which we will often be incapable of answering.[10] Or, as some would put it, if a question has no answer, it may suggest that it is in fact the wrong question to ask.[11]

Second, opponents contend that, even where anticompetitive effects can be reliably identified or predicted, a court may not be able feasibly to construct any remedy that is likely to provide more benefit to society than could be achieved by the operation of market forces alone.[12] A particular concern is that courts should not become regulators. A court which finds a price, or a refusal of access, to be anticompetitive, may well find itself in the position of regulator if it attempts to frame orders to remedy the situation. Market regulation is neither an appropriate function for a court, nor within the skill-set of the average judge: courts are unlikely to produce superior outcomes to the market itself.[13]

Third, the risks of adopting an effects-based test extend beyond the risk of 'getting it wrong' in individual, litigated cases. The prospect of litigation also has effects on the behaviour of firms who have never been the subject of a complaint.[14] In assessing the risks of engaging in any course of conduct, firms naturally consider the potential for

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[9] See Easterbrook, 'Limits', above n 7, 11; Popofsky, above n 7, 465; A Douglas Melamed, 'Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal' (2005) 20 *Berkeley Technology Law Journal* 1247, 1252–5; David McGowan, 'Between Logic and Experience: Error Costs and *United States v Microsoft Corp*' (2005) 20 *Berkeley Technology Law Journal* 1185, 1188–9, 1243; Andrew I Gavil, William E Kovacic and Jonathan B Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (West Academic, 2nd ed, 2008) 207, arguing that '"rule of reason balancing" is perhaps the greatest myth in all of US antitrust law'.

[10] Josef Drexl, 'Real Knowledge is to Know the Extent of One's Own Ignorance: On the Consumer Harm Approach in Innovation Related Competition Cases' (2010) 76 *Antitrust Law Journal* 677, 677.

[11] Easterbrook, 'Limits', above n 7, 14.

[12] Ibid 2–3; McGowan, above n 9, 1199.

[13] Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 312: 'It would be a rare day that a court, not fully understanding what it is doing, could be a better facilitator of competition than the market itself.'

[14] See Easterbrook, 'Limits', above n 7, 3, 6, 9–10, 13, 15–6; McGowan, above n 9, 1188–9.

accusation, litigation and sanction. Even if one dominant firm has been correctly sanctioned for engaging in certain behaviour with an anticompetitive effect, other firms may be deterred from engaging in similar behaviour even when that behaviour would result in important benefits for consumers.[15] The fact that the behaviour is open to serious antitrust scrutiny may mean that firms consider it too risky to compete in that way.[16] Low pricing and innovative products are cited as examples.[17] The losses from deterring practices such as these, it is said, would be far greater than any benefit from capturing the odd anticompetitive instance.[18]

The appropriateness of adopting an effects-based test for unilateral conduct is therefore limited by the uncertainty which attends both the assessment of competitive effects and the impact of state intervention. In these circumstances, commentators on both sides of the debate have adopted decision theory under conditions of uncertainty[19] to argue in favour of different approaches to effects-based tests or standards.[20]

This chapter explains various proposals for effects-based tests for unilateral conduct, and particularly the way in which they address these key criticisms. It begins, in Part II, by outlining the origins of the debate over the appropriateness of effects-based analysis in US antitrust commentary in the last decades of the twentieth century, including arguments for a reduced application of antitrust laws advanced by Easterbrook on decision-theoretic grounds and the counter-proposal by Williamson to incorporate decision theory in the judicial decision-making process. Part III describes three effects-based approaches advanced by Salop and Romaine, Hovenkamp and the DC Circuit, respectively, in the course of the most-analysed case in recent antitrust history, namely

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[15] See Popofsky, above n 7, 465.

[16] Firms will attempt to 'steer clear of the danger zone': Easterbrook, 'Limits', above n 7, 17.

[17] See Parts VIII(B), (C) below.

[18] Easterbrook, 'Limits', above n 7, 15–6.

[19] See the discussion of decision theory and error cost analysis in Chap 1 Part V(B) herein.

[20] See, eg, Salop and Romaine, above n 4; Oliver Williamson, 'Delimiting Antitrust' (1987) 76 *Georgetown Law Journal* 271.

United States v Microsoft Corp ('*Microsoft*').[21] Each of these tests responds differently to the challenges arising from error cost analysis.

Shortly after this debate began in the US, the EU began its own process of 'modernising' its competition laws to take greater account of the economic effects of conduct.[22] Part IV of this chapter analyses the approach to unilateral conduct in the *EC Guidance Paper*,[23] published by the European Commission in 2009 as part of this modernisation process, which demonstrates significantly more suspicion of dominant firm conduct than the US effects-based tests. Part V explains the proposed Australian 'SLC' test, including its potential strengths and weaknesses as a standard for unilateral anticompetitive conduct.

The common themes among the various effects-based tests are considered in Part VI. This comparison is expanded in Parts VII to VIII to explain the relative strengths and weaknesses of the tests, having particular regard to their administrability and implications for business certainty; as well as their likely error costs and incentive effects. The comparison reveals that, relative to the proposals for effects-based tests in the US in particular, the Australian SLC test is likely to be both more inclusive and more prone to deter beneficial dominant firm conduct.

II. US ORIGINS OF THE EFFECTS TEST DEBATE AND THE APPLICATION OF DECISION THEORY

The origins of the modern debate over effects-based tests can be found in US antitrust commentary of the 1980s, when some commentators began to express strong views about the use of such tests to identify anticompetitive conduct. One of the best-known arguments against effects-based tests was made by Easterbrook in his 1984 article, *The*

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[21] 253 F 3d 34, 58–9 (DC Cir, 2001) ('*Microsoft*'). See Salop and Romaine, above n 4, 617; Popofsky, above n 7, 435, referring to *Microsoft*, 253 F 3d 34 (DC Cir 2001); *LePage's Inc v 3M Corp,* 324 F 3d 141 (3d Cir 2003); *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP*, 540 US 398 (2004).

[22] See the discussion of the EU modernisation process in Chap 1 Part IV(C) herein.

[23] *EC Guidance Paper*, above n 4.

Limits of Antitrust.[24] Easterbrook's article focused on the use of a 'rule of reason' analysis in antitrust claims concerning *multilateral* arrangements between firms under section 1 of the *Sherman Act*.

Easterbrook noted the Supreme Court's explanation that the inquiry mandated by the rule of reason is 'whether the challenged agreement is one that promotes competition or one that suppresses competition. … [T]he purpose of the analysis is to form a judgment about the competitive significance of the restraint.'[25] According to the classic definition of the 'rule of reason' in the *Chicago Board of Trade* decision of 1918:[26]

> The court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.[27]

Easterbrook noted the 'open-ended' nature of the rule of reason formula and expressed the view that courts, competition authorities and firms were unlikely to arrive at any meaningful conclusions from such a complex weighing exercise.[28] In this and a later article concerning unilateral anticompetitive conduct,[29] Easterbrook (at least implicitly) applied decision theory to argue against the application of a rule of reason analysis, and in favour of simpler, deliberately under-inclusive rules.[30]

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[24] Easterbrook, 'Limits', above n 7.

[25] Ibid 12, citing *National Society of Professional Engineers v United States*, 435 US 679, 691, 692 (1978).

[26] *Board of Trade of the City of Chicago v United States*, 246 US 231 (1918).

[27] Ibid 244.

[28] Easterbrook, 'Limits', above n 7, 11–14.

[29] See Frank H Easterbrook, 'On Identifying Exclusionary Conduct' (1986) 61 *Notre Dame Law Review* 972, 977.

[30] Ibid.

Easterbrook essentially argued that an antitrust standard based on a case-by-case analysis of effects is likely to give rise to significant false positives: that is, the condemnation of beneficial conduct by firms.[31] In his view, courts are ill equipped to explain complex economic problems, let alone weigh various economic outcomes against each other. Given the historical suspicion with which courts regard conduct that has no explanation (or no explanation which the court can comprehend), courts are likely to condemn some beneficial conduct under an open-ended analysis of purpose and effects.[32] By contrast, Easterbrook's own proposals for under-inclusive rules would give rise to absolution for some harmful conduct. The latter error, he said, should be preferred, having regard to the respective costs of the errors.[33]

In support of this view, Easterbrook argued that incorrect judicial condemnation of beneficial firm conduct causes great losses to society, particularly since these errors are perpetuated by the doctrine of *stare decisis* and expanded by the efforts of other firms to 'steer clear of the danger zone'.[34] By contrast, he considered that most anticompetitive conduct, including unilateral anticompetitive conduct,[35] will generally be corrected by market forces in the long run.[36] He therefore argued that the costs of false positives in identifying anticompetitive single-firm conduct are high relative to the costs of false

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[31] Easterbrook, 'Limits', above n 7, 4–8; Easterbrook, 'Exclusionary Conduct', above n 29, 977–8.

[32] Easterbrook, 'Limits', above n 7, 4–8, citing R H Coase, 'Industrial Organization: A Proposal for Research' in 3 *Policy Issues And Research Opportunities In Industrial Organization* (National Bureau of Economic Research, 1972) 59, 67:

> If an economist finds something. . . that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be rather large, and the reliance on a monopoly explanation frequent.

[33] Easterbrook, 'Exclusionary Conduct', above n 29, 977. See also Richard A Epstein, 'Monopoly Dominance or Level Playing Field? The New Antitrust Paradox' (2005) 72 *University of Chicago Law Review* 49.

[34] Easterbrook, 'Limits', above n 7, 2, 17.

[35] See Frank H Easterbrook, 'Monopolization: Past, Present and Future' (1992) 61 *Antitrust Law Journal* 99, 108; Frank H Easterbrook, 'Allocating Antitrust Decisionmaking Tasks' (1987) 76 *Georgetown Law Journal* 305, 306–7, 313–4.

[36] Ibid 306–7; Easterbrook, 'Limits', above n 7, 15.

negatives.[37] Effects-based tests also have the disadvantage that increased analysis gives rise to much greater costs in enforcement, litigation and adjudication than simple, under-inclusive rules.[38]

Williamson responded to Easterbrook's arguments in an article published in 1987.[39] Williamson accepted the relevance of an error-cost analysis in framing antitrust rules, as well as the contention that certain errors give rise to high costs from deterring beneficial firm conduct. However, Williamson disagreed with Easterbrook's assessment of the relative error costs of under- and over-inclusive rules and Easterbrook's solution of greatly reducing the scope of antitrust rules.[40] In particular, he expressed concern about strategies dominant firms could adopt to impair the ability of rivals to expand in, or potential rivals to enter, a market.

In Williamson's view, the better approach would be to integrate error-cost and administrability considerations into the judicial decision-making process on a case-by-case basis.[41] That is, in a given case, the court should determine the actual merits of the claim by determining whether strategic or nonstrategic explanations more plausibly explain the behaviour in question.[42] In determining whether to condemn the conduct, the court should not be limited by 'hard', permanent rules intended to err on the side of under-inclusiveness, but should proceed with caution, in light of the limits of current theory and the potential for error costs.[43] According to Williamson, this is an approach 'which invokes temporary constraints but anticipates evolutionary refinements'.[44] McGowan refers to this approach to error costs as the 'integration approach', since it

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[37] Easterbrook, 'Past, Present and Future', above n 35, 108.

[38] Easterbrook, 'Exclusionary Conduct', above n 29, 972.

[39] Williamson, above n 20, 280.

[40] Ibid 289.

[41] Ibid 280, 289. Cf Easterbrook, 'Allocating Antitrust Decisionmaking', above n 35, 306–7, 313–4.

[42] Williamson, above n 20, 281, 288.

[43] Ibid 289.

[44] Ibid.

integrates decision-theoretic analysis into the judicial decision-making process rather than requiring a reduced scope for antitrust rules more generally.[45]

III. EFFECTS-BASED TESTS IN THE UNITED STATES

A. The 'Unnecessarily Restrictive Conduct' and 'Consumer Harm' Tests

1. Salop and Romaine: 'Unnecessarily Restrictive Conduct' Test

The next wave in the effects test debate was set in motion by the most-debated antitrust case of the late twentieth century, namely *Microsoft*.[46] The significance of the *Microsoft* case, and the surrounding debate, were explained in Chapter 1.[47] In 1999, Salop and Romaine responded to this debate with an in-depth analysis of the conduct in question and its competitive effects.[48] The authors acknowledged throughout this analysis that unilateral conduct may be ambiguous: the same conduct may give rise to both consumer benefit and consumer harm. Accordingly, they argued that the best antitrust standard is one that 'balances the benefits and harms to consumers in the context of an evaluation of the unnecessarily restrictive conduct'.[49]

Salop and Romaine noted that, at the time of writing, there was significant uncertainty concerning the applicable test for monopolization in US case law. On the one hand, early monopolization cases revealed an expansive approach which condemned 'avoidable exclusionary conduct'. That is, a dominant firm would infringe if it were possible for the firm to avoid or forego the exclusionary conduct which raised barriers to competition, 'irrespective of other beneficial motives and effects'.[50] On the other hand, others had

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[45] McGowan, above n 9, 1187.

[46] 253 F 3d 34, 58–9 (DC Cir, 2001). See Salop and Romaine, above n 4, 617; Popofsky, above n 7, 435.

[47] See Chap 1 Part IV(B) herein.

[48] Salop and Romaine, above n 4.

[49] Ibid 618.

[50] Ibid 649–50 (citing *United States v Aluminum Co of America*, 148 F 2d 416, 432 (2d Cir 1945)), 655–6.

more recently advocated a far narrower scope for the monopolization offence. At this extreme, the 'sole purpose and effect test' would essentially condemn only 'naked' exclusionary conduct, which had the sole purpose and effect of raising barriers to competition.[51] If the conduct had *any* beneficial effects – such as reducing costs or creating a better product – it would be permitted, regardless of its overall impact on consumer welfare.[52]

Salop and Romaine recommended a third test, namely the 'unnecessarily restrictive conduct test' as a 'middle ground'. According to this approach, unilateral conduct would infringe section 2 if a rule of reason evaluation established that the conduct was, on balance, likely to harm rather than benefit consumers – that is, if the conduct was 'unnecessarily restrictive' or 'unnecessarily exclusionary'.[53] This test would weigh or balance 'the conflicting motives and effects to determine which has the primary effect on consumers',[54] thereby constraining anticompetitive conduct while permitting the monopolist to continue to compete and innovate in ways that benefit consumers.[55]

In their analysis, Salop and Romaine acknowledged the relevance of decision theory to the choice of an appropriate standard for unilateral conduct, as well as the views of Easterbrook and other 'laissez-faire supporters' in this respect, views which Microsoft had espoused in its defence.[56] The authors also countered some of Easterbrook's arguments. They argued that the risk that courts were incapable of striking a reasonable balance or drawing proper lines between procompetitive and anticompetitive conduct seemed 'greatly overstated', having regard to analogous line-drawing in various areas of

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[51] Ibid 650.

[52] Ibid 650, 656. More recently, Andrew I Gavil, 'Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 52–3, considered that a 'pure application' of the 'but for' test advocated by the US Department of Justice (explained in Chap 4 herein) would have a similar result.

[53] Ibid 652.

[54] Ibid 659. See the criticism of the 'balancing' approach in Part VII below.

[55] Ibid 618.

[56] Ibid 653–5.

the law, including in the field of negligence and analyses under section 1 of the *Sherman Act*.[57] In their view, the argument that false positives were more harmful than false negatives was weak and, further, the fear of false positives due to complicated analyses could not justify adopting a standard which 'dramatically tips the scales towards false acquittals' and 'leaves monopolists unconstrained'.[58]

Salop and Romaine argued that their 'unnecessarily restrictive conduct test' was most consistent with the decision-theoretic approach in that it enabled courts to take account of the incentive effects of both false acquittals and false convictions.[59] Following in the footsteps of Williamson's 'integration approach',[60] Salop and Romaine argued that the antitrust courts could adjust and determine 'the weights' for determining whether conduct is unnecessarily restrictive – for example, by adjusting the standard of proof for a certain 'class of conduct' – and thereby achieve 'the optimal mix of incentives'.[61]

2. Salop's 'Consumer Harm' Test

Some years later, following the 2001 decision of the DC Circuit in *Microsoft*,[62] Salop responded to proposals for profit-focused tests for unilateral conduct[63] with a refined and expanded version of the test from the 1999 article. Salop labeled this refined version a

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[57] Ibid 670.

[58] Ibid 670–1: 'The argument that false convictions are more harmful than false acquittals is weak, particularly for monopolization cases in markets where network-based barriers to entry make monopoly power more durable.' Other commentators have expressed similar skepticism about the extent to which the correction of anticompetitive strategies should be entrusted to market forces alone. See, eg, Hovenkamp, *Antitrust Enterprise*, above n 13, 34-5; Gavil, above n 52, 36–41. At 40:

> Before embracing the "self-correcting market" narrative, therefore, it is essential to ask: What firm will undertake – and what investor will seriously support – entry into a market occupied by a dominant firm that has already demonstrated its penchant for entry-deterring strategies especially if it has received the imprimatur of the courts?

[59] Ibid 659.

[60] McGowan, above n 9, 1187–8. See Part II above.

[61] Salop and Romaine, above n 4, 659.

[62] See Pt III(C) below.

[63] See Chap 4 herein.

'consumer welfare effect' or 'consumer harm' test, explaining that this test focused 'directly on the anticompetitive effect of exclusionary conduct on price and consumer welfare'.[64] Unlike profit-focused tests, which have regard to the impact of the conduct on the defendant firm, the 'consumer harm' test concentrates on evaluating the net impact of the conduct on consumers in each case.[65] According to this approach, unilateral conduct would violate antitrust laws 'if it reduces competition without creating a sufficient improvement in performance to fully offset these potential adverse effect[s] on prices and thereby prevent consumer harm'.[66]

Under Salop's 'consumer harm' test, a comparison is required between the effects or likely effects of the conduct on the relevant markets, and the likely state of competition in the absence of the conduct. The test particularly focuses on identifying the counterfactual market price that would occur in the absence of the alleged anticompetitive conduct.[67] This is *not* necessarily the price that prevailed *before* the conduct was undertaken. The counterfactual price may actually be lower than the price occurring before the conduct was undertaken if the firm engages in strategic conduct to maintain its monopoly. On the other hand, if the conduct in question leads to product or service improvements, those consumer benefits should be compared with the price effect of the conduct to evaluate the net impact of the conduct on the 'quality-adjusted price'.[68]

Salop provided examples of how his test would address various types of unilateral conduct. For example, if a dominant firm entered exclusive dealing agreements with critical input suppliers such that its disadvantaged rival would have the incentive to

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[64] Salop, 'Flawed Profit-Sacrifice', above n 4, 313–4. See also Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 92.

[65] Salop, 'Flawed Profit-Sacrifice', above n 4, 318, 331, 345. See Chap 6 herein.

[66] Ibid 330.

[67] Ibid 311, 361. See also Salop and Romaine, above n 4, 745.

[68] Salop, 'Flawed Profit-Sacrifice', above n 4, 361; Salop and Romaine, above n 4, 626.

reduce its output and raise its own price,[69] the conduct would be condemned due to this harmful effect on consumer welfare unless there were benefits – for instance, product quality benefits from the elimination of free-riding – that were sufficient to reverse or offset the higher prices.[70] The dominant firm's 'procompetitive rationales for the conduct' would thereby be taken into account in evaluating the overall competitive impact of the conduct on consumers.[71]

Importantly, Salop's 'consumer harm' test required a case-by-case assessment of the net effect of the impugned conduct on consumers. At the same time, Salop acknowledged that it may be necessary to make 'marginal' adjustments to the test to take account of considerations of fairness, deterrence and error costs, for example, by varying the applicable standard of proof, or by assessing conduct in the light of information reasonably available to the firm at the time it engaged in the conduct, as explained later in this chapter.[72]

B. Hovenkamp's 'Disproportionality' Definition

Another frequently-cited standard for unilateral conduct is that proposed by Herbert Hovenkamp, co-author of the highly influential *Antitrust Law* treatise.[73] In earlier editions of the treatise, the original authors, Areeda and Turner, defined exclusionary conduct as 'conduct, other than competition on the merits or restraints reasonably "necessary" to competition on the merits, that reasonably appear capable of making a significant

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[69] A case of raising rivals costs.

[70] Salop, 'Flawed Profit-Sacrifice', above n 4, 322–3. The conduct would violate if there were no such offsetting benefits for consumers, or if there were modest benefits that were insufficient to reverse or offset the higher prices: at 336–7.

[71] Ibid 318. Salop (at 333–4) drew support for this approach from the decision of the DC Circuit in *Microsoft*, 253 F 3d 34 (DC Cir, 2001) (see Part III(C) below).

[72] Ibid 353–4. See further Part VIII below.

[73] See, eg, Salop, 'Flawed Profit-Sacrifice', above n 4, 353; Gavil, above n 52, 61–2; Nazzini, above n 64, 93; Barry E Hawk, 'The Current Debate About Section 2 of the Sherman Act: Judicial Certainty versus Rule of Reason' in Abel M Mateus and Teresa Moreira (eds), *Competition Law and Economics: Advances in Competition Policy Enforcement in the EU and North America* (Elgar, 2010) 223.

contribution to creating or maintaining monopoly power'.[74] Defining anticompetitive conduct in this way raises the critical question: what is 'competition on the merits'? Areeda and Turner offered no general definition in this respect, but provided a 'laundry list' of conduct which would not offend, including 'non-exploitative pricing, higher output, improved product quality, energetic market penetration, successful research and development, cost-reducing innovations, and the like'.[75]

In 2000, the year before the DC Circuit's decision in *Microsoft* was delivered, Hovenkamp proposed a new definition of unilateral exclusionary conduct, suggesting that 'monopolistic conduct' be defined as acts that:

(1) are reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals; and
(2) that either (2a) do not benefit consumers at all, or (2b) are unnecessary for the particular consumer benefits claimed for them, or (2c) produce harms disproportionate to any resulting benefits.[76]

Hovenkamp later explained that, in proposing this definition, he had attempted to 'craft a more general statement' on the meaning of exclusionary conduct, which, unlike earlier definitions offered by the *Antitrust Law* treatise, would be capable of being administered.[77] He emphasized the need for a flexible standard. Single-firm anticompetitive conduct should not be defined too narrowly because 'anticompetitive

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[74] Herbert Hovenkamp, 'Exclusion and the Sherman Act' (2005) 72 *University of Chicago Law Review* 147, 149, citing Phillip E Areeda and Donald F Turner, 3 *Antitrust Law I* (Little, Brown 1978) 83.

[75] Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 149, citing Phillip E Areeda and Donald F Turner, 3 *Antitrust Law I* (Little, Brown 1978) 77. It is submitted that these forms of competition might be summarised as low prices (based on costs) and increased output in terms of either quantity or quality.

[76] This definition was first put forward in Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1038. The same wording was used in the 2002 edition of the *Antitrust Law* treatise: Phillip E Areeda and Herbert Hovenkamp, *3 Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Aspen, 2d ed, 2002) 72 [651a].

[77] Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 149.

strategic behaviour by dominant firms comes in many kinds, many of which may not be known or even anticipated today'.[78]

Like Salop, Hovenkamp recognized the often-ambiguous nature of unilateral conduct. Unilateral conduct laws should only condemn business conduct that is likely to create, increase or prolong monopoly power *without giving significant benefits to society*.[79] Many competitive practices, such as innovation and aggressive pricing, can create monopoly power, but they do so by creating significant social benefits as well.[80] Anticompetitive conduct, on the other hand, prevents or impairs competition by rivals in a way that either does not benefit consumers or does so in an unnecessarily restrictive way.[81]

Hovenkamp's definition of unilateral exclusionary conduct has received attention as an example of an effects-based test and, in particular, a test which considers whether any consumer harm caused by the impugned conduct is 'disproportionate' to any consumer benefits that the conduct creates.[82] However, one of the most interesting points to note about Hovenkamp's test is that Hovenkamp himself asserts that it is not so much a test as a general definition of exclusionary conduct; a series of premises which can be used as a starting point for creating multiple, workable tests for specific types of unilateral conduct.[83]

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[78] Herbert J Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct' (Research Paper No 08-28, The University of Iowa College of Law, June 2008) 40.

[79] Hovenkamp, *Antitrust Enterprise*, above n 13, 157 (emphasis added).

[80] Ibid.

[81] Hovenkamp, 'Antitrust Standard', above n 78, 27; Hovenkamp, 'Monopolization Offense', above n 76, n 25.

[82] See, eg, Gavil, above n 52, 61–2; Hawk, above n 73, 223.

[83] See Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 118; Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 150–1. See further Part VIII below.

For Hovenkamp, administrability is key: in his view, 'antitrust is a justifiable enterprise only if court intervention can make markets work better', that is, if intervention can produce higher output and lower prices.[84] The influence of decision theory on Hovenkamp's views is clear. In areas where there is significant uncertainty and it is not possible to develop reliable rules or effective remedies, he argues that 'courts and enforcement agencies should err on the side of caution' and decline to intervene.[85] In his view, the costs of incompetent intervention are too great.

On this basis, Hovenkamp has put forward different tests for different types of conduct, always having regard to his imperative of erring on the side of under-inclusiveness where a more inclusive test might capture procompetitive conduct. For example, he considers that dominant firms should only be made liable for unilateral refusals to deal in very limited circumstances,[86] having regard to the limited capacity of courts to create useful remedies in these situations and the potential for judicial intervention to reduce the incentives for dominant firms to invest in valuable assets or infrastructure.[87] On the other hand, where conduct clearly injures rivals and has no 'business justification', Hovenkamp would not require elaborate proof of actual or threatened consumer harm. This would be the case, for example, where a dominant firm launched an infringement action on a fraudulently obtained patent.[88] In such cases, consumer harm can be inferred from the injury to rivals itself, particularly since the conduct is not likely to produce any social benefit.[89]

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[84] Hovenkamp, *Antitrust Enterprise*, above n 13, 7, 157.

[85] Ibid 312.

[86] Herbert J Hovenkamp, 'The Obama Administration and Section 2 of the Sherman Act' (Research Paper No 10-05, College of Law, University of Iowa, December 2010) 1632, 1636–9. See also Part VIII below.

[87] Ibid 1631–2; Hovenkamp, *Antitrust Enterprise*, above n 13, 152; Hovenkamp, 'Harvard and Chicago Schools', above n 83, 118.

[88] Hovenkamp, 'Antitrust Standard', above n 78, 31.

[89] Ibid. See also Herbert J Hovenkamp, 'Patent Deception in Standard Setting: the Case for Antitrust Policy' (Legal Studies Research Paper, University of Iowa, 20 July 2010) 28.

Most importantly, Hovenkamp recommends *against* courts engaging in a broad assessment of the net impact of the impugned conduct in each case. Rather, he argues that unilateral conduct laws should incorporate multiple judge-made tests for anticompetitive conduct, depending on the class of conduct and the likely error costs and incentive effects for that class of conduct.[90] In fact, Hovenkamp and others argue that this is in fact the approach which US antitrust courts adopt in respect of unilateral conduct.[91] A 'multiple test' approach to unilateral conduct has also been advocated by antitrust commentators in the EU.[92]

It is important to take into account the context of Hovenkamp's views in this respect. In particular, in the US, section 2 cases may be determined by a jury trial and result in the award of treble damages: in Hovenkamp's words, 'a truly miserable way to make economic policy'.[93] Accordingly, the extent to which US courts and commentators advocate the categorisation of unilateral conduct and the application of multiple tests is explained to a significant degree by the desire to limit the extent to which firms are exposed to treble damages awarded by lay juries.[94] But even when cases are decided by generalist or specialist judges, there is still an argument for reducing the extent to which socially beneficial conduct is exposed to antitrust scrutiny and/or liability.[95]

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[90] See Hovenkamp, 'Harvard and Chicago Schools', above n 83, 118.

[91] See, eg, Popofsky, above n 7, 437; Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 150–1.

[92] Keith N Hylton, 'The Law and Economics of Monopolization Standards' in Keith N Hylton (ed) *Antitrust Law and Economics – Volume 4: Encyclopedia of Law and Economics* (Edward Elgar, 2nd ed, 2010) 82; Arndt Christiansen and Wolfgang Kerber, 'Competition Policy With Optimally Differentiated Rules Instead of "Per Se Rules vs Rules of Reason"' (2006) 2 *Journal of Competition Law and Economics* 215.

[93] Hovenkamp, *Antitrust Enterprise*, above n 13, 4.

[94] Ibid 48–9, 61–3.

[95] Easterbrook, 'Past, Present and Future', above n 35, 109.

C. The DC Circuit's Burden-Shifting Approach in Microsoft

In 2001, the DC Circuit delivered its judgment in the appeal by the Department of Justice in the *Microsoft* case and enunciated an effects-based approach to monopolisation claims, often noted for its four-step, burden-shifting process.[96] This approach amounted to a 'structured' rule of reason analysis. Rather than an open-ended investigation of the various effects of the impugned conduct, the court limited the inquiry by specifying the matters for proof, and the party who bore the burden of proof, at each stage of the analysis. As will be seen, this approach bears some obvious similarities to that advocated by Salop and Romaine in their 1999 article.[97]

In *Microsoft*, the Court noted at the outset the principle, long-established by *United States v Grinnell Corp*,[98] that the offence of monopolization has two elements, namely the possession of 'monopoly power' in the relevant market, and 'the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident'.[99] It also noted that the central difficulty lies in determining when this second element is present; that is, in discerning whether the impugned conduct is exclusionary, rather than merely a form of vigorous competition.[100]

The Court determined that, from a century of case law under section 2 of the Sherman Act, several principles emerged. Based on this case law, the Court outlined a four-step approach for determining whether particular conduct by a monopolist should be found to violate section 2.[101] According to this approach, the plaintiff must first establish a prima

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[96] *Microsoft*, 253 F 3d 34 (DC Cir 2001). See Salop, 'Flawed Profit-Sacrifice', above n 4, 334; Gavil, above n 52, 21–2.

[97] See McGowan, above n 9, 1198. See Part III(A)(1) above.

[98] 384 US 563, 570–1 (1966).

[99] 253 F 3d 34, 50 (DC Cir, 2001).

[100] Ibid 58.

[101] Ibid 58–9. See Salop, 'Flawed Profit-Sacrifice', above n 4, 334, pointing out the similarities between the DC Circuit's formulation of this balancing approach and the Second Circuit's description of the rule of

facie case that the relevant conduct has an 'anticompetitive effect'. The defendant monopolist may then offer a 'procompetitive justification' for its conduct. The plaintiff then has an opportunity to rebut this justification, failing which the plaintiff must prove that the anticompetitive harm from the conduct outweighs the procompetitive benefit.[102]

The concept of 'anticompetitive effect' was central to the determination of liability in *Microsoft*. According to the Court, the conduct 'must harm the competitive *process* and thereby harm consumers'.[103] Harm only suffered by one or more competitors will not suffice. The Court also emphasized that the focus is on 'the effect of that conduct, not upon the intent behind it': evidence of intent will only be relevant to the extent that it assists the court in understanding the likely effect of the conduct.[104]

Further detail of the 'anticompetitive effect' concept can be gleaned from the Court's analysis of the facts in *Microsoft*. From this analysis, it is clear that the Court did not require the plaintiff to prove direct harm to consumers, for instance, higher prices or reduced output. Rather it found that there was an anticompetitive effect where the conduct excluded rivals and thereby protected the defendant's monopoly power.[105] Further, it was not necessary to show that the exclusion of competitors led to the actual exit of competitors from the market. It was sufficient that the defendant's conduct prevented access by competitors to some significant distribution or promotional channel, and/or reduced the usage share of rivals' products, and thereby preserved the defendant's monopoly.[106]

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reason analysis under s 1 of the *Sherman Act*, citing *United States v VISA USA, Inc*, 344 F 3d 229, 238 (2d Cir, 2003).

[102] 253 F 3d 34, 58–9 (DC Cir, 2001).

[103] Ibid 58.

[104] Ibid 58–9.

[105] Ibid 61–77.

[106] Ibid.

To establish an 'anticompetitive effect', however, it was necessary to show something more than exclusionary conduct which preserved the defendant's monopoly. In finding that the plaintiff had proved an anticompetitive effect, the Court repeatedly referred to the fact that the offending conduct was not 'competition on the merits'.[107] But what meaning did the Court give to 'competition on the merits'? At the first stage of the inquiry in *Microsoft*, the Court only held that the plaintiff had failed to establish anticompetitive effect where the conduct amounted to low pricing (based on the firm's costs) or a pure product improvement.[108] The Court did not, for example, consider the possibility of benefits flowing from exclusivity arrangements at this point.

If the plaintiff proved a prima facie case of anticompetitive effect – that is, that the conduct excluded rivals and thereby preserved the defendant's monopoly, other than by competition on the merits – the defendant might still defend its conduct by advancing a 'procompetitive justification'. The Court explained that the defendant's procompetitive justification must be 'a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal'.[109] The defendant must show that the conduct has a purpose other than the purpose of preserving the defendant's monopoly.[110] Preserving monopoly power, in itself, is a 'competitively neutral' goal.[111] Something more – such as greater efficiency or enhanced consumer appeal – is required to demonstrate that that goal is being pursued by way of competition on the merits.[112]

In summary, the *Microsoft* decision established a process for characterising a practice as either competition on the merits or anticompetitive conduct. This process began with consideration of whether the exclusionary conduct was simply competition on the merits

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[107] Ibid 62, 65, 77.

[108] Ibid 68, 75.

[109] Ibid 59.

[110] Ibid 67. See also 64, 71.

[111] Ibid 72.

[112] Ibid 59.

in its clearest form – that is, pure low pricing or a superior product – such that it should be absolved without further analysis. Where the conduct involved some restraint or hindrance of rivals beyond this, the burden shifted to the dominant firm to show that the conduct was more than a method of preserving its monopoly power, for instance, that it involved efficiency gains or improved consumer appeal. According to the Court, any substantiated gains should then be weighed against the harm from the enhanced monopoly power to determine the ultimate impact of the conduct on consumers. That is, if the plaintiff cannot rebut the defendant's justification, the plaintiff must prove that the anticompetitive harm from the conduct outweighs the procompetitive benefit.[113] The actual extent of the balancing exercise in the *Microsoft* case is explained in Part VII below.

IV. EUROPEAN COMMISSION GUIDANCE PAPER ON EXCLUSIONARY CONDUCT

The process of the 'modernisation' of competition law in the EU, and the *EC Guidance Paper*, were explained in Chapter 1.[114] Central to both the modernisation process and the Commission's approach in the *EC Guidance Paper* was the acknowledgement that the assessment of competition complaints should depend on an analysis of the actual competitive effects of the impugned conduct, and not on presumptions that certain forms of conduct were anticompetitive and therefore unlawful per se.[115]

The Commission indicated that the aim of its enforcement activity in respect of exclusionary conduct under Article 102 of the *TFEU* is to ensure that dominant undertakings 'do not impair effective competition by foreclosing their competitors in an

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[113] Ibid 58–9.

[114] See Chap 1 Part IV(C) herein.

[115] See Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart, 2nd ed, 2013) 67–73; Liza Lovdahl Gormsen, *A Principled Approach to Abuse of Dominance in European Competition Law* (Cambridge University Press, 2010) 1–3.

anti-competitive way, thus having an adverse impact on consumer welfare', including through higher price levels, limiting quality or reducing consumer choice.[116]

The Commission defined 'anti-competitive foreclosure' as 'a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices [or otherwise exercise market power] to the detriment of consumers'.[117] As in Salop's 'consumer harm' test, the Commission will determine whether such foreclosure has occurred by comparing the actual or likely future situation in the relevant market (with the dominant firm's conduct in place) with an 'appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices'.[118]

The Commission acknowledged that dominant firms may also exclude their rivals by competing on the merits of the products or services they provide, and that rivals who deliver less to consumers in terms of price, choice, quality and innovation may be forced to leave the market.[119] At least in respect of pricing practices, the Commission stated that it would generally[120] only intervene where the pricing conduct hampers, or is capable of hindering, expansion or entry by competitors which are *as efficient* as the dominant firm.[121]

Notwithstanding evidence of anticompetitive foreclosure in a market, the Commission will also consider claims by the dominant firm that its conduct is justified. A dominant

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[116] *EC Guidance Paper*, above n 4, 9 [19].

[117] Ibid 9–10 [19].

[118] Ibid 11 [21].

[119] Ibid 7 [6].

[120] However, the Commission indicated that, in some circumstances, 'a less efficient competitor may also exert a constraint which should be taken into account when considering whether particular price-based conduct leads to anti-competitive foreclosure': ibid 11 [24].

[121] Ibid 11 [23]; 14 [41]; 16 [59]; 17 [67]; 18 [80].

firm may claim justification in one of two ways, either by demonstrating that its conduct is 'objectively necessary' or by raising an efficiency defence.[122] A justification of objective necessity covers a very narrow range of conduct: the only example cited by the Commission was conduct that is objectively necessary for health or safety reasons.[123] A dominant firm may alternatively raise an efficiency defence.[124] Such efficiencies may include technical improvements in the quality of goods, or a reduction in the cost of production or distribution.[125] Thus, even if the impugned conduct forecloses competitors, the dominant firm may justify that conduct on 'the ground of efficiencies that are sufficient to guarantee that no net harm to consumers is likely to arise'.[126]

However, in the *EC Guidance Paper* the Commission proceeded to outline relatively stringent requirements for efficiency claims on the part of dominant firms. These requirements 'broadly mirror' the requirements for efficiency claims in respect of multilateral anticompetitive agreements under Art 101 of the TFEU.[127] Thus, the Commission would expect a dominant firm to demonstrate 'with a sufficient degree of probability, and on the basis of verifiable evidence that the following cumulative conditions are fulfilled':

(a) the efficiencies have been, or are likely to be, realized as a result of the conduct;
(b) the conduct is indispensable to the realization of those efficiencies, such that there are no less anticompetitive alternatives to the conduct that are capable of producing the same efficiencies;

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[122] Ibid 12 [28].

[123] Although the Commission went on to say that even this is normally the concern of public authorities rather than private firms: ibid 12 [29].

[124] Ibid 12 [28].

[125] Ibid 12 [30].

[126] Ibid. See further the description of the 'proportionality' approach to assessing efficiency claims in the EU case law in Nazzini, above n 64, 167.

[127] O'Donoghue and Padilla, above n 115, 285.

(c) the likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets; and

(d) the conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition. That is, where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains: exclusionary conduct which maintains, creates or strengthens a market position approaching that of a monopoly cannot normally be justified on efficiency grounds.[128]

If the dominant firm demonstrates an efficiency justification which meets these conditions, the Commission will determine whether the relevant conduct is likely to result in consumer harm, 'based on a weighing-up of any apparent anti-competitive effects against any advanced and substantiated efficiencies'.[129]

The burden-shifting approach advocated by the Commission in the *EC Guidance Paper* is somewhat analogous to that of the DC Circuit in *Microsoft*, requiring first a finding of exclusion which is likely to lead to enhanced or protected market power, after which the burden shifts to the dominant firm to establish an efficiency justification in accordance with the Commission's conditions.[130] If the dominant firm meets this threshold, the burden returns to the competition authority or claimant to prove that the conduct is likely to result in consumer harm in light of the weighing of competitive effects against the substantiated efficiencies.[131]

The approach in the *EC Guidance Paper* differs most markedly from the US tests in the substantial obstacles it creates for a dominant firm seeking to defend its conduct on the basis of efficiency gains. Commentators have argued that the Commission's conditions

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[128] *EC Guidance Paper*, above n 4, 12 [30].

[129] Ibid 12 [31].

[130] See O'Donoghue and Padilla, above n 115, 286.

[131] Ibid.

for the efficiency justification are likely to be very difficult to satisfy.[132] Gormsen criticizes the last requirement at paragraph (d), in particular, arguing that, if the goal of abuse of dominance rules is consumer welfare, a dominant firm should be permitted to eliminate effective competition if the conduct benefits consumers.[133] There may be relevant efficiency gains even in monopolized markets, including willingness to innovate; competition for the market; and pricing above marginal cost to cover total costs of research and development.[134]

V. THE AUSTRALIAN 'SLC' TEST

A. The SLC Test and Criticisms of the SLC Test

In its Final Report, the Harper Panel recommended that section 46(1) of the *CCA* be repealed and replaced by the following provision:

> A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.[135]

According to this proposal, characterisation of unilateral conduct as anticompetitive, and therefore unlawful, would depend on proof that the conduct 'has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market' ('the SLC test'). The Panel argued that amending section 46(1) to incorporate the SLC test would improve the provision's effectiveness in targeting unilateral anticompetitive conduct, and bring the Australian law closer to unilateral

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[132] See, eg, Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 382; O'Donoghue and Padilla, above n 115, 287-90; Geradin, above n 5, 65–6; Pinar Akman, *The Concept of Abuse in EU Competition Law: Law and Economic Approaches* (Hart Publishing, 2012) 280–4.

[133] Gormsen, above n 115, 56–7. See also Akman, above n 132, 284.

[134] Gormsen, above n 115, 130.

[135] *Harper Report*, above n 2, 513.

conduct laws in other comparable jurisdictions.[136] The Panel also pointed out that the SLC test has the advantage of creating consistency within the *CCA*, since the same test is adopted in other key provisions in Part IV of the Act in respect of anticompetitive arrangements, exclusive dealing and mergers.[137]

In contrast to the other effects-based tests considered in this chapter, the SLC test does not expressly permit the dominant firm to raise an efficiency defence or justification for its conduct. Accordingly, to 'clarify the law and mitigate concerns about overcapture', the Harper Panel proposed that the amended section 46 should include legislative guidance with regard to the meaning of the SLC test.[138] In particular, a new section 46(2) would provide that:

> Without limiting the matters that may be taken into account for the purposes of subsection (1), in determining whether conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in a market, the court must have regard to:
>
> (a) the extent to which the conduct has the purpose, or would have or be likely to have the effect, of increasing competition in the market including by enhancing efficiency, innovation, product quality or price competitiveness; and
>
> (b) the extent to which the conduct has the purpose, effect or likely effect of lessening competition in the market, including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market.[139]

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[136] Ibid 340, 344.

[137] Ibid 341, referring to *CCA* ss 45, 47, 50.

[138] Ibid 61, 344.

[139] Ibid 342, 344, 513–4. The potential consideration of efficiency gains under the Harper Proposal is examined in Part V(E) below.

The Harper Panel also recommended that 'authorisation' should be available to exempt conduct from prohibition in section 46 and that the ACCC should issue guidelines on its approach to enforcing section 46, which, in the Panel's view, would further mitigate any concerns regarding business certainty.[140] (Together these recommendations will be referred to as the 'Harper Proposal'.)

The Harper Proposal, and the government's decision to adopt that Proposal, have provoked considerable controversy and criticism in Australia. The central claim made by opponents is that an effects-based test would deter dominant firms from engaging in vigorous competition, which would be beneficial to consumers, because that conduct might eliminate rivals and thereby fall foul of the SLC test.[141]

At the outset, it is submitted that these claims have been significantly overstated. Samuel and King, for example, have suggested that SLC test would prohibit 'a highly efficient business from profitably out-competing its rivals by offering better products at a lower price' and 'protect poor competitors from [the competitive] process'.[142] As explained in the following section, the SLC test has been interpreted under other provisions in Part IV of the *CCA* to require a comparison of rivalry in the market with and without the impugned conduct, to determine whether that rivalry is substantially reduced by the conduct.[143] Better products and lower prices are the very essence of increased rivalry,[144] and would generally pass the SLC test with ease, regardless of the fact that they eliminate 'poor' competitors.

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[140] Ibid 62 (Recommendation 30), 345. See the explanation of 'authorisation' in Chap 3 Part III(B) herein.

[141] See Chap 1 Parts I, II herein.

[142] Graeme Samuel and Stephen King, 'Competition Law: Effects Test Would Have Shackled Competition' *Australian Financial Review* (online), 9 September 2015 <http://www.afr.com/opinion/competition-law-effects-test-would-have-shackled-competition-20150908-gjhq5l>.

[143] *ACCC v Cement Australia Pty Ltd* (2013) 310 ALR 165, 747–8 [3013] ('*Cement Australia*').

[144] See, eg, *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 137 ('*Dowling*').

The weaknesses in the Harper Proposal are more subtle than those claimed in the popular press. It is submitted that there are three key weaknesses:

(a) the question of what amounts to a 'substantial' lessening of competition has not been adequately answered by the case law on the SLC test to date;[145]

(b) the existing interpretation of the requirement that conduct has the 'likely effect' of substantially lessening competition to mean that conduct has 'a real chance or possibility' of substantially lessening competition sets a low threshold for liability, particularly for firms considering inherently unpredictable, but potentially beneficial, plans;[146] and

(c) under the 'effect' limb of the SLC test, the Harper Proposal exposes all types of dominant firm conduct to the same potential liability on the basis of its actual, ex post effects. The *risk* of liability under this limb may deter dominant firms from engaging in some socially beneficial practices, where there is genuine doubt as to what the ex post effects might be, or how those effects might be interpreted by a court.[147]

Each of these weaknesses is explained in the following sections.[148] The 'purpose' limb of the SLC test is considered in Chapter 6.

B. Exclusionary Conduct under the SLC Test

The SLC test has been analysed in the case law under other provisions in Part IV of the *CCA*, and so it is possible to outline some of its likely parameters as a test for unilateral anticompetitive conduct under section 46(1). As with the other effects-based tests

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[145] See Section (C) below.

[146] See Section (D) below.

[147] See Part VIII below.

[148] Brent Fisse, 'The Australian Competition Policy Review Final Report 2015: Sirens' Call or Lyre of Orpheus?' (Presented at New Zealand Competition Law & Policy Institute, 26th Annual Workshop, Auckland, 16 October 2015) 11-13, also makes a strong argument that the absence of an 'exclusionary' element is a flaw in the Harper Proposal.

outlined in this chapter, the SLC test is not concerned with conduct that harms competitors per se, but with conduct that harms the competitive process. It is well established that rivalry is not lessened simply because one or more competitors are harmed or even removed from the field of play.[149] Thus the elimination of less efficient rivals, who are simply unable to match the competitive price or superior product of a dominant firm, is unlikely to amount to amount to a substantial lessening of competition. What must be lessened is the 'future field of rivalry',[150] or 'rivalrous market behaviour',[151] and this is 'a process rather than a situation'.[152] As described by the ACCC:

> The SLC test in the context of Part IV is … essentially targeted at distinguishing between conduct which has the purpose or effect of impeding the competitive process rather than conduct by a firm which is 'competition on the merits'. Competition on the merits which results in the elimination of competitors, or even in a monopoly, does not amount to an SLC.[153]

The case law has established the relevant counterfactual to be considered under the SLC test. Consistent with Salop's 'consumer harm' test and the *EC Guidance Paper*, the SLC test requires the court to consider the likely state of competition with and without the impugned conduct. Importantly, this is not a 'before and after' test,[154] but a comparison of the future state of competition *with* the impugned conduct and the future state of

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[149] See, eg, *Stationers Supply Pty Ltd v Victorian Authorised Newsagents Associated Ltd* (1993) 44 FCR 35, 56 ('*Stationers Supply*'); *Universal Music Australia Pty Ltd v ACCC* (2003) 131 FCR 529, 585 ('*Universal Music*'); *Qantas Airways Ltd* (2005) ATPR ¶42-065, 42,936, 42,944 ('*Qantas Airways*'); *Cement Australia* (2013) 310 ALR 165, 747–8 [3013].

[150] *Cement Australia* (2013) 310 ALR 165, 747–8 [3013].

[151] *Re Queensland Co-Operative Milling Association Limited and Defiance Holdings Limited* (1976) 25 FLR 169, 188 ('*QCMA*').

[152] Ibid 189.

[153] ACCC, Submission to the Competition Policy Review Panel, *Response to the Draft Report*, 26 November 2014, 50.

[154] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR ¶41-752, 41267 ('*Stirling Harbour*').

competition *without* that conduct (which may differ from the pre-existing situation) to determine whether competition is substantially less in the former scenario.[155]

But when does a negative impact on actual or potential competitors amount to a lessening of rivalry relative to the rivalry that would be present without that conduct? Early Australian decisions concerning the SLC test seemed to suggest that a restraint imposed on competition would be condemned if it increased the relative strength or power of the firm imposing it, along the same lines as the 'avoidable exclusionary conduct test' identified by Salop and Romaine in early US case law.[156] It was not, apparently, necessary to examine the extent to which competitive outcomes might continue to be achieved in the market, or whether the restraint itself gave rise to increases in rivalry in price or quality.[157] Rather, it was objectionable that a firm should preserve or enhance its market power by restricting the *choices* of other market participants.[158] According to these cases, if conduct imposed a restraint on market participants and thereby enhanced the dominant firm's market power, the conduct could not be redeemed by evidence that it also resulted in substantial benefits to consumers.[159]

In later cases, however, the Australian courts have highlighted a different aspect of the impugned restraints, namely that the restraints in question prevented rivals from offering

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[155] Ibid 40731–2; *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238, 259–60 ('*Dandy Power*').

[156] See Part III(A)(1) above. See, eg, *Re Ford Motor Co of Australia Ltd v Ford Sales Co of Australia Ltd* (1977) ATPR P40-043, 17498 ('*Ford Motor Co*').

[157] See *Ford Motor Co* (1977) ATPR P40-043, where the Tribunal found that there had been a SLC based on the volume of sales diverted to Ford as a result of exclusivity agreements, without analysing the impact of those agreements on prices or other aspects of the offering in the market for passenger cars generally. See also *Re Southern Cross Beverages Pty Ltd* (1981) 50 FLR 176, 206, 208, 217; *Dandy Power* (1982) 64 FLR 238, 259–60, 275.

[158] See *O'Brien Glass Industries Ltd v Cool & Sons Pty Ltd* (1983) 77 FLR 441, 449: 'It is not to the point to say … O'Brien was providing a wide variety of the subject commodity, or selling at low prices, or providing good services. If enhanced dominance and a resultant lessening of competition were to come about by reason of such considerations, it had to be by leaving uninhibited the right of choice, or substitution, in the market.'

[159] See nn 157 and 158 above.

a better price-product-service package than the firms imposing the restraint.[160] In these cases, the incumbent's method of winning in the competition for custom was to impair the ability of rivals to compete for that custom. The incumbent did not succeed by outcompeting its rivals but by interfering with competition, 'freezing out realistic competitive offers',[161] and insulating itself from the effects of competition.[162]

The courts have emphasised that the exclusion of rivalry in these circumstances is likely to lead to higher prices and/or lower quality offerings than those which would be made in the absence of the conduct. In *Rural Press Ltd v ACCC*,[163] for instance, the High Court found that the new entrant, River News, had become 'a small but significant competitor' of the kind that 'tended to dilute the impact of the existing monopoly'.[164] Following threats by Rural Press, however, River News left the relevant market. The majority found that this 'arrangement'[165] between the parties had the purpose and effect of substantially lessening competition since it 'almost totally negated the beneficial effects' of the previous competitive behaviour by River News, including the previous increase in consumer choice, wider range of news, and lower advertising rates.[166]

Similarly, in *ACCC v Cement Australia Pty Ltd*,[167] Greenwood J found that preventing the entry of one rival by buying up a critical input could substantially lessen competition. Importantly, his Honour found that entry by that rival would have caused prompt and

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[160] *Gallagher v Pioneer Concrete (NSW) Pty Ltd* (1993) 113 ALR 159, 205–6 ('*Gallagher*').

[161] *ACCC v Baxter Healthcare Pty Ltd (No 2)* (2008) 170 FCR 16, 68–9, 100, 102.

[162] *Gallagher* (1993) 113 ALR 159, 204.

[163] (2003) 216 CLR 53.

[164] *Rural Press Ltd v ACCC* (2003) 216 CLR 53, 73 (Gummow, Hayne and Heydon JJ, Kirby J concurring) ('*Rural Press*').

[165] Cf Salop and Romaine, above n 4, 629 n 36, 640, regarding the proper treatment of coerced agreements from unilateral predatory threats.

[166] *Rural Press* (2003) 216 CLR 53, 73 (Gummow, Hayne and Heydon JJ, Kirby J concurring).

[167] (2013) 310 ALR 165.

vigorous price responses which would not otherwise occur given the virtual monopoly of the respondents.[168]

In determining whether the conduct has the effect or likely effect of substantially lessening competition, the Australian courts have therefore focused on the impact of the conduct on future competitive rivalry, 'particularly with consumers in mind'.[169] Nonetheless, the SLC test is not a consumer welfare test, but a test of competitive rivalry.[170] As explained further below, the SLC test permits the court to take into account efficiencies created by dominant firm conduct to the extent that those efficiencies promote competitive rivalry, but where a dominant firm's conduct gives rise to a substantial lessening of competitive rivalry in a given market, it cannot be absolved on the ground that, having regard to all the circumstances, the conduct in fact promoted consumer welfare.[171]

C. The Meaning of 'Substantial' Effects

Each of the effects-based tests outlined in this chapter requires proof of 'substantial' or 'significant' harm to the competitive process.[172] In Australia, the *CCA* does not define the concept of 'substantiality' but only specifies that 'substantially lessening competition' includes 'hindering or preventing competition',[173] the reference to 'hindrance' indicating

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[168] Ibid 779–80 [3087]–[3088]. And at: 748 [3014], 775 [3072], 799 [3178]–[3180], 809 [3226]–[3227].

[169] *Universal Music* (2003) 131 FCR 529, 585. See also *Dowling* (1992) 34 FCR 109, 137; *Stationers Supply* (1993) 44 FCR 35, 57, 58. See also, in the context of *CCA* s 46(1), *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 459 [261] (McHugh J): 'While conduct must be examined by its effect on the competitive process, it is the flow-on result that is the key — the effect on consumers …'

[170] Brent Fisse, 'The Australian Competition Policy Review Final Report 2015: Sirens' Call or Lyre of Orpheus?' (Presented at New Zealand Competition Law & Policy Institute, 26th Annual Workshop, Auckland, 16 October 2015) 12–13.

[171] See S G Corones, *Competition Law in Australia* (Thomson Reuters, 6th ed, 2014) 448–50 [7.140]–[7.145]. See further Section (E) below.

[172] See, eg, Salop, 'Flawed Profit-Sacrifice', above n 4, 347 (liability would not attach if there was no 'significant impact on price or consumer welfare'); *Microsoft*, 253 F 3d 34, 64, 69, 72 (DC Cir, 2001).

[173] *CCA* s 4G.

that it is not necessary to prove that rivals have actually been excluded from the market. The case law has provided some modest direction about the kinds of effects which are *not* a substantial lessening of competition. Thus the inability of consumers to view different brands of a product at a particular outlet is not a substantial lessening of competition.[174] The removal of just one of many competitive firms will not cause a substantial lessening of competition.[175] Further, 'a short term effect readily corrected by market processes is unlikely to be substantial'.[176]

The courts have also offered some *positive* explanation of the meaning of the word 'substantial' in this context. 'Substantial' has been said to mean 'considerable';[177] or 'a greater, rather than a lesser, degree of lessening competition'.[178] Following the judgment of French J in *Stirling Harbour*,[179] it has often been stated that the effect or likely effect must be 'substantial in the sense of meaningful or relevant to the competitive process'.[180] To determine whether such a meaningful or relevant effect has occurred, it is necessary to go beyond any numerical assessments and make '[q]ualitative judgments … about the impact of conduct'.[181]

Unfortunately, these rather vague and subjective terms do not provide significant guidance for those concerned with ex ante compliance. As Deane J commented in another

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[174] *Dandy Power* (1982) 64 FLR 238, 278–9; *Outboard Marine Australia Pty Ltd v Hecar Investments (No 6) Pty Ltd* (1982) 66 FLR 120, 134–5 ('*Outboard Marine*').

[175] *Outboard Marine* (1982) 66 FLR 120, 125, 134.

[176] *Universal Music* (2003) 131 FCR 529, 585.

[177] *Dowling* (1992) 34 FCR 109, 135.

[178] *Universal Music* (2003) 131 FCR 529, 585, citing *Dandy Power* (1982) 64 FLR 238.

[179] (2000) ATPR ¶41-752.

[180] Ibid 40732. See, eg, *ACCC v Australian Medical Association (WA)* (2003) 199 ALR 423, 483 ('*AMA*'); *Rural Press* (2003) 216 CLR 53, 71 [41] (Gummow, Hayne and Heydon JJ); *Australian Gas Light Co v ACCC (No 3)* (2003) 137 CLR 317, 417 ('*AGL (No 3)*'); *Cement Australia* (2013) 310 ALR 165, 747–8 [3013].

[181] *AMA* (2003) 199 ALR 423, 485 [339].

context,[182] the word 'substantial' is 'not only susceptible to ambiguity: it is a word calculated to conceal a lack of precision'.[183] This criticism has been vindicated by the case law on the meaning of the SLC test.[184]

Turning to the analyses in the decided cases for guidance, there is some inconsistency in the approaches adopted by Australian courts in considering whether conduct has a 'substantial' effect. For example, it seems that it is not necessary to prove that the conduct in question has raised, or is likely to raise, prices[185] in the market generally.[186] Thus, in *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd*,[187] the Court found that Bursill's refusal to supply Salomon-branded ski boots to one retailer was likely to cause a substantial lessening of competition because the retailer in question was a heavy discounter and the refusal to supply Salomon-branded ski boots to such a competitor removed 'significant competition to some retailers'.[188] The Court did not indicate that it had considered whether price competition from *other* brands of ski boots (which had a combined market share of two-thirds) might mean that there would be no increase in prices in the market as a whole. Similarly, in *Universal Music Australia Pty Ltd v ACCC*,[189] the court apparently assumed that the elimination of *intra*brand competition

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[182] *Tillmanns Butcheries Pty Ltd v Australian Meat Industry Employees' Union* (1979) 42 FLR 331.

[183] Ibid 348.

[184] See, eg, *Outboard Marine* (1982) 66 FLR 120, 134 (Fitzgerald J) ('Indeed, in the end, the answer in this case really depends on little more than *one's own instinctive impressions* formed by weighing the various considerations in this particular market which favour one view or the other.' (emphasis added)); *Dandy Power* (1982) 64 FLR 238, 260 (Smithers J) ('[C]ompetition in a market is substantially lessened if the extent of competition in the market which has been lost, is seen *by those competent to judge* to be a substantial lessening of competition. Has competitive trading in the market been substantially interfered with? It is then that the public as such will suffer.' (emphasis added))

[185] Or maintain supracompetitive prices.

[186] See *Dandy Power* (1982) 64 FLR 238, 260.

[187] (1987) 75 ALR 581.

[188] Ibid 597–8.

[189] (2003) 131 FCR 529.

would leave the defendants free from constraints from interbrand competition such that competition was substantially lessened.[190]

On the other hand, in considering a merger in *Re Qantas Airways Ltd*,[191] the Tribunal cautioned against relying on a short-term 'snapshot' of competition in the relevant market, and stressed the need to consider the 'potential dynamic interaction' with other competitors in that market.[192] Likewise, in *ACCC v Air New Zealand*,[193] Perram J found that an exchange of information between competitors concerning a component of the price charged by those competitors did not necessarily substantially lessen competition, emphasising that 'one needs to keep in mind that one is gauging the competitive effects *in the overall market*'.[194]

These inconsistent approaches, and the general vagueness of judicial statements on the meaning of 'substantial' effect, give rise to significant uncertainty for firms attempting to comply with the legislation; as well as the possibility that conduct will be condemned even where it gives rise to no persistent, market-wide effect on competition.[195]

D. Low Threshold for 'Likely Effect' Limb under the SLC Test

Under the 'likely effect' limb, the Harper Proposal would condemn conduct if it 'has the likely effect of substantially lessening competition'. According to the interpretation of

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[190] Ibid 590, 591. Cf *Stationers Supply* (1993) 44 FCR 35, 59–60, where Ryan J found that, despite an arrangement for a large number of newsagents to switch their buying allegiance to the Newspower brand, there might in future be active competition between Newspower and other wholesale stationery brands. Similarly, in *AW Tyree Transformers Pty Ltd and Wilson Transformer Co Pty Ltd* (1997) ATPR (Com) ¶50-247, 21, the Tribunal found that, even though the conduct might reduce some competition in the market in relation to one range of transformers, this did not give rise to a significant anticompetitive effect on the market as there was a significant degree of competition in the overall market.

[191] (2005) ATPR ¶42-065.

[192] Ibid 42,914–5.

[193] (2014) 319 ALR 388 (overturned on other grounds).

[194] Ibid 610 [1107], 634 [1243] (emphasis added).

[195] See Fisse, above n 170, 12, 16–20. Cf the approach to 'substantiality' proposed by Tom Leuner, 'Time and Dimensions of Substantiality' (2008) 36 *Australian Business Law Review* 327.

this phrase under other provisions of Part IV of the *CCA*, proof of 'likely effect' only requires the applicant to demonstrate that the conduct had a 'real chance or possibility' of substantially lessening competition in a market.[196] This assessment is made on an ex ante basis, having regard to the circumstances existing at the time the firm engaged in the conduct.[197]

A finding that conduct gave rise to a *real chance or possibility* of substantially lessening competition sets a relatively low, and relatively uncertain, threshold for infringement, particularly when combined with the uncertain standard of 'substantiality'. It is submitted that this limb of the SLC test may give rise to false positives. That is, an applicant might successfully argue that conduct had a real chance or possibility of lessening competition when the conduct had an inherently unpredictable outcome at the outset, even though the suppression of competition was not the most likely explanation for the conduct.[198] The 'likely effect' limb of the SLC test may therefore reduce dominant firm incentives to engage in behaviour, including risky investment in innovation, which is generally beneficial to society, as explained in Part VIII below.

E. Offsetting Consumer Benefits or Efficiency Gains

As noted earlier, the Harper Proposal includes legislative guidance to the effect that, under the SLC test, the court must have regard, in part, to

> the extent to which the conduct has the purpose, effect or likely effect of increasing competition, in the market, including by enhancing efficiency, innovation, product quality or price competitiveness.

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[196] *Monroe Topple & Associates v The Institute of Charter Accountants* (2002) 122 FCR 110, 140 [111] (Heerey J), citing *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 42 FLR 331, 346–8 (Deane J).

[197] See *Universal Music* 131 FCR 529, 586 [247], citing *Trade Practices Commission v TNT Management Pty Ltd* (1985) 6 FCR 1, 50. See also *Seven Network Ltd v News Ltd* (2009) 182 FCR 160, 342 ('*Seven Network*').

[198] Eg, when the dominant firm invests in increased capacity or research and development.

It is arguable that incorporating such guidance in section 46 would weigh against the consistency created by adopting the SLC test across different provisions of the Act, since this legislative guidance would only be included in respect of section 46. But are efficiency considerations inherent in the SLC test as it stands?

The matters to which a court may have regard under the SLC test in Part IV of the *CCA* are sometimes contrasted with the broader factors which may be taken into account by the Commission and the Tribunal pursuant to an application for authorisation of conduct under Part VII Division 2 of the Act.[199] Pursuant to an authorisation application, the Commission and the Tribunal may take into account a broad range of public interest considerations, including, but not limited to, 'the achievement of the economic goals of efficiency and progress'.[200]

On one view, under the SLC test, the courts are only concerned with whether *allocative* efficiency has been reduced by the conduct in question: that is, effects on productive or dynamic efficiency can only be weighed against effects on allocative efficiency pursuant to an authorisation application to the Tribunal.[201] However, it is submitted that any perceived restriction on the court's consideration of the various competitive effects of conduct under the SLC test cannot be justified. Price (or price elasticity) is not the only manifestation of competition. Firms also compete through new technologies, new methods and innovation in general.[202] In Australia, the High Court, the Federal Court and

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[199] *Outboard Marine* (1982) 66 FLR 120, 128–9; *AGL (No 3)* (2003) 137 FCR 317, 492–3. See Chap 3 Part III(B) for an explanation of the 'authorisation' process.

[200] *Qantas Airways* (2005) ATPR ¶42-065, 42871, 42,874–5.

[201] The law in respect of mergers, eg, has created 'a clear distinction between an SLC test (in which efficiencies are largely not considered) and the test for authorisation (that explicitly considers efficiencies)': Philip Williams and Graeme Woodbridge, 'The Relation of Efficiencies to the Substantial Lessening of Competition Test for Mergers: Substitutes or Complements?' (2002) 30 *Australian Business Law Review* 435, 436. See also *Qantas Airways* (2005) ATPR ¶42-065, 42,874. See the discussion of economic efficiency in Chap 2 Part III(E) herein.

[202] See Committee of Review of the Application of the Trade Practices Act 1974, Parliament of Australia, *National Competition Policy* (1993) ('Hilmer Report'), referring to the objective of the 'effective functioning of the competitive process, and hence economic efficiency and the welfare of the community as a whole'.

the Tribunal have all acknowledged these aspects of competition.[203] According to the High Court:

> On the basis of many studies and long experience, economists have concluded that the main virtue of competition is that it provides a very powerful means of securing important gains in allocative and especially dynamic efficiency.[204]

Gains in dynamic efficiency are not merely an outcome of competition but a manifestation of competition itself: that is, innovation is a means of competing and increasing competition.

If certain conduct reduces price competition, it should be relevant that the same conduct has led to an increase in innovation, or dynamic efficiency.[205] The Tribunal, for example, has recognised that prices may sometimes increase because the quality of the product increases: consumers are not induced or pressured, but are paying for what they value.[206] Further, a relatively minor lessening of competition in respect of some sales in the market may be more than offset by increases in productive and dynamic efficiency.[207]

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[203] See *Gallagher* (1993) 113 ALR 159, 205, 206, where Lockhart J found there was a lessening of competition having regard not only to the restricted ability of rivals to offer lower prices, but also to offer flexible services, reduce costs, introduce effective technology or increase productivity. See also *Seven Network Ltd* (2009) 182 FCR 160, 283–4, 307, referring to firms competing through new products, new technology, more effective service or improved cost efficiency; '[C]ompetition may manifest itself as innovation in the product and/or the way in which it is supplied'.

[204] *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012), quoting from *Duke Eastern Gas Pipeline*. See also *Fortescue Metals Group Ltd* [2010] ACompT 2 (30 June 2010): 'Some economists contend that innovative efficiency provides the greatest enhancement of social welfare, suggesting it is the single most important factor in the growth of real output in industrial countries.' See Martyn Taylor, 'Competition Law in High Technology Industries: Insights for Australia' (Paper presented at Competition Law Conference, Sydney, 30 May 2015) 28–33.

[205] See the consideration of this possibility by the Tribunal in *Qantas Airways* (2005) ATPR ¶42-065, 42,870-1.

[206] *Qantas Airways* (2005) ATPR ¶42-065, 42,918.

[207] Ibid 42965; *ACCC v Metcash Trading Ltd* (2011) 282 ALR 464, [168], [170]–[171].

However, in contrast to the other tests considered in this chapter, under the SLC test, increases in efficiency can only be considered to the extent that they promote competitive rivalry in the *same* market in which the lessening of competition occurs.[208] The question under the SLC test is whether competition in a given market has been substantially lessened, not whether the conduct reduces or improves consumer welfare in general.

Even the legislative guidance added by the Harper Proposal requires consideration of improvements in efficiencies only for the purpose of determining whether the conduct has the purpose, effect or likely effect of 'increasing competition, *in the market*'. It is submitted that a dominant firm would not be permitted to argue that, although the impugned conduct is likely to substantially lessen competition in one market, it will also lead to overwhelming improvements in dynamic efficiency, or consumer benefits, in another market. The other effects-based tests considered in this chapter are not expressly limited to the consideration of effects within a given market.

VI. COMMON THEMES IN EFFECTS-BASED TESTS

This Part briefly summarises the findings of the analysis to this point before a more detailed comparison is made. The central feature of effects-based tests is that they focus on the competitive impact of the impugned conduct, rather than focusing on the dominant firm's intent, purpose or incentives. Each of the tests considered here takes into account evidence of a negative impact on actual or potential rivals, but harm to rivals is not sufficient to establish liability. Advocates of effects-based tests agree that low prices based on costs, and increases in product quality or innovation, are manifestations of vigorous competition, which, by themselves, should not be condemned, even if they cause detriment to competitors. Less efficient competitors should not be protected from the natural outcomes of competition for custom. Before unilateral conduct is condemned, the negative impact on rivals must be such that it amounts to substantial harm to the competitive *process*.

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[208] *Outboard Marine* (1982) 66 FLR 120, 128–9.

Harm to the competitive process is likely to occur where conduct constrains actual or potential rivals from making competitive offers to consumers to a substantial degree.[209] Such constraints on rivals enhance or maintain the dominant firm's market power, meaning that prices will be elevated and output reduced (in quantity or quality) to the detriment of consumers. Under most effects-based tests, direct proof of net harm to consumers is usually sufficient, but not essential, to establish liability. The requisite harm may also be demonstrated by proof of 'substantial' or significant foreclosure of rivalry.

Conduct which results in some constraint on rivalry, and thus some increase in the firm's market power, may also give rise to benefits for consumers. Effects-based tests therefore generally permit dominant firms to justify their conduct on the basis that it gives rise to procompetitive gains, or consumer benefits, which outweigh any harm to the competitive process (noting the limitations on such justifications under the SLC test, as explained in the previous section).

However, the effects-based approaches considered in this chapter reveal very different perceptions about the dangers inherent in an effects-based analysis, and particularly the case-by-case assessment of competitive effects.[210] These dangers include the risk that courts may not be competent to arrive at accurate conclusions concerning effects in individual cases; the risk that the costs of arriving at such conclusions may outweigh the benefits of imposing the rule; and the risk that the case-by-case scrutiny of certain types of behaviour may reduce dominant firm incentives to engage in behaviour which would otherwise create important benefits for society.

In the following parts of this chapter, this comparison is extended to give consideration to different ways in which the respective effects-based tests address several key criticisms, particularly with regard to their administrability; and likely error costs and deterrent effects on dominant firm behaviour.

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[209] Bernheim and Heeb, above n 4, 1.1–1.2.

[210] Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 147, 150–1. See also Hovenkamp, *Antitrust Enterprise*, above n 13, 157, 312.

VII. ADMINISTRABILITY: THE DIFFICULTY OF 'BALANCING' EFFECTS

Effects-based tests for unilateral conduct have been criticised for requiring courts to 'balance' or 'weigh' the procompetitive and anticompetitive effects of conduct in a market – or, equally, the different effects which the same conduct may have on different groups of consumers – given that any sensible balancing exercise may be impossible, or at least prohibitively expensive, in practice.[211] That is, assuming that the nature of the respective effects of the conduct can be identified, those effects will often be unquantifiable and incommensurable.[212] Even where balancing of opposing effects is possible, the increased cost of compliance, enforcement and litigation may well offset the economic benefit of applying such a test.[213]

Opponents of effects-based tests draw support for this view from the fact that, where courts have in fact purported to apply an effects-based approach, they have rarely engaged in any actual weighing of anticompetitive and procompetitive effects.[214] The *Microsoft* case is offered as an example.

Interestingly, given the test expounded by the DC Circuit in *Microsoft*, in applying its test to the facts, the Court engaged in almost no balancing of efficiency gains against anticompetitive harms.[215] From the extensive list of allegations of monopolisation, the Court only undertook any semblance of a balancing exercise in respect of one aspect of the defendant's conduct, namely a restrictive term in a software licence agreement. The Court found that this term prevented a 'drastic alteration' of Microsoft's software by

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[211] Hawk, above n 73, 225; Popofsky, above n 7, 465; Melamed, above n 9, 1252–5.

[212] Richard D Cudahy and Alan Devlin, 'Anticompetitive Effect' (2010) 95 *Minnesota Law Review* 59, 65.

[213] Hovenkamp, *Antitrust Enterprise*, above n 13, 108; Hovenkamp, 'Antitrust Standard', above n 78, 32; Einer Elhauge 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 317.

[214] McGowan, above n 9, 1188–9, 1217–9; Popofsky, above n 7, 447; Hovenkamp, 'Antitrust Standard', above n 78, 32.

[215] See Andrew I Gavil and Harry First, *The Microsoft Antitrust Cases: Competition Policy for the Twenty-First Century* (MIT Press, 2014), 99–101; Popofsky, above n 7, 445–7; McGowan, above n 9, 1188–9; Hovenkamp, 'Antitrust Standard', above n 78, 32.

computer manufacturers, and that the gravity of the risk of such alteration outweighed the 'marginal' anticompetitive effect of prohibiting such alterations under the licence agreement.[216] The Court did not engage in a fine balancing of substantial anticompetitive effects against substantial procompetitive justifications in respect of any impugned conduct.

Some argue that the proposed 'balancing' exercise in this context is in fact a 'myth':[217] rather than weighing effects, courts have tended summarily to declare the impugned conduct to be 'competition on the merits', or to arrive at a conclusion regarding the claimed benefits and detriments of the conduct without attempting to weigh those effects against each other. This, say opponents, is evidence that the balancing exercise cannot be undertaken in practice. To pretend that it is possible, and that it is being undertaken, only obscures the real, undeclared process by which the court is arriving at its conclusions on the conduct.[218]

However, the fact that the application of a balancing exercise is very rare should not automatically lead to the conclusion that the exercise is mythical. It may simply indicate that it is rarely required. While effects-based tests generally incorporate a final 'balancing' or 'weighing' stage, as Salop argues, in most cases the test produces a result before this stage is reached, including where:

- the dominant firm excludes rivals purely by offering a better price or product, in which case the conduct is absolved;
- the conduct does not impair rivalry to any significant degree, in which case the conduct is absolved;
- the conduct impairs competition by rivals to a substantial degree and lacks any efficiency justification, in which case the conduct is condemned; or

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[216] 253 F 3d 34, 63 (DC Cir, 2001). See also Gavil and First, above n 215, 106.

[217] Andrew I Gavil, William E Kovacic and Jonathan B Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (West Academic, 2nd ed, 2008) 207.

[218] See McGowan, above n 9, 1219–20.

- the conduct impairs competition by rivals to a substantial degree and that exclusion is not necessary to secure any claimed efficiency gains, in which case the conduct is condemned.[219]

A balancing exercise would only be required in cases involving truly exclusionary conduct, which is offset by a compelling efficiency explanation, where the impugned conduct is necessary for the achievement of those efficiencies.[220] This is not a common scenario.[221]

The rarity of cases necessitating a balancing exercise provides some explanation for the absence of balancing in the case law, limiting the extent of error costs arising from such an exercise and militating against claims that the test is not administrable.[222] Nonetheless, there will be some cases where courts must evaluate conduct that creates some benefit for consumers and also unavoidably threatens consumer harm. In these situations, proponents of effects-based tests argue that the difficulty of such an exercise should not inevitably lead to the conclusion that the scope of the prohibition should be narrowed, leaving consumers to the mercies of those who innovate in anticompetitive strategies.[223]

As to the nature of the balancing exercise, when it is required, Salop argues that it is not necessary for courts to *quantify* the various effects of the conduct. What is required is a weighing of *the strength of the evidence* on each side. The court should 'compare and weigh the magnitude and credibility of evidence on both the procompetitive and anticompetitive sides to evaluate which evidence is stronger on balance'.[224] For example,

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[219] Salop, 'Flawed Profit-Sacrifice', above n 4, 363–4.

[220] Hovenkamp, 'Antitrust Standard', above n 78, 32.

[221] Ibid. See also Salop, 'Flawed Profit-Sacrifice', above n 4, 363–4.

[222] See, eg, Gavil and First, above n 215, 319–20, arguing that the DC Circuit in *Microsoft* did not in fact 'purport to be balancing effects in the sense of quantifying and comparing harms and benefits to determine which was measurably greater' but, in keeping with a rule of reason analysis, reached 'a judgment about [the] conduct's effect on competition on the basis of the evidence'.

[223] See Salop, 'Flawed Profit-Sacrifice', above n 4, 363–4. See also Gavil and First, above n 215, 319.

[224] Ibid 332.

if the facts in a given case indicate that the exclusionary conduct likely increases or maintain barriers to competition or entry and leads to higher prices, the conduct would be condemned 'unless evidence of likely and substantial procompetitive benefits is so strong that consumers are unlikely to be harmed'.[225]

However, complexity arises from the fact that conduct may give rise to substantial increases in one dimension of competition at the same time as it substantially decreases competition in another dimension. As Wright points out:

> Firms compete on price, output, reputation, quality, innovation, and cost. In many cases, though not all, these forms of rivalry are negatively correlated. This inverse correlation implies that regulators or judges must determine which bundle of competitive forms maximizes efficiency (or consumer welfare) in the face of welfare trade-offs between these activities.[226]

Where conduct has substantial, but opposing, effects on different forms of competition, courts must decide which of these forms of competition should be given priority, having regard to the objective of protecting consumer interests. Given the limits of current economic theory and empirical knowledge, such a decision may amount to little more than the expression of a subjective preference,[227] which may erroneously condemn, or deter, conduct which is in fact socially beneficial.

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[225] Ibid 330.

[226] Joshua D Wright, 'Antitrust, Multidimensional Competition and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now?' in Geoffrey A Manne and Joshua D Wright (eds), *Competition Policy and Patent Law Under Uncertainty* (Cambridge University Press, 2014) 231.

[227] Ibid 231–4.

VIII. ERROR COSTS AND INCENTIVE EFFECTS

A. Error Costs and Incentive Effects from Effects-Based Tests

As explained in the introduction to this chapter, effects-based tests have been criticised on the basis that they may capture conduct which is actually procompetitive,[228] and unacceptably reduce the incentives of dominant firms to engage in beneficial competitive conduct.[229] The effects-based tests considered in this chapter take quite different approaches to these risks.

At one extreme, the *EC Guidance Paper* places considerable faith in the authority's ability to assess competitive effects, and to weigh the procompetitive against the anticompetitive. The Commission also places a heavy burden on the defendant to justify its conduct on efficiency grounds, reflecting a perception that the danger from dominant-firm conduct in the market is far greater than the danger of state intervention. This approach reveals relatively little concern with the effect of such a process on dominant-firm incentives to engage in aggressive competition.

In contrast, Salop responds to criticisms regarding incentive effects by arguing that marginal adjustments may be made to the 'consumer harm' test – for instance to the standard of proof – to take into account the potential consequences of the test for firm incentives and deterrence in respect of certain types of conduct, as explained below.[230]

Hovenkamp would go further. The risk of deterring socially beneficial conduct is one of the key reasons that Hovenkamp does not in fact recommend the use of an effects-based test, or rule of reason enquiry, in respect of unilateral conduct on a case-by-case basis.[231] Instead Hovenkamp advocates what might be called a 'meta' rule of reason, or effects-

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[228] Easterbrook, 'Limits', above n 7, 4–8, citing Coase, 'Industrial Organization: A Proposal for Research' (1972) 3 *Policy Issues And Research Opportunities In Industrial Organization* 59.

[229] See, eg, Drexl, above n 10, 677; Melamed, above n 9, 1254; Popofsky, above n 7, 436, 443, 465.

[230] Salop, 'Flawed Profit-Sacrifice', above n 4, 353–4.

[231] Hovenkamp, 'Harvard and Chicago Schools', above n 83, 109, 114, 118, 120–1.

based test, as the over-arching principle for selecting the conduct-specific tests that maximise long-term consumer welfare.[232] Popofsky has proposed a similar approach, arguing that, in the developing jurisprudence on monopolisation under the Sherman Act, '[c]ourts should select the test that makes consumers better off in the longrun.'[233] In some circumstances, the best solution from a consumer standpoint might be to apply certain simplified screening tests, or tests which capture a more limited range of anticompetitive conduct, so as to preserve incentives for dominant firms to engage in behaviour that ultimately benefits consumers. Examples of such simplified tests are considered in the following sections.

In contrast to these conduct-specific rules for unilateral conduct, the Australian SLC test does not create, or permit courts to create, more or less stringent standards of liability depending on the particular conduct which is alleged to be anticompetitive. According to the test put forward by the Harper Panel, any unilateral conduct would infringe s 46(1) if it has the purpose, effect or likely effect of substantially lessening competition in a market. The question whether the conduct meets the SLC test does not provide scope for the courts to take into account the broader implications of condemning the behaviour in question, including effects on dominant firm incentives.

On the other hand, unlike the *EC Guidance Paper*, it is submitted that the SLC test would err in favour of the dominant firm in close cases. On a practical level, the applicant is likely to make arguments as to how the impugned conduct reduced rivalry in a manner likely to cause detriment to consumers, while the respondent would attempt to prove that the conduct in fact represented increased rivalry, or conduct which was essential to increased rivalry, leading to benefits for consumers. However, the burden of proof remains on the applicant to prove that the conduct substantially lessens competition. If the court were unable to discern, on the balance of probabilities, and having regard to the

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[232] Popofsky, above n 7, 456.

[233] Ibid.

respondent's procompetitive justifications, whether the conduct has substantially lessened competition, the respondent would prevail.

B. Low Prices: Error Costs and Incentive Effects

Critics of the Harper Proposal for an effects-based test in Australia have argued that such a test is likely to inappropriately condemn firms for engaging in vigorous price competition, as well as deterring such competition more generally to the detriment of consumers.[234] This section considers how low pricing is treated by the various effects-based tests.

In Hovenkamp's view, low pricing should only be sanctioned where the price is clearly below average variable cost or marginal cost and where 'the structural conditions for recoupment exist'.[235] Hovenkamp acknowledges that, occasionally, *above*-cost pricing may also produce anticompetitive effects, but contends that identifying these rare cases 'would tax the measurement capabilities of tribunals so severely that it cannot be controlled without discouraging socially beneficial behaviour'.[236] While Hovenkamp admits that such an approach is somewhat under-deterrent, he considers that this is justified by administrability considerations,[237] and by the fact that, for pricing claims in

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[234] See, eg, Marianna Papapakis, 'Harper 'Effects Test' Will Hurt Business; Lawyers', *Australian Financial Review* (online), 31 March 2015 < http://www.afr.com/business/legal/harpers-effects-test-will-hurt-business-lawyers-20150401-1mbnle>; Stephen King and Graeme Samuel, 'Competition Law Fix Could Seriously Harm Competition', *The Conversation* (online) 5 May 2015 <https://theconversation.com/competition-law-fix-could-seriously-harm-competition-41159>.

[235] Hovenkamp, 'Obama Administration', above n 86, 1644–7. Strict proof of recoupment should not be required if the defendant's prices are clearly below the relevant cost measure.

[236] Hovenkamp, 'Antitrust Standard', above n 78, 27; Hovenkamp, 'Harvard and Chicago Schools', above n 83, 120–1.

[237] It is simply too difficult for courts to identify those situations in which above-cost pricing will be anticompetitive.

particular, the cost of incorrectly condemning conduct is high relative to the cost of incorrectly absolving predatory prices.[238]

In cases of alleged predatory pricing, Salop explains that the 'consumer harm' test would recognise the benefits to consumers, at least in the short-run, of lower prices. But the defendant's strategy would violate the consumer harm standard if higher prices (and therefore consumer welfare losses) during a subsequent recoupment period were such that 'the net present value of consumer welfare decreased'.[239] Under Salop's approach, it would *not* be necessary to show that the pricing was below some measure of costs, since above-cost pricing may still ultimately reduce the net present value of consumer welfare.[240]

According to the *EC Guidance Paper*, the European Commission would not engage in an open-ended consideration of the effects of low pricing. Rather it takes the general approach that low pricing should not be condemned unless it would exclude a rival who is as efficient as the dominant firm.[241] Further, the Commission has provided detailed cost benchmarks below which a firm will be considered to price at a predatory level.[242] However, the Commission has noted that, in exceptional circumstances, a firm's pricing may be found to have an anticompetitive effect even where it prices above all of the relevant cost measures.[243] The Commission has been criticized for adding this exception, on the basis that it creates uncertainty and may deter beneficial price competition.

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[238] Hovenkamp, 'Obama Administration', above n 86, 1644; Hovenkamp, Hovenkamp, *Antitrust Enterprise*, above n 13, 159–67. See also Hovenkamp, *Antitrust Enterprise*, above n 13, 173–4, re under-deterrent cost-based tests for 'bundled' discounts.

[239] Salop, 'Flawed Profit-Sacrifice', above n 4, 337–8.

[240] Ibid 337–8 and n 108. See also Jonathan Faull and Ali Nikpay, *The EU Law of Competition* (Oxford University Press, 3rd ed, 2014) 401–6, for an explanation of instances in which above-cost pricing may amount to predation.

[241] *EC Guidance Paper*, above n 4, 11 [23]; 14 [41]; 16 [59]; 17 [67]; 18 [80].

[242] Ibid 11 (price-based exclusionary conduct), 13 (conditional rebates).

[243] Ibid 11 [24].

The Australian SLC test permits a relatively open-ended analysis of predatory pricing claims. On the one hand, Australian courts have indicated that low pricing is generally a key indicator of healthy competition: thus low prices alone will not reflect a substantial lessening of competition.[244] On the other hand, courts also recognise that a dominant firm's low prices will sometimes drive other firms from the market if those firms are not as efficient as the dominant firm, and that this is the natural outcome of successful competition.[245] Something further will be required if an applicant is to prove that low prices are likely to substantially lessen competition.

In this respect, it is likely that an applicant arguing that a dominant firm's low prices substantially lessened competition would attempt to show that the prices in question were below some appropriate cost measure in accordance with current economic theories on predatory pricing.[246] The fact that the dominant firm's price was below an appropriate cost measure for a significant period, for example, may indicate that the price was set with the purpose or likely effect of substantially lessening competition, since the dominant firm would be unlikely to incur such losses unless it expected to recoup its costs by charging a supracompetitive price once other firms exited the market.[247]

However, as noted earlier, economic theory indicates that dominant firms may exclude vital competitive constraints and protect their market power by lowering their prices even where such prices are above the dominant firm's own costs.[248] It is therefore conceivable that, under the Harper Proposal, prices above cost might be found to substantially lessen

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[244] *Dowling* (1992) 34 FCR 109, 137.

[245] *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 409, 411–2.

[246] Bearing in mind, however, the warning by the High Court that care should be exercised in the 'importation of [predatory pricing concepts] from different legislative contexts': *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 420 (Gleeson CJ and Callinan J).

[247] See Hovenkamp, 'Obama Administration', above n 86, 1644–7. In considering whether the firm possessed the purpose of substantially lessening competition, it would be necessary to consider alternative explanations for such pricing, such as 'learning by doing'.

[248] See, eg, Jonathan Faull and Ali Nikpay, *The EU Law of Competition* (Oxford University Press, 3rd ed, 2014) 401–6; Aaron Edlin, 'Stopping Above-Cost Predatory Pricing' (2002) 111 *Yale Law Journal* 941.

competition in a market and thereby infringe the amended provision. On the one hand, it might be considered desirable that the SLC test is sufficiently flexible to capture anticompetitive conduct in these circumstances. On the other hand, in making such a finding, it would not be open to an Australian court to take into account the consequences of such a finding on pricing behaviour more generally. This has implications for dominant firm incentives: if it is possible for courts to find that above-cost pricing infringes section 46(1), firms might be reluctant to engage some beneficial low pricing, to the detriment of consumers.

C. Innovation: Error Costs and Incentive Effects

Claims of unilateral anticompetitive conduct often concern novel products, services or business methods. It is generally acknowledged that dominant firms may engage in 'predatory innovation' which improperly excludes rivals to the detriment of consumers:[249] that is, dominant firms may engage in the anticompetitive strategy of selecting some technology, or other novel method of doing business, to take advantage of its adverse impact on rivalry.[250] However, numerous commentators have argued that antitrust rules should err heavily on the side of permissibility in such cases, particularly given the overwhelming economic benefits flowing from innovation and the perverse effects of deterring highly beneficial conduct.[251]

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[249] See,eg, Alan Devlin and Michael Jacobs, 'Anticompetitive Innovation and the Quality of Invention' (2012) 27 *Berkeley Technology Law Journal* 1.

[250] Hovenkamp, 'Monopolization Offense', above n 76, 1039. See further Devlin and Jacobs, above n 256, 8–10, re methods of 'predatory innovation'.

[251] Drexl, above n 10, 679–80; Rachel Trindade, Rhonda L Smith and Alexandra Merrett, 'Building Better Mousetraps: Harper's Re-write of Section 46' (2014) 20 *State of Competition* 1, 4. See also Geoffrey A Manne and Joshua D Wright, 'Innovation and the Limits of Antitrust' (2010) 6 *Journal of Competition Law and Economics* 153; Geoffrey A Manne and Joshua D Wright, 'Google and the Limits of Antitrust: The Case Against the Case Against Google' (2011) 34 *Harvard Journal of Law and Public Policy* 171, 183–4.

Hovenkamp has acknowledged that dominant firms may engage in predatory innovation.[252] At the same time, he argues that unilateral innovations should only be condemned in the rare situation where the following stringent conditions are met, including that there is no significant actual improvement for which the challenged innovation was necessary, and that the the defendant did not intend, at the outset, to create a better product but only to redesign it in order to exclude a rival, generally by making the rivals product incompatible with its own.[253] Accordingly, an innovative act should never be condemned unless it is a 'sham' in the sense that it 'does not benefit consumers at all, but is profitable only because it locks consumers into the dominant firm's technology'.[254]

Hovenkamp argues that where innovative conduct is actually necessary for *any* significant improvement in the product, it should be absolved. In his view, where there is any significant improvement, the courts are 'simply not up to the job of balancing the gains from innovation against the losses from reduced competition'.[255] Even though successful innovations may injure competitors and have the effect of creating or expanding monopoly power, he points out that there is general consensus in the economic literature that gains from innovation are likely to be significantly greater than gains from increased competitiveness.[256] Accordingly, '[o]ur market system simply places too high a premium on innovation' to condemn such innovations.[257]

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[252] Hovenkamp, 'Monopolization Offense', above n 76, 1039. See further Devlin and Jacobs, above n 256, 8-10, re methods of 'predatory innovation'.

[253] Ibid; Hovenkamp, 'Exclusion and the Sherman Act', above n 74, 158; Hovenkamp, 'Antitrust Standard', above n 78, 23–4, regarding the ex ante analysis of the firm's subjective intent. See also Devlin and Jacobs, above n 249, for an alternative approach to predatory innovation claims.

[254] Hovenkamp, 'Monopolization Offense', above n 76, 1039.

[255] Ibid.

[256] Ibid. See also Hovenkamp, 'Obama Administration', above n 86, 1663: 'The welfare gains from innovation almost certainly exceed the available gains from squeezing price monopoly out of the economy. An important corollary of this proposition, however, is that the *harm caused by an act that restrains innovation* can cause far greater harm than a restraint on simple output or pricing.' (emphasis added)

[257] Hovenkamp, 'Monopolization Offense', above n 76, 1039.

Salop's approach varies most markedly from Hovenkamp's in respect of innovations or product design changes by dominant firms. Salop would condemn a dominant firm's product design change if it maintains or enhances the firm's market power by creating incompatibility with a rival's product if that incompatibility was not necessary for the improvement of the dominant firm's product. However, even if the incompatibility were inextricably linked to the dominant firm's quality improvement, Salop would find a violation if the dominant firm 'consequently gains the ability to raise its price by far more than the [value of the] quality improvement'.[258] Salop would thus have courts compare the additional value, or performance benefits, to consumers from the design change with the additional price that the consumers would be required to pay. A beneficial design change might still infringe if the resulting price is higher than the quality-adjusted price. That is, the change would be condemned if 'the product improvement is valued by consumers, but not by enough when it comes unavoidably bundled with increased barriers to competition that permit such large price increases'.[259]

However, Salop adds a qualification which takes some account of incentive effects. Salop acknowledges that innovative conduct can often have unpredictable results. His solution is that, in such situations, the conduct should be evaluated from an ex ante perspective, based on the information reasonably available at the time that the innovator made its investment decision.[260] The consumer harm test would therefore only require the firm 'to make a good-faith effort to estimate the expected impact of its conduct on consumers',[261] and the court to 'evaluate the likelihood and magnitude of expected consumer benefits or

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[258] Salop, 'Flawed Profit-Sacrifice', above n 4, 323–6.

[259] Ibid 338–9. Cf Devlin and Jacobs, above n 256, arguing that the appropriate test for predatory innovation should condemn innovative conduct 'only when the offending product offers the consumer nothing new and valuable'.

[260] Salop, 'Flawed Profit-Sacrifice', above n 4, 339.

[261] Ibid 365–6.

harms based on the information reasonably available at the time that the conduct was undertaken'.[262]

As explained in Part V above, Australian courts have acknowledged that innovation is in fact a vital aspect of competition itself. If certain conduct reduces price competition, it should be relevant that the same conduct has led to an increase in innovation, or dynamic efficiency.[263] On the other hand, a product design change or new product may necessarily exclude existing or potential rivals, particularly if the innovation holds vastly superior appeal for consumers. But this does not necessarily equate to a substantial lessening of competition.

Competition may not be significantly lessened even in cases where the market is reduced to a single supplier.[264] The critical consideration is not the 'snapshot' of competition at a given point in time, but the potential for rivalry, including innovation by competitors, over time.[265] In the absence of additional strategic behaviour on the part of the incumbent, new products and standards can and do arrive to the benefit of consumers. Particularly in the 'new economy',[266] competition may take the form of competition to *obtain* transient monopolies, with the prospect of a lucrative monopoly accelerating the rate of innovation.[267] But where a dominant firm's new product or design change excludes rivalry *without* giving rise to any benefit to consumers, the innovation may be found to have substantially lessened competition. Accordingly, strategic behaviour or 'sham' design changes by dominant firms may be captured by the Australian SLC test.[268]

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[262] Ibid 341–2.

[263] See the consideration of this possibility by the Tribunal in *Qantas Airways* (2005) ATPR ¶42-065, 42,870–1.

[264] See *Stirling Harbour* (2000) ATPR ¶41-752, 40,725, 40728, 40733–4.

[265] *Qantas Airways* (2004) ATPR ¶42-027, 42,914–5.

[266] That is, the manufacture of computer software, internet-based businesses and communications services which support these two markets.

[267] Richard A Posner, 'Antitrust in the New Economy' (2001) 68 *Antitrust Law Journal* 925, 929–30.

[268] Assuming the requirement of 'substantiality' is met.

Importantly, however, the SLC test might also give rise to liability where the genuine, underlying objective of a dominant firm's design change was the creation of benefits for consumers, but the intended benefits ultimately failed to materialise. In this respect, the court would not be required to consider the dominant firm's intent or purpose in introducing the design change if the conduct in fact gave rise to a substantial lessening of competition. A dominant firm may also infringe if its conduct had the 'likely effect' of SLC, which has been held to require only proof that there was a 'real chance or possibility' of such an effect at the outset.[269] In either case, the court would not be permitted to take into account the fact that condemning such conduct may affect the incentives of dominant firms to invest in innovative conduct more generally.

Under the Harper Proposal, incentives for dominant firms to invest in potentially beneficial research and development may be dampened if that investment is subject not only to the risk that no marketable product will eventuate, but also to the risk that the end product will create antitrust liability for the firm. It might be possible to insure against this latter risk by seeking authorisation for design changes or new products where outcomes are uncertain at the outset.[270] The Harper Panel has recommended that corporations with substantial market power should be permitted to seek authorisation for conduct which might otherwise contravene section 46(1). As explained earlier, the original rationale for excluding unilateral conduct from the authorisation process is based on superseded theories and outdated circumstances.[271] If the Harper Proposal were adopted, the possibility of authorisation would be an important accompaniment to the amendment, so that a dominant firm might establish the legality of a strategy which is, on balance, socially beneficial.

However, the availability of such authorisation is not a complete answer to the weaknesses in the Harper Proposal outlined above. For example, some business strategies cannot reasonably be put on hold for extended periods pending the outcome of an

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[269] See Part VI(D) above.

[270] See Chap 3 Part III(B) herein.

[271] Ibid.

authorisation application.[272] To the extent possible, it would be preferable to adjust the legal standard itself to reduce the risk of liability for conduct that is, on balance, likely to improve long-term consumer welfare.

IX. CONCLUSION

The key weakness of the Australian SLC test is that it would expose all types of dominant firm conduct to the same potential liability on the basis of its actual, ex post effects. The *risk* of liability in this respect may deter dominant firms from engaging in some socially beneficial practices, where there is doubt as to what the actual effects of that conduct might be, or as to how those effects might be interpreted by a court. In this respect, the SLC test resembles the relatively expansive approach to unilateral conduct under the *EC Guidance Paper*.

Other effects-based tests considered in this chapter take account of the risk of disincentive effects by altering the applicable test according to the category of conduct to take into account decision theoretic principles. Alternatively, as Salop proposes, it may be preferable to assess unilateral conduct on an ex ante basis, having regard to information reasonably available to the dominant firm at the time it engaged in the conduct, in cases where the outcomes of conduct are unpredictable at the outset.

By contrast, the proposed SLC test would apply uniformly to all dominant firm conduct, exposing the dominant firm to liability for all types of conduct on the basis of its actual, ex post effects. In this respect, the SLC test is a much blunter instrument than the US proposals for effects-based tests considered in this chapter, which may discourage some good conduct with the bad.

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[272] See Fisse, above n 170, 13.

CHAPTER 6: AN 'OBJECTIVE ANTICOMPETITIVE PURPOSE' STANDARD FOR UNILATERAL CONDUCT

I. INTRODUCTION

In November 2015, the Federal Treasurer expressed concern that the Australian debate over the law against misuse of market power had become 'binary', with the key parties respectively insisting on two diametrically opposed approaches, either 'the full Harper or the no Harper'.[1] Accordingly, in December 2015, the Treasury released a Discussion Paper, which sought to 'reinvigorate the debate' on the Harper Proposal,[2] 'with a view to bringing parties closer together on the misuse of market power provision'.[3] As explained in Chapters 4 and 5, the respective positions in this debate are briefly as follows.

Under the current provision, the 'take advantage' requirement focuses on the profitability of the impugned conduct for the dominant firm, and particularly the connection between that profitability and the firm's substantial market power, to determine whether conduct is anticompetitive.[4] The Harper Panel reached the conclusion that the 'take advantage' requirement has proved uncertain and under-inclusive as a test for identifying unilateral anticompetitive conduct.[5] The analysis in Chapter 4 supports that view. Importantly, the under-inclusiveness of the current standard means that rivals and potential rivals of dominant incumbents are likely to be prevented or deterred from engaging in some socially beneficial, competitive conduct.

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[1] Fleur Anderson, 'Scott Morrison to Consider "Part-Harper" Option For the Effects Test', *The Australian Financial Review* (online), 24 November 2015 <http://www.afr.com/news/politics/scott-morrison-to-consider-a-part-harper-option-for-the-effects-test-20151124-gl6dad>.

[2] The 'Harper Proposal' is defined in Chap 5 Part V(A) herein.

[3] The Treasury (Cth), *Options to Strengthen the Misuse of Market Power Law: Discussion Paper* (December 2015).

[4] See Chap 4 Parts IV–VIII herein.

[5] Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) ('*Harper Final Report*'), 338–9.

By contrast, the SLC test proposed by the Harper Panel would allow courts to focus on the effect or likely effect of the impugned conduct on rivalry in a market.[6] However, large retailers and some commentators have argued that this test creates uncertainty for dominant firms, whose board and management cannot be expected to predict accurately the actual outcome of every strategy, and cannot be certain of how a court may interpret the mixed outcomes of conduct after the fact, even if the strategy was an attempt to 'compete on the merits'.[7] While the criticisms of the Harper Proposal in the press have been overstated, the analysis in Chapter 5 concluded that the SLC test is likely to reduce dominant firm incentives to engage in *some* socially beneficial conduct, particularly where the outcomes of the conduct are unpredictable at the outset. It is also arguable that the SLC test would create uncertainty regarding the boundaries of lawful pricing for a dominant firm.

These seemingly intractable positions in Australia mirror the contest between competing unilateral conduct standards in the international antitrust arena, as evidenced by the comparative analysis of proposals from other jurisdictions in Chapters 4 and 5. Internationally, most commentary in this area highlights the difficulty in distinguishing aggressive competition (which society prizes) from anticompetitive exclusionary conduct (which should be condemned), and emphasises the differences between the major approaches proposed for the characterisation of exclusionary conduct.[8]

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[6] The 'purpose' limb of the Harper Proposal is discussed in Part III below.

[7] See Business Council of Australia, *Submission on Options to Strengthen the Misuse of Market Power Law* (February 2016) 7, 26–7. See also Graeme Samuel and Stephen King, 'Competition Law: Effects Test Would Have Shackled Competition' *Australian Financial Review* (online), 9 September 2015 <http://www.afr.com/opinion/competition-law-effects-test-would-have-shackled-competition-20150908-gjhq5l>; Marianna Papapakis, 'Harper "Effects Test" Will Hurt Business; Lawyers', *Australian Financial Review* (online), 31 March 2015 <http://www.afr.com/business/legal/harpers-effects-test-will-hurt-business-lawyers-20150401-1mbnle>.

[8] See, eg, Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 114; Einer Elhauge, 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 268 *et seq*; Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311, 312; John Vickers, 'Abuse of Market Power' (2005) 115 *Economic Journal* 244, 252–3.

This chapter seeks to do the opposite. In this chapter, it is argued that, despite the apparent differences between the key proposals in this area, a common thread can be identified. In particular, each of these proposals reveals a central concern, not with the actual effect of the conduct, or with its profitability for the dominant firm or the firm's subjective intent, but with the *objective purpose* of the impugned conduct. There is in fact a unifying theme, an implicit norm, at work in the proposals for unilateral conduct standards. The implicit norm is that a firm should not engage in conduct which has the *purpose, objectively assessed*, of creating, protecting or enhancing monopoly power by suppressing rivalry, without creating proportionate benefits for consumers ('an objective anticompetitive purpose').

For the Australian debate, this approach offers a potential compromise, or third way, between the existing 'take advantage' standard under section 46(1) and the SLC test proposed by the Harper Panel. It is submitted that, as a stand alone standard for unilateral anticompetitive conduct, and having regard to likely error costs, administrability and business certainty, a standard which focuses on whether the unilateral conduct had an objective anticompetitive purpose is preferable to both profit-focused and effects-based approaches.

This chapter proceeds as follows. Part II defines the key terms, including objective and subjective purpose. Part III explains the general opposition to a unilateral conduct standard based on the dominant firm's subjective intent or purpose, as well as the origins of the focus on subjective purpose under the Australian competition legislation. Part IV analyses the case law in respect of a different category of purpose which has been relevant in this area, namely 'legitimate business purpose'. Part V outlines the various 'signposts' to an objective anticompetitive purpose standard in the existing proposals for, and commentary on, unilateral anticompetitive conduct laws. It also revisits the underlying rationale of unilateral conduct laws and explains the significance of the objective purpose of unilateral conduct with reference to that rationale. Part VI argues that, as a stand-alone standard for unilateral anticompetitive conduct, a standard based on objective anticompetitive purpose is superior to both the profit-focused and effects-based approaches advanced to date.

II. PURPOSE, INTENT AND MOTIVE DEFINED

One unfortunate feature of the antitrust commentary in this area is a frequent lack of precision in the use of the terms 'purpose', 'intent' and 'motive', as well as a lack of specificity about the type of purpose, intent or motive under consideration. While these terms are sometimes used interchangeably in the commentary, it is submitted that each has a distinct meaning.

In this chapter, they are defined as follows. 'Motive' is the impulse or desire which drives a person to behave in a certain way, but it need not be conscious to the individual mind.[9] 'Intent' refers to the person's 'psychological attitude to engaging in particular conduct'.[10] For present purposes, it is taken to mean a person's conscious desire, or acceptance, that certain things will occur as a result of the person's act or omission. 'Purpose' means the end or goal which a person seeks to achieve by their act or omission.[11]

Clearly there is some overlap between these concepts, each of which explains a person's conduct and particularly the reasons for that conduct. Nonetheless each plays a different role in explaining that conduct. A person may, for example, be driven by greed, or the desire to enrich oneself (the motive), to remove a charity collection box from a café (the conduct) with the conscious desire to take the box and treat the contents as their own (the intent) to achieve the goal of possessing the funds necessary to buy a mobile phone (the purpose).

Competition law is generally unconcerned with motives.[12] Competition law seeks to protect the process of competition, which is considered to create certain benefits for

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[9] Donald Robertson, 'The Primacy of "Purpose" in Competition Law – Part 1' (2002) 9 *Competition and Consumer Law Journal* 101, 118; *News Ltd v South Sydney District Rugby League Football Club Ltd* (2003) 215 CLR 563, 573 [18] (Gleeson CJ) ('*South Sydney*').

[10] Robertson, 'Primacy of "Purpose"– Part 1', above n 9, 116–7.

[11] *South Sydney* (2003) 215 CLR 563, 573 [18] (Gleeson CJ).

[12] In *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 194 ('*Queensland Wire*'), Deane J held with regard to the existing wording of *TPA* s 46(1), that

> it is not to the point that that degree of market power was acquired by praiseworthy means (eg hard work, efficiency, product quality and service) or that the anti-competitive purpose is inspired by altruistic or even patriotic motives (eg to avoid the consequences to the small trader

society. If a firm engages in a practice – for example, forming a cartel with its rivals or fending off potential rivals through predatory pricing – it should be irrelevant that the firm was motivated by the desire to protect its employees from redundancy,[13] or preserve the culture or standards of a long-running sporting event,[14] or the desire to secure performance bonuses for top management. Antitrust is concerned with protecting the proper functioning of the competitive process and not the impulses that prompt firms to hinder that process.

Intent is sometimes described as general or specific. 'General intent' refers to the intent to engage in the immediate act in question: for example, taking the collection box from the café.[15] 'Specific intent' refers to the intention that the act will achieve a certain end: for the contents of the box to be treated as one's own, for example.[16] In the context of unilateral anticompetitive conduct, the issue is generally whether the firm possessed specific, rather than general, intent. It would be unusual for a firm to change its price or set terms of trade by accident, but a firm might, for example, possess the general intent to lower its price, with or without the specific intent to drive its rival out of business.[17]

With regard to purpose, it is possible to distinguish between subjective and objective purpose. 'Subjective purpose' means the end which the relevant person actually seeks to achieve. Proof of subjective purpose requires direct or indirect evidence of that

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of irrational and extreme price competition or to protect local standards and employment).

See Robertson, 'Primacy of "Purpose"– Part 1', above n 9, 118, contrasting the statements regarding 'purpose' and 'motivation' in *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 134; *South Sydney District Rugby League Football Club Ltd v News Ltd* (2001) 181 ALR 188.

[13] See the discussion of the *Coal Vend Case* in Chap 3 Part II(A)(2) herein.

[14] See *South Sydney* (2003) 215 CLR 563.

[15] See Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 57–8.

[16] Ibid.

[17] Reference is sometimes made to 'direct' or 'indirect' intent. This is more accurately described as direct or indirect evidence of specific intent, where direct evidence refers to subjective evidence (such as testimony from the person in question; documents; correspondence etc) and indirect evidence refers to objective evidence of the specific intent (the nature of the conduct; surrounding circumstances; features of the relevant market). See, eg, *Tui Foods Limited v New Zealand Milk Corporation* (1993) 5 TCLR 406 (CA), 409.

person's actual state of mind.[18] 'Objective purpose', on the other hand, refers to a purpose determined objectively, without the need to refer to the actor's mental state. That is, it is possible to bypass claims concerning a person's actual state of mind and to 'attribute a purpose to an artificial or notional mind that is deemed responsible for some act or omission'.[19] This type of purpose may be deduced from the nature of the act or omission, and the surrounding circumstances.[20] To be clear, this is not a matter of using indirect or objective evidence to prove a person's actual state of mind.[21] Under an objective standard, these factors are taken into account to determine the *nature* of conduct rather than the mind of actors.[22] In the context of unilateral anticompetitive conduct, this means that conduct would not be absolved on the basis of the actor's erroneous assessment of the likely impact of its conduct, or because the firm failed to turn its mind to the likely impact of its conduct.

Clearly there is some overlap between the concept of specific intent (a person's conscious desire, or acceptance, that something will occur as a result of that person's

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[18] *Dandy Power* (1982) 64 FLR 238, 276–7 (Smithers J).

[19] *South Sydney* (2003) 215 CLR 563, 580 (McHugh J). See also *South Sydney* (2003) 215 CLR 563, 605–6 (Kirby J), advocating an objective 'characterisation' or 'classification' of the relevant purpose; Ronald A Cass and Keith N Hylton, 'Antitrust Intent' (2001) 74 *Southern California Law Review* 657, 659.

[20] In *Dandy Power* (1982) 64 FLR 238, 276–7, Smithers J distinguished subjective purpose ('the purpose in the mind of the person who engaged in the relevant conduct') from objective purpose ('the purpose attributed to the act of engaging in that conduct and to be ascertained from the nature of that act of engaging in that conduct' which is 'looked at in the light of the surrounding circumstances').

[21] Cf Marina Lao, 'Reclaiming a Role for Intent Evidence in Monopolization Analysis' (2004) 54 *American University Law Review* 151, 202–5; Marina Lao, '*Aspen Skiing* and *Trinko*: Antitrust Intent and "Sacrifice"' (2006) 73 *Antitrust Law Journal* 171, 199–201.

[22] See, eg, Gregory J Werden, 'Identifying Exclusionary Conduct under Section 2: The "No Economic Sense" Test' (2006) 73 *Antitrust Law Journal* 413, 416–7, noting that under his proposed 'no economic sense' test for exclusionary conduct,

> *what matters are the objective economic considerations for a reasonable person*, and not the state of mind of any particular decision maker. The test does not condemn conduct undertaken because of an unreasonable belief that the conduct would have an exclusionary effect. Nor does it condemn conduct because the decision maker did not clearly focus on, or even was unaware of, what were sound economic reasons for undertaking the conduct. (emphasis added)

Rather than focusing on the 'subjective motivation' for the conduct, the test asks 'whether the conduct would have been rational but for any payoff from eliminating competition': at 426.

act or omission) and the concept of subjective purpose (the end or goal which a person seeks to achieve by their act or omission). Both concern the particular outcome to be achieved by the person's conduct. In fact, in US commentary, the terms 'intent' or 'specific intent' are often given the same meaning that is attributed to the term 'purpose' in this chapter.[23] However, the term 'purpose' is favoured here, given that this is the terminology more commonly adopted in Australian competition law and commentary.[24]

III. SUBJECTIVE PURPOSE AND INTENT

A. Introduction to Purpose and Intent in Competition Law

Since the passage of the first unilateral conduct laws, courts, commentators and legislators have given consideration to the purpose or intent of a dominant firm when characterising its exclusionary behaviour.[25] In more recent decades, this focus on purpose or intent has been criticised as irrelevant and misleading, particularly from the time the Chicago School began to exert its influence on the field in the late 1970s.[26] Competition law, it is said, is not concerned with morality, or subjective perceptions of commercial intentions, but with the actual or likely economic effect of

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[23] See, eg, Cass and Hylton, above n 19; Lao, 'A Role for Intent Evidence', above n 21.

[24] See, eg, Robertson, 'Primacy of "Purpose"– Part 1', above n 9; Kathryn McMahon, 'Church Hospital Board or Board Room?: The Super League Decision and Proof of Purpose under Section 4D' (1997) 2 *Competition and Consumer Law Journal* 129.

[25] See, eg, *Standard Oil Co v United States*, 221 US 1, 75–7 (1911); *United States v American Tobacco Co*, 221 US 106, 182 (1911); *Chicago Board of Trade v United States*, 246 US 231, 238 (1918); *Northern Pacific Railway Co v United States*, 356 US 1, 8 (1958); Barry E Hawk, 'Attempts to Monopolize-Specific Intent as Antitrust's Ghost in the Machine' (1973) 58 *Cornell Law Review* 1121, 1125 *et seq*. See also the discussion of the *Coal Vend Case* in Chap 3 Part II(A)(2) herein.

[26] See, eg, Richard A Posner, *Antitrust Law* (University of Chicago Press, 2nd ed, 1976) 214–6; *Ball Memorial Hospital, Inc v Mutual Hospital Insurance, Inc*, 784 F 2d 1325, 1339 (1986); *Barry Wright Corporation v ITT Grinnell Corporation*, 724 F 2d 227, 232 (1983). See also Lawrence A Sullivan, 'Economics and More Humanistic Disciplines: What Are the Sources of Wisdom of Antitrust?' (1977) 125 *University of Pennsylvania Law Review* 1214, 1229; Lao, 'A Role for Intent', above n 21, 164–8; Eleanor M Fox, 'What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect' (2002) 70 *Antitrust Law Journal* 371, 378–80; C Scott Hemphill, 'Less Restrictive Alternatives in Antitrust Law' (Public Law and Legal Theory Research Paper Series Working Paper No 15-28, New York University School of Law, November 2015) 39; Donald Robertson, 'The Primacy of "Purpose" in Competition Law – Part 2' (2002) 10 *Competition and Consumer Law Journal* 42, 47.

firm conduct.[27] Unlike a firm's subjective intentions, the effect of a firm's conduct can also be measured with the assistance of expert economists, at least in theory. Nonetheless, courts and commentators continue to refer to the purpose or intent which underlies the unilateral conduct in question.[28]

The relevance of purpose or intent in characterising unilateral conduct has been debated in the antitrust commentary. Opinions are divided between those who consider that purpose or intent has a critical, but currently underrated, role to play in the characterisation of unilateral anticompetitive conduct,[29] and those who argue that considerations of purpose or intent are at best a distraction and at worst a ground for wrongly condemning procompetitive conduct.[30] Other commentators concede that a dominant firm's subjective purpose may occasionally prove a useful consideration, especially where the competitive impact of the conduct is ambiguous.[31]

It is submitted that, once more precise terminology is adopted and the relevant commentary more carefully analysed, there is actually significant consensus about the role of purpose or intent in the assessment of unilateral conduct. At the outset, it is generally accepted that liability should not be based on a firm's subjective intention to harm or eliminate rivals alone, since this intention may be consistent with procompetitive conduct.[32] Even if the test is reframed to consider whether the firm

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[27] See *Queensland Wire* (1989) 167 CLR 177, 194 (Deane J); Herbert Hovenkamp, *Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 51; Robertson, 'Primacy of Purpose – Part 2', above n 26, 43; Donald Robertson, 'Taking Advantage of Market Power in a Modern Economy' (2004) 10 *New Zealand Business Law Quarterly* 26, fn 46; Hemphill, above n 26, 39.

[28] See, eg, Robertson, 'Primacy of "Purpose"– Part 1', above n 9; Lao, 'A Role for Intent Evidence', above n 21; McMahon, above n 24; Cass and Hylton, above n 19; *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 US 585, 608 (1985).

[29] See, eg, Lao, 'A Role for Intent Evidence', above n 21; Cass and Hylton, above n 19; McMahon, above n 24.

[30] See, eg, Posner, above n 26, 214-6; Frank H Easterbrook, 'Monopolization: Past, Present, and Future' (1992) 61 *Antitrust Law Journal* 99, 102-3, 106. See also Michael Quinn, 'Predatory Pricing Strategies: The Relevance of Intent Under Antitrust, Unfair Competition and Tort Law' (1990) 64 *St John's Law Review* 607, 617, 628.

[31] See, eg, David McGowan, 'Networks and Intention in Antitrust and Intellectual Property' (1999) 24 *Journal of Corporation Law* 485, 516.

[32] See Part III(B) below.

acted with the purpose of harming the competitive *process* – along the lines of the 'purpose' limb in the Harper Proposal – a focus on subjective purpose still gives rise to difficulties in proving corporate intention.[33] There is also the more fundamental problem that the actual 'state of mind' of the relevant agents of a corporation is not a consistent predictor of the type of harm which unilateral conduct rules are intended to address.[34]

But this does not mean that all considerations of purpose are redundant. On the contrary, an analysis of the underlying rationale for unilateral conduct rules, and the tests proposed for the characterisation of unilateral conduct, reveal a fundamental concern with the *objective* purpose or rationale of the conduct. Unilateral conduct rules are not intended to condemn the possession of substantial market power, but only a certain method of preserving or enlarging that power which is considered to damage social welfare: that is, the extension of market power by the suppression of competitive responses by the firm's rivals or potential rivals and not by improvement of the firm's efficiency, performance or innovation to the benefit of consumers.[35] The adoption of such a method of maintaining market power is evident in the inherent design of the conduct.[36] It can be ascertained objectively, having regard to the nature of the conduct in the relevant market context. The role of 'objective anticompetitive purpose' is explained further in Part IV(C) below.

B. Subjective Purpose or Intent to Harm Competitors

Antitrust courts and commentators have often disparaged considerations of a dominant firm's subjective purpose or intent as potentially misleading in unilateral

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[33] See Part III(C) below.

[34] Posner, *Antitrust Law*, above n 16, 214–5. As explained in Part Part III(C) below.

[35] See Chap 2 herein.

[36] In *Dandy Power* (1982) 64 FLR 238, 277, Smithers J described an objective purpose as 'the *purpose to be attributed to the act* of engaging in the relevant conduct as revealed by the nature and character of that act', noting that

> the plaintiff will succeed in establishing the relevant purpose if it proves that the overt acts done in the course of engaging in the conduct were *intrinsically of such a character that it is proper to infer therefrom that the purpose of the engaging in those acts* was substantially to lessen competition in a relevant market. (emphasis added)

anticompetitive conduct cases.[37] Fact finders, it is said, might be overly impressed by evidence of aggressively competitive intent and misconstrue it as an indication of an anticompetitive plot.[38] Some commentators concede that there may be a role for subjective purpose in a limited range of unilateral conduct cases, as explained in the following section. However, there is substantial consensus that antitrust liability should not generally be triggered by a certain type of purpose or intent, in particular, a dominant firm's subjective purpose, or specific intent, to damage or eliminate its competitors ('eliminatory purpose or intent').

A number of US monopolisation cases have emphasized that evidence of a firm's eliminatory intent is not only insufficient to establish antitrust liability, but may be entirely consistent with the very competition which antitrust legislation seeks to promote.[39] In *Ball Memorial Hospital, Inc v Mutual Hospital Insurance, Inc*,[40] the Seventh Circuit of the US Court of Appeals pointed out that harm to rivals is an inevitable side effect of procompetitive behaviour:

> Competition is a ruthless process. A firm that reduces cost and expands sales injures rivals—sometimes fatally. The firm that slashes costs the most captures the greatest sales and inflicts the greatest injury. The deeper the injury to rivals, the greater the potential benefit. These injuries to rivals are byproducts of vigorous competition, and the antitrust laws are not balm for rivals' wounds.[41]

It is acknowledged that rivals will be harmed by competitive behaviour and aggressive competitors are aware of this as a likely outcome. As the Seventh Circuit stated in *A A Poultry Farms, Inc v Rose Acre Farms, Inc*: [42]

> Rivalry is harsh, and consumers gain the most when firms slash costs to the bone and pare price down to cost, all in pursuit of more business. Few firms cut price unaware

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[37] See Posner, above n 26, 214; Robertson, 'Primacy of Purpose – Part 2', above n 26, 50–1. But see Nazzini, above n 15, 64.

[38] Ibid; Hovenkamp, *Antitrust Enterprise*, above n 27, 178; Cass and Hylton, above n 19, 711–2.

[39] See, eg, *Barry Wright Corporation v ITT Grinnell Corporation*, 724 F 2d 227, 232 (1983).

[40] 784 F 2d 1325 (1986).

[41] Ibid 1338.

[42] 881 F 2d 1396 (1989).

> of what they are doing; price reductions are carried out in pursuit of sales, at others' expense. … If courts use the vigorous, nasty pursuit of sales as evidence of a forbidden "intent", they run the risk of penalizing the motive forces of competition. … Almost all evidence bearing on "intent" tends to show both greed-driven desire to succeed and glee at a rival's predicament.[43]

Even the fact that a firm is motivated by hostility, or 'pure malice',[44] towards its rivals does not distinguish anticompetitive conduct from procompetitive.[45]

These views on the inevitability of damage to rivals in the competitive process have been endorsed in the Australian case law on misuse of market power. As Mason CJ and Wilson J observed in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* ('*Queensland Wire*'):[46]

> Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to "injure" each other in this way. This competition has never been a tort … and these injuries are the inevitable consequence of the competition s 46 is designed to foster.[47]

Gleeson CJ and Callinan J echoed this view in *Boral Besser Masonry Ltd v ACCC*,[48] adding:

> A rational business firm seeks to maximise profit and to increase its share of the market. However, the very nature of such conduct is detrimental to other competitors in the market and may cause some of those competitors to leave the market.[49]

Even those who advocate a central role for purpose in the assessment of unilateral conduct acknowledge that eliminatory intent alone should not be a ground for

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[43] Ibid 1401–2.

[44] *Brooke Group Ltd* v *Brown & Williamson Tobacco Corp,* 509 US 209, 225 (1993).

[45] *Olympia Equipment Leasing Company v Western Union Telegraph Company*, 797 F 2d 370, 379 (1986); Easterbrook, 'Past, Present, and Future', above n 30, 102–3.

[46] (1989) 167 CLR 177.

[47] Ibid 191.

[48] (2003) 215 CLR 374.

[49] Ibid 458.

liability.[50] The critical point is that vigorous, socially-beneficial competition necessarily harms, and may ultimately exclude, less efficient competitors.[51] The fact that a dominant firm acts with the specific intent to achieve, or the subjective purpose of achieving, this end does not distinguish anticompetitive conduct from procompetitive conduct. A test which relies on eliminatory intent is not a sound basis for a unilateral conduct standard.

C. Subjective Purpose of Hindering the Competitive Process

While competitors may be harmed by vigorous competition, they are also harmed when a dominant firm adopts strategies aimed at hindering the competitive process. Some commentators have argued that evidence of a dominant firm's subjective purpose to harm the competitive *process* may play a useful role in characterisation in certain kinds of unilateral conduct cases.[52] Such evidence may be especially relevant where objective evidence concerning the impact of the impugned conduct is ambiguous: that is, where it is difficult to discern the likely outcome of the conduct from an effects analysis alone.[53] For example, in considering whether a firm accused of predatory pricing will be able to recoup its losses from below-cost pricing by charging supracompetitive prices, it may be relevant, at least in close cases, that the firm itself was aware that it was pricing below cost and expected to profit from it.[54] In

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[50] *William Inglis & Sons Baking Co v ITT Continental Baking Co*, 668 F 2d 1014, 1028 (9th Cir 1981); Robertson, 'Taking Advantage', above n 27, 35, 36; Lao, 'A Role for Intent Evidence', above n 21, 200; Paul G Scott, 'The Purpose of Substantially Lessening Competition: The Divergence of New Zealand and Australian Law' (2011) 19 *Waikato Law Review* 168, 180–31. See also Okeoghene Odudu, 'The Role of Specific Intent in S 1 of the Sherman Act: A Market Power Test?' (2002) 25 *World Competition* 463, 484–35.

[51] See Robert H Bork, *The Antitrust Paradox* (Basic Books, 1978) 39.

[52] See Daniel J Gifford, 'The Role of the Ninth Circuit in the Development of the Law of Attempt to Monopolize' (1986) 61 *Notre Dame Law Review* 1021, 1021–3.

[53] See Hovenkamp, *Antitrust Enterprise*, above n 27, 52; Geoff Edwards, 'The Perennial Problem of Predatory Pricing: A Comparison and Appraisal of Predatory Pricing Laws and Recent Predation Cases in the United States and Australia' (2002) 30 *Australian Business Law Review* 170, 190–1. See also Hemphill, above n 26, 42, favouring the use of a 'less restrictive alternative' test where the evidence of anticompetitive effect is ambiguous.

[54] See Edwards, 'Perennial Problem of Predatory Pricing', above n 53, 190–1; John R Allison 'Ambiguous Price Fixing and the Sherman Act: Simplistic Labels or Unavoidable Analysis' (1979) 16 *Houston Law Review* 761, 767.

these circumstances, the alleged predator may be in the best position to predict the likely losses from its below-cost pricing and its chances of profiting from the strategy.

Evidence that the firm possessed the subjective purpose of harming the competitive process might also be relied on as a *substitute* for proof of anticompetitive effect in cases where there is a high risk of under-deterrence from a rule which requires a demonstration of anticompetitive effect.[55] This category of conduct includes certain types of 'plain' or 'naked' exclusion, where the dominant firm engages in exclusionary conduct with the sole purpose of suppressing rivalry.[56] In these circumstances, it may be unreasonably costly to prove the actual harm caused by the conduct where there is no plausible procompetitive justification for the conduct.[57]

On the other hand, some have argued that it would be reasonable to require proof of subjective purpose *in addition to* proof of anticompetitive effect in cases where there is a high risk of over-deterrence. Hovenkamp, for instance, contends that proof of subjective intent to harm to the competitive process should be required in cases concerning product design changes which create some improvement for consumers, but also exclude rivals to a certain extent.[58] He argues that innovative activity of this kind is so valuable to society, and the potential cost of 'false convictions' so great, that the conduct should only be condemned if it is established that the design change was a 'sham' intended to hamper rivalry in the market.[59]

Notwithstanding the recognition of the potential role of subjective purpose in these limited situations, the weight of academic opinion is against a general requirement of subjective purpose in all cases.[60] At the outset, a general test based on subjective purpose is not well aligned with the central objective of competition law, namely the protection of the competitive process.[61] Expressions of the state of mind of the

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[55] Nazzini, above n 15, 60–1.

[56] Ibid 60–2. See also the discussion of 'plain' exclusion in Chap 4 Part VI(D).

[57] Ibid 61.

[58] Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1039.

[59] Ibid. See also Nazzini, above n 15, 60.

[60] See Lao, 'A Role for Intent Evidence', above n 21, 152, n1; Nazzini, above n 15, 65.

[61] See *South Sydney* (2003) 215 CLR 563, 579 [38], 605 [127].

relevant actors rarely address the critical question whether the proposed conduct is likely to extend the firm's market power by suppressing the competitive responses of rivals, but are more likely to relate to the firm's eliminatory intent or a desire to protect its market share, both of which may cause no harm to the competitive process.[62]

The mental states of the dominant firm's officers and employees – their own perceptions of the competitive impact of the firm's conduct – do not determine the likelihood that the firm's conduct will have an adverse effect on the competitive process.[63] The critical issue is the nature of the conduct in the context of the relevant market and not the dominant firm's awareness of the nature of that conduct. [64]

A rule which conditions liability on proof of subjective purpose in all cases may also fail to capture important instances of anticompetitive conduct and create perverse incentives for dominant firms. The Full Court of the Federal Court observed in *Universal Music Australia Pty Ltd v ACCC*:[65]

> The purpose of a corporation is a legal fiction. A corporation has no mind and can have no purpose, in the usual sense of that word. Its activities will necessarily reflect the purposes of the individuals who make the decisions which control those activities. In the case of most corporations, this will be a group rather than a single individual. ...

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[62] See Posner, above n 26, 214–5.

[63] Cass and Hylton, above n 19, 697, 712. See also Easterbrook, 'Past, Present, and Future', above n 30, 106, commenting that the Court in *Matsushita Electrical Industries Co v Zenith Radio Corp*, 475 US 535 (1985) 'casts aside all inquiries into intent, viewing the subject as too ambiguous to be useful. It uses objective criteria to search for actual or potential injury to consumers'.

[64] Robertson, 'Primacy of Purpose – Part 2', above n 26, 51–2. In respect of section 2 of the *Sherman Act*, the American Bar Association, 'Joint Comments of the American Bar Association Section of Antitrust Law and Section of International Law on the Australian Competition Policy Review Issues Paper', Submission to the Harper Review (2014) 7, stated that:

> Modern US decisions hold that it is not subjective intent but objective intent that is relevant, and that intent can be inferred from conduct and effect. The focus of the US courts is on evidence of monopoly power and proof of exclusionary conduct. (citations omitted)

[65] (2003) 131 FCR 529.

> The members of the group will often have differing reasons for arriving at a decision, some spoken and some unspoken.[66]

While the claim that 'the purpose of a corporation is a legal fiction' should be challenged,[67] it is true that, under a subjective purpose test, plaintiffs face the signficant evidentiary hurdle of proving corporate intent in circumstances where evidence of the intentions and purposes of various employees and officers of the firm often vary considerably.[68]

Requiring proof of subjective anticompetitive intent or purpose may also create the wrong incentives for dominant firms, encouraging firms to conceal evidence of anticompetitive plans and adopt 'correct' semantic descriptions for their strategies, rather than alter the substantive nature of those strategies. In this way, a subjective purpose test is said to favour sophisticated, well-counselled firms over the more naïve.[69]

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[66] Ibid 587. See also *ACCC v Cement Australia Pty Ltd* (2013) 310 ALR 165, 745–6 [3005]–[3006] ('*Cement Australia*'): 'The subjective purpose of the relevant actors (with the relevant decision-making authority) must be made good by the applicant, either by direct evidence on the question or by evidence of facts from which an inference might be drawn of subjective purpose based upon statements, emails, documents and actions, the subject of probative evidence, judged in the light of common human experience.' At 746 [3010]: 'it contemplates a proscribed purpose of substantially lessening competition *subjectively* held by someone or perhaps a number of people within the corporation, and the operative connection between those individuals and the corporation …'

[67] Brent Fisse and John Braithwaite, *Corporations, Crime and Accountability* (Cambridge University Press, 1993), 19, refute the notion that 'only individuals are real in the social world, while social phenomena like corporations are abstractions which cannot be directly observed'. 'Both individuals and corporations are defined by a mix of observable and abstracted characteristics' (at 19) and corporate action is 'more than the sum of its parts' (at 18). On the subject of corporate intention, the authors state (at 26):

> Although it is often said that corporations cannot possess an intention, this is true only in the obvious sense that a corporate entity lacks the capacity to entertain a cerebral mental state. Corporations exhibit their own special kind of intentionality, namely corporate policy. (citations omitted)

[68] *CCA* s 84(1)(b) provides that, where it is necessary to establish the state of mind of a corporation in respect of conduct to which s 46 applies, it is sufficient to show that a director, employee or agent of the corporation engaged in that conduct; was acting within the scope of his or her actual or apparent authority in engaging in that conduct; and had that state of mind.

[69] Posner, above n 26, 214; Cass and Hylton, above n 19, 732: 'The subjective-intent test … introduces a large payoff for legal sophistication, or more generally, strategic sophistication in a litigious

Generally speaking, then, where an objective analysis of the economic nature and effect of the conduct is possible, evidence of subjective purpose or intent is considered to add little and potentially distract attention from the real issues.

D. The Origins of the Subjective Purpose Interpretation in Part IV of the CCA

Notwithstanding these arguments against a requirement of subjective purpose, in Australia, the current misuse of market power prohibition requires proof of the dominant firm's subjective purpose.[70] Further, the 'purpose' limb in the Harper Proposal would almost certainly be interpreted as requiring proof of subjective purpose, given that 'purpose' has been interpreted in this way under the SLC test in other provisions of Part IV of the *CCA*.[71] It is useful at this point to understand why these provisions have been interpreted to require proof of subjective, as opposed to objective, purpose.

The genesis of the current interpretation of 'purpose' under Part IV of the *CCA* is to be found in the judgment of Toohey J in *Hughes v Western Australian Cricket Association (Inc)* ('*Hughes*').[72] His Honour considered the meaning of the term in the context of determining whether a provision of an 'understanding' between the relevant parties 'has the purpose, or would have or be likely to have the effect, of substantially lessening competition' under section 45(2). After reviewing the authorities, he concluded:

> I accept the view that it is the subjective purpose of those engaging in the relevant conduct with which the court is concerned. All other considerations aside, the use in s 45(2) of 'purpose' and 'effect' tends to suggest that a subjective approach is intended by the former expression.

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environment.' See also Mark Berry, 'Competition Law' [2006] *New Zealand Law Review* 599, 608–9; McGowan, above n 31, 514–6.

[70] See *ACCC v Pfizer Australia Pty Ltd* (2015) 323 ALR 429, 444 [47] ('*Pfizer Australia*'); *Cement Australia* (2013) 310 ALR 165, 513 [1913], 745–6 [3005]–[3006]; *Eastern Express Pty Limited v General Newspapers Pty Limited* (1992) 35 FCR 43, 66 ('*Eastern Express*').

[71] As explained in the following discussion.

[72] (1986) 19 FCR 10, 37–8.

Implicitly, the legislature must have intended to distinguish the concept of 'purpose' from the concepts of 'effect' and 'likely effect'.[73] Since the determination of effect and likely effect require an analysis of the objective impact or 'substantive effect' of the conduct, it was unlikely that the legislature intended to create an additional ground of liability based on objective purpose, which would also require an analysis of the 'substantive effect' of the conduct.[74] According to this view, the reference to 'purpose' must therefore give rise to a different type of enquiry, namely a subjective enquiry. (The view that considerations of objective purpose are the same as, or made redundant by, considerations of effect or likely effect is challenged later in this chapter.)[75]

In *ASX Operations v Pont Data (No 1)*,[76] the Full Federal Court adopted the reasoning of Toohey J with regard to the interpretation of 'purpose' in section 45(2).[77] In *Universal Music Australia Pty Ltd v ACCC*,[78] the Full Federal Court also favoured this approach for the interpretation of 'purpose' under section 47(10).

In respect of the misuse of market power prohibition in section 46(1), the question whether the requisite purpose is to be ascertained subjectively or objectively has received relatively little detailed consideration. In *Queensland Wire*, Toohey J simply stated that:

> The reference to "for the purpose of" carries with it the notion of an intent to achieve the result spoken of in each of the paragraphs in s 46(1).[79]

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[73] See *South Sydney* (2003) 215 CLR 563, 586–7 [63] (Gummow J).

[74] Ibid.

[75] See Part V(D) below.

[76] (1990) 27 FCR 460 ('*Pont Data*').

[77] Ibid 482–3. The Court added a further consideration in favour of the subjective purpose interpretation. *CCA* s 4F, which had been inserted since the decision in *Hughes*, provided that a provision of a contract would be deemed to have a particular purpose if that provision was *included* in the contract for that purpose: at 476. In the Court's view, this indicated that one must look to the purposes of the *individuals* who included the provision in the contract, rather than the provision itself.

[78] (2003) 131 FCR 529.

[79] (1989) 167 CLR 177, 214.

In *Dowling v Dalgety Australia Ltd*,[80] Lockhart J referred to this observation, as well as the statements made by Toohey J in *Hughes* regarding the meaning of 'purpose' in sections 45 and 47, and held that:

> The determination of purpose for the purposes of s 46 is to be ascertained subjectively, in the sense of ascertaining the intent of the corporation in engaging in the relevant conduct ... "Purpose" in s 46 is not concerned directly with the effect of conduct, but with purpose in the sense of motivation and reason, though, as mentioned earlier, purpose may be inferred from conduct ...[81]

This statement has since been cited in numerous cases as authority for the proposition that section 46(1) is concerned with subjective purpose.[82]

Nonetheless, some judges have expressed doubt about the subjective interpretation given to purpose under Part IV. In *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* ('*Dandy Power*'),[83] Smithers J observed, *obiter*, that the reference to 'purpose' in section 47(10) was likely a reference to objective purpose on the basis that the relevant purpose was the 'purpose which the engaging in the relevant conduct "has"',[84] rather than a purpose possessed by a person.[85]

However, in *Universal Music Australia Pty Ltd v ACCC*,[86] the Full Federal Court rejected this reasoning, holding that section 47(10) required proof of the actual, subjective purpose of the relevant respondent.[87] In particular, the Court distinguished legislation which refers to the purpose of a contract or arrangement (which may require demonstration of objective purpose) from legislation, such as section 47(10), which requires the court to ascertain 'the purpose for which conduct was engaged in

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[80] (1992) 34 FCR 109.

[81] Ibid 143.

[82] See *Pfizer Australia* (2015) 323 ALR 429, 444 [47]; *Cement Australia* (2013) 310 ALR 165, 513 [1913], 745–6 [3005]–[3006]; *Eastern Express* (1992) 35 FCR 43, 66.

[83] (1982) 64 FLR 238.

[84] Ibid 276 (emphasis added).

[85] See also *Trade Practices Commission v TNT Management Pty Ltd* (1985) 6 FCR 1, 75 (Franki J).

[86] (2003) 131 FCR 529.

[87] Ibid 588 [255]–[256].

by a party'. In the court's view, '[i]t would make no sense to consider that issue without paying regard to the direct and indirect evidence as to the actual intentions and purposes of the party'.[88] While an inference as to purpose is drawn from all of the circumstances of the conduct, including the objective circumstances, that inference is nonetheless 'as to the purpose of the particular respondent, not of some hypothetical bystander'.[89]

Later, in *News Ltd v South Sydney District Rugby League Football Club Ltd*,[90] McHugh J expressed his preference for an objective purpose test under section 45(2), having regard, inter alia, to the object of the competition legislation. His Honour pointed out the difficulty in discerning the subjective purpose of a provision in a contract, arrangement or understanding under section 45, given the differing purposes for which the various parties may have included that provision.[91] Further, in his Honour's words, an objective approach to purpose

> seems more in accord with the Act's object of promoting competition, an object that is weakened if what is objectively anti-competitive conduct escapes proscription only because the parties did not in fact intend to achieve such a proscribed purpose.[92]

McHugh J went on to explain the nature of an objective purpose test. He observed that, in some cases,

> the tribunal of fact must attribute a purpose to an artificial or notional mind that is deemed responsible for some act or omission. In such contexts, the tribunal of fact deduces the purpose of the artificial or notional person from the background of the act or omission including relevant statements and what was done or not done.[93]

His Honour concluded that, if the purpose element in section 45(2) were being considered for the first time, he would prefer the view that the purpose of the

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[88] Ibid 588-9 [256].

[89] Ibid 589 [256].

[90] (2003) 215 CLR 563.

[91] Ibid 579 [38].

[92] Ibid.

[93] Ibid 580 [40].

impugned provision should be 'determined objectively without regard to the mental state of the parties who made the provision'. However, recognizing that the subjective interpretation had stood for 17 years and that the term 'purpose' in section 45(2) was clearly open to such a construction, his Honour considered that this authority should not be overruled.[94]

In the same case, Kirby J went further, expressing the dissenting view that the relevant line of authority in the Federal Court was wrong and that, for the purposes of section 45(2), an objective approach to 'purpose' should be preferred.[95] In support of this view, his Honour relied on both the text of the statutory provision, which required an assessment of the purpose of a 'provision', and on policy grounds, having regard to the purpose of the Act itself. In relation to the latter, his Honour observed that:

> a subjective test might effectively allow parties an unwarranted escape from the provisions of the Act, defeating the attainment of its important national purposes. It would not make much sense to allow parties to enter anticompetitive ''arrangements'' and then to escape the consequences because their subjective purposes were something other than anticompetitive. Such a construction would defeat attainment of the economic objectives of the Act.[96]

The approach favoured by Kirby J would require an objective characterisation or classification of the relevant purpose:[97] this is an 'objective construct, deduced by a court when obliged to characterise the "purpose" in question', as opposed to the subjective purpose of the parties to the arrangement.[98] However, even in the case of an objective characterisation, it would 'still be necessary to take into account any admissible evidence of the subjective purposes of the relevant actors'.[99]

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[94] Ibid 580 [41]-[43].

[95] Ibid 606 [130].

[96] Ibid 605 [127].

[97] Ibid 605 [126], 606 [130].

[98] Ibid 605 [126].

[99] Ibid 606 [130].

This analysis of the jurisprudence gives rise to two important conclusions. First, a subjective approach to purpose under Part IV of the *CCA* has been preferred largely as a matter of the interpretation of the current wording of the legislation: critically, given the objective nature of the 'effect' and 'likely effect' limbs of the various provisions, the courts seem to have assumed that an objective interpretation of purpose would leave the 'purpose' limb with 'no work to do'.[100] Second, and in some contrast, in the High Court, those judges preferring an objective approach to purpose, have advanced an important normative argument in favour of this approach: that is, given the economic goals of the legislation, a corporation should not escape liability for conduct which is, by its nature, objectively anticompetitive, on the basis of its own actual but misguided (or self-preferring) assessment of the competitive nature of the conduct.[101]

E. Subjective and Objective Purpose Distinguished

Notwithstanding the consensus that the purpose required under sections 45, 46 and 47 of the *CCA* is the subjective purpose of the relevant parties, it is clear that a court is entitled to take into account objective factors in ascertaining that subjective purpose. Section 46(7) of the *CCA* specifically provides that the necessary purpose under section 46(1) may be established

> notwithstanding that, after all the evidence has been considered, the existence of that purpose is ascertainable only by inference from the conduct of the corporation or of any other person or from other relevant circumstances.

Even where there is direct evidence of the relevant person's intention, subjective purpose may be inferred from conduct,[102] and the circumstances surrounding the relevant conduct.[103] In fact, some courts have recognised that the best evidence of subjective purpose may be provided 'by looking at what was actually done', bearing

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[100] This view is challenged in Part V(D) below.

[101] Or where the anticompetitive conduct was the product of inattention by the firm, or the firm simply had no considered reason for engaging in the conduct: Hemphill, above n 26, 58.

[102] *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 143.

[103] *Hughes* (1986) 19 FCR 10, 38; *Universal Music* (2003) 131 FCR 529, 588–9.

in mind the relevant experience, knowledge and expertise of the person in question;[104] or by determining the objective effect or likely effect of the relevant conduct.[105]

Some Australian courts and commentators have suggested that, since courts are permitted to take account of these objective factors in determining subjective purpose, it may matter very little whether the test of purpose is subjective or objective: the outcome, in most cases, will be the same.[106] On the one hand, the application of a *subjective* purpose test in cases concerning a corporation requires consideration of the activities of the corporation, and the reasoning of the individuals who make the decisions which control those activities, such that a state of mind may be attributed to the corporation.[107] On the other hand, the application of an *objective* purpose test requires consideration of the activities of the corporation in the context of the relevant market, such that a state of mind may be attributed to a notional person engaging in the relevant conduct.[108] Accordingly, it is said that the distinction between these two legal fictions will often be 'blurred', and the debate about subjective and objective purposes may have 'an air of unreality', at least in connection with corporate conduct.[109]

Robertson refers to the 'sterile debate' about whether the relevant purpose[110] is subjective or objective, which, in his view, has 'consumed much judicial time to the detriment of sound competition policy analysis'.[111] He suggests that the fact that the

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[104] *Pont Data* (1990) 27 FCR 460, 482–3.

[105] *ACCC v Universal Music Australia Pty Ltd* (2001) 115 FCR 442, 568 [469], 549–50 [473]–[475], 552 [484]–[485].

[106] See, eg, *South Sydney* (2003) 215 CLR 563, 580 [44] (McHugh J); Robertson, 'Primacy of Purpose – Part 2', above n 26, 42; *Universal Music* (2003) 131 FCR 529, 587. Cf Paul G Scott, 'The Purpose of Substantially Lessening Competition: The Divergence of New Zealand and Australian Law' (2011) 19 *Waikato Law Review* 168, 184–5.

[107] *Universal Music* (2003) 131 FCR 529, 587.

[108] *South Sydney* (2003) 215 CLR 563 (McHugh J).

[109] See *Universal Music* (2003) 131 FCR 529, 587.

[110] Referring to the type of purpose required by ss 45 and 47 in respect of multilateral conduct.

[111] Robertson, 'Primacy of Purpose – Part 2', above n 26, 42.

outcome under either standard is generally the same may demonstrate 'that little is to be gained by trying to distinguish between subjective and objective purposes'.[112]

However, it is submitted that, at least in the context of section 46(1), the distinction between subjective and objective purpose is significant. It is true that under both standards courts may have regard to objective factors, such as the nature and likely effect of the conduct within the context of the relevant market. But this does not mean that the standards are equivalent. In particular, it is submitted that the nature of the ultimate enquiry under each standard is different. Each takes account of similar evidence, for a different purpose.

Under an objective standard, objective factors are taken into account to attribute a state of mind to a notional person standing in the shoes of the respondent, based on the nature of the impugned conduct in its context. The focus is on determining 'the nature of conduct rather than the mind of actors'.[113] According to Robertson's description of objective purpose:

> The ultimate issue for determination when a court is assessing purpose is: What is the economic actor *really* trying to do in commercial or economic terms? We are concerned with the commercial, not the criminal context. We are not trying to discern what people mean by having a "purpose" in everyday commercial conversations. In asking this question we are asking for an *explanation* of commercial conduct – to make the best sense we can of the conduct – not a psychological analysis of the minds of the economic agents.[114]

In contrast, under a subjective standard, objective factors are taken into account to determine the actual state of mind of the person engaging in the conduct. The evidence may be objective, but it is nonetheless used to reach a conclusion about the subjective intent of the relevant person; 'the purpose of the particular respondent'.[115]

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[112] Ibid.

[113] *Dandy Power* (1982) 64 FLR 238 (Smithers J).

[114] Robertson, 'Primacy of "Purpose"– Part 1', above n 9, 121–2.

[115] See *Universal Music* (2003) 131 FCR 529, 589 [256]:

> That inference, however, is as to the purpose of the particular respondent, not of some hypothetical bystander. That said, the objective circumstances will be of considerable (often

In this case, the focus is on testing the plausibility of any direct evidence regarding purpose.[116]

In a given case, the court may be satisfied that the direct evidence establishes that the subjective purpose of the particular corporation was not anticompetitive: for example, where there is 'a single directing mind' and clear evidence of his or her purpose.[117] If the direct evidence of the corporation's subjective purpose is strong, the fact that the conduct *by its nature* has an anticompetitive purpose will not be determinative:[118] a corporation may escape liability for conduct which is, by its nature, objectively anticompetitive, on the basis of its own actual but misguided assessment of the competitive nature of the conduct.[119] More importantly, it is submitted that the subjective purpose approach overlooks the superior logic of using objective purpose to characterise unilateral anticompetitive conduct, as explained in Part V below.

IV. 'LEGITIMATE BUSINESS PURPOSE'

Before explaining the concept of 'objective anticompetitive purpose' in more depth, one further category of purpose should be mentioned. In the case law on unilateral anticompetitive conduct, the courts have sometimes considered whether the defendant firm acted with an acceptable purpose or rationale, sometimes described as a 'legitimate business purpose'. In both the US and Australia, courts have asked whether there is a 'legitimate' explanation for allegedly anticompetitive conduct such that it should be absolved. The requisite explanation has been variously described as a

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critical) probative value in assessing whether to draw the inference.

[116] Ibid:

> Of course, proof of the required purpose is not limited to direct evidence as to those purposes. Further, the court is not bound to accept such evidence. Indeed, it will normally be critically scrutinised; it is often ex post facto and self-serving.

[117] *Universal Music* (2003) 131 FCR 529, 587 [251]. See also *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 143, where there was apparently satisfactory direct evidence of the parties' subjective purposes.

[118] Cf McMahon, above n 24, making the argument that, in certain cases, Australian courts have failed to take this approach, essentially applying an objective purpose under a 'subjective purpose' label.

[119] Cf Hemphill, above n 26, 39, arguing that 'even where firms lack any clear provable intent to behave anticompetitively, there remains an interest in halting and deterring that conduct if it has adverse effects'.

'normal business purpose';[120] 'legitimate business reasons';[121] a 'valid business reason';[122] a 'legitimate business purpose';[123] 'business rationale';[124] and 'legitimate business considerations'.[125]

All of these labels make clear that the courts are concerned to discover the underlying purpose or rationale of the impugned conduct. And yet, in the absence of further explanation as to the *type* of purpose which should absolve a dominant firm, these phrases merely beg the question. What is it that makes a purpose 'normal' or 'valid' or 'legitimate' in this context? The fact that it is considered to be a 'business' purpose cannot be determinative. Anticompetitive practices are undertaken in the course of 'business' as surely as procompetitive practices. It is submitted that the relevant, absolving purpose is improved efficiency, innovation or quality, which creates benefits for consumers, as opposed to the suppression of rivalry by competitors.[126] The importance of this particular distinction, and the objective quality of the relevant purpose, can be discerned in the case law on legitimate business purposes in the US and Australia.

In *Aspen Skiing Co v Aspen Highlands Skiing Corp* ('*Aspen*'),[127] the US Supreme Court found that the defendant ski field operator had contravened section 2 of the *Sherman Act* by terminating its joint venture with the operator of a neighbouring ski field, a joint venture which had previously enabled consumers to purchase an 'all-Aspen ticket' providing entry to all of the ski fields in the area. In reaching its conclusion, the Court stated that '[p]erhaps the most significant evidence' of

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[120] *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 US 585, 605, 608 (1985).

[121] Ibid.

[122] *Eastman Kodak Co v Image Technical Services, Inc*, 504 US 451, 483 (1992).

[123] Ibid.

[124] *ACCC v Australian Safeway Stores Pty Ltd* (2003) 129 FCR 339, 408 [329] ('*Safeway*').

[125] Ibid 409 [330].

[126] As the First Circuit of the US Court of Appeal explained in Data General Corp v Grumman System Support Corp, 36 F 3d 1147, 1183 (1st Cir 1994): 'In general, a business justification is valid if it relates directly or indirectly to the enhancement of consumer welfare.'

[127] 472 US 585 (1985).

monopolisation was the defendant's failure to persuade the jury that its conduct was 'justified by any normal business purpose'.[128]

The Court in *Aspen* emphasised the short-term sacrifice by the defendant inherent in the impugned conduct, as well as the defendant's failure to provide any convincing 'efficiency justification' for the conduct.[129] It held that, in the circumstances, the jury might well have concluded that the defendant had elected to forego the short-run benefits of offering the all-Aspen ticket 'because it was more interested in reducing competition in the Aspen market over the long run by harming its smaller competitor'.[130] That is, the objective purpose of the termination of the multi-ticket arrangement was not to improve the dominant firm's efficiency or performance but to suppress the rivalry offered by its erstwhile joint venture partner to preserve its monopoly power.[131] It was this purpose which was objectionable.

A similar process of reasoning is evident in certain Australian decisions under section 46(1), where reference has been made to the decision in *Aspen*.[132] The facts in *ACCC v Australian Safeway Stores Pty Ltd* ('*Safeway*')[133] were explained in Chapter 4.[134] On appeal, Heerey and Sackville JJ rejected the primary judge's finding that, because a non-dominant firm might just as easily have engaged in the impugned conduct, Safeway had not infringed section 46(1). According to Heerey and Sackville JJ, the primary judge's approach in this respect overlooked the critical issue of the defendant's purpose or rationale in engaging in the conduct:

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[128] Ibid 608.

[129] Ibid.

[130] Ibid.

[131] For an alternative view on the nature of the conduct in *Aspen*, see Easterbrook, 'Past, Present, and Future', above n 30, 107.

[132] See *Queensland Wire* (1989) 167 CLR 177, 193 (Mason CJ and Wilson J), noting that BHP 'did not offer a legitimate reason for the effective refusal to sell'; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, 135 [22]–[25], 136–7 [31]–[33], citing *Aspen* 472 US 585, 608 (1985); *ACCC v Boral Ltd* (1999) 166 ALR 410, 440 [158].

[133] (2003) 129 FCR 339.

[134] See Chap 4 Part IV(B)(5) herein.

> In our view, this analysis ignores the question of *why* Safeway engaged in the impugned conduct. This is not the same question as to whether one or more of the statutorily proscribed purposes existed. Before reaching that point it is necessary to look at not only what the firm did, but why the firm did it. That is why a business rationale for the conduct, independent of the question of market power, is relevant. …The rationale for the conduct is critical.[135]

Their Honours went on to examine the rationale or purpose of the defendant's conduct with reference to the objective circumstances of the case, in particular, by asking whether a firm would be likely to behave in the same way if it did not possess market power. The relevant conduct was Safeway's termination of supplies from bakery suppliers – 'plant bakers' – who supplied bread to rival supermarkets at a discount. According to their Honours:

> Its reason for doing so was to induce the plant baker to cease supplying discounted bread to an independent retailer in competition with a Safeway supermarket. As we have explained, there would have been no purpose in Safeway acting in this manner in a competitive market. On the contrary, had Safeway done so it would have inflicted economic harm on itself for no gain.[136]

In the absence of market power, a firm engaging in the same conduct 'would have produced harm for itself without any countervailing benefit';[137] that is, the non-dominant firm would have lost sales without any prospect of profiting by preserving its substantial market power. The critical consideration was the objective purpose of the conduct, inferred from the surrounding circumstances. Implicitly, the conduct was condemned because the underlying purpose of the conduct was the suppression of rivalry from competing supermarkets[138] to preserve the dominant firm's market power. Similar references to the objective purpose or rationale underlying the

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[135] Ibid 408 [329].

[136] Ibid 409 [333].

[137] Ibid 409 [330].

[138] In particular, their sale of discounted bread.

impugned conduct form a common thread throughout the case law on unilateral conduct.[139]

While these cases make the argument that the purpose or rationale underlying the conduct is critical, they have not clarified whether the mere existence of *some* 'business' explanation should absolve conduct even if that conduct is also likely to cause substantial harm to the competitive process.[140] In contrast, the objective anticompetitive purpose approach proposed in this chapter clarifies that the mere existence of a 'normal business purpose', or efficiency justification, does not automatically exempt unilateral conduct from antitrust scrutiny. Even if conduct is likely to give rise to some improvement to the firm's efficiency or the quality of its product, the conduct may have an anticompetitive purpose if its designed restraint of rivalry by competitors is disproportionate to those improvements. Thus a proportionality enquiry will sometimes be necessary to determine the true objective purpose of the conduct, as explained further in Part VI(B) below.

V. THE SIGNIFICANCE OF OBJECTIVE PURPOSE IN CHARACTERISING UNILATERAL CONDUCT

A. Signposts to Objective Anticompetitive Purpose in the Existing Law and Proposals

It is submitted that the existing case law and commentary on the characterisation of unilateral anticompetitive conduct repeatedly point to the importance of objective anticompetitive purpose in this process, although this is rarely articulated. As explained in the foregoing chapters, the common thread of objective purpose can be discerned in the following areas:

(a) Profit-focused tests – including the 'take advantage' test, the 'no economic sense' test, the 'profit sacrifice' test and the Areeda-Turner test for predatory

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[139] See the references in n 132 above.

[140] See, eg, *Pacific National (ACT) Ltd v Queensland Rail* [2006] FCA 91, [1077]–[1079], where Jacobson J found that the existence of a 'business explanation' for the conduct meant that the firm had not taken advantage of its market power, apparently without the need to consider how or why the conduct was profitable for the firm.

pricing – each represent *one method* of proving objective anticompetitive purpose in some cases, but they do not cover all significant instances of unilateral anticompetitive conduct.[141]

(b) References in the case law to 'legitimate business purposes' or 'valid business reasons' highlight the significance of the underlying purpose or rationale of the conduct, but they fail to articulate what makes a business purpose legitimate or illegitimate.[142]

(c) Advocates of an effects-based test, or 'consumer harm' test, recognise that an ex ante assessment, having regard to information reasonably available to the dominant firm at the time it engaged in the conduct, may be required in cases where the outcomes of conduct are unpredictable at the outset.[143] This is not because the direct effect of such conduct is necessarily less harmful to consumers, but because it is desirable to protect conduct which, objectively speaking, was initiated with a procompetitive purpose.

(d) There is general consensus that 'naked' or 'plain' exclusion should be condemned without the need for any detailed effects analysis.[144] This is not because, as some assert, 'no test is needed' in these cases, but because courts and commentators are applying an implicit norm, based on objective anticompetitive purpose.[145]

(e) Courts applying a subjective purpose test have increasingly focused on the objective evidence of purpose to the extent that they have been criticised for applying what is essentially a test of objective purpose.[146]

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[141] See Chap 4 Part V(A) herein.

[142] See Part IV above.

[143] See Chap 4 Part IX(C).

[144] See Chap 4 Part VI(D) herein; Part III(C) above.

[145] Ibid.

[146] See, eg, McMahon, above n 24, making the argument that, in certain cases, Australian courts have failed to take this approach, essentially applying an objective purpose under a 'subjective purpose' label.

B. A Return to the Rationale for Unilateral Conduct Rules

It is submitted that objective purpose should play a central role in the characterisation of unilateral conduct. To understand the significance of objective purpose in the application of unilateral conduct standards, it is necessary to return to the rationale which underlies these rules and antitrust's treatment of unilateral market power generally.

As explained in chapter 2, it is generally accepted that the mere existence of a monopoly causes some detriments to society. A monopolist has the power to decrease output in a market and thereby increase price to the monopoly level. In so doing, the monopolist deprives certain consumers of the opportunity to purchase the desired product at the cost of producing the product. For the sake of charging a higher price, the monopolist loses those sales and the consumers who were willing to make those purchases are forced to put their resources to a lesser use by purchasing a less desired alternative. These foregone transactions are said to represent a 'deadweight loss' to society as a whole. The existence of a monopoly may also result in lower productive efficiency as the monopolist enjoys the 'quiet life' free from competitive constraints. Monopolies also arguably reduce the rate of innovation over time.

To some extent, each of these results also ensues when firms possess 'substantial market power' in the absence of a complete monopoly.[147]

Notwithstanding these detrimental effects, antitrust laws do not prohibit the possession of a monopoly position or substantial market power per se. The reason for this is partly pragmatic: it would be very difficult to specify or identify the level of unilaterally-achieved market power which should be condemned, let alone to construct a method of divesting firms of such power without creating more serious detriments to society.

But the possession of monopoly or substantial market power is also tolerated because this power is believed to create certain benefits for society. In particular, firms often achieve and maintain such power by outcompeting their rivals with superior

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[147] See the explanation of 'substantial market power' in Chap 2 Part IX herein.

efficiency, performance and/or innovation. Substantial market power provides the incentive for firms to achieve this superior efficiency, performance and innovation, which in turn creates benefits for society as a whole. The prospect of attaining such power also provides rival firms with the incentive to outcompete the incumbent, limiting the duration of any monopoly position and offering consumers better products or services in the process.

Thus, while monopolies are acknowledged to cause some harm, the competitive process by which monopolies are created, defended and superseded is believed to produce redeeming benefits, which outweigh the potential harm.

Nonetheless, it is also possible for firms to achieve or maintain a monopoly position or substantial market power by another method – not by outcompeting their rivals, not by offering consumers a better product or service, but by preventing rivals from offering consumers a better product or service.[148] If a dominant firm can hamstring its rivals' attempts to compete, it can enjoy its position of power without creating any benefits for consumers. It can deprive consumers of the benefits of increased rivalry. In these circumstances, society suffers the harms inherent in the possession of substantial market power without enjoying any of its redeeming side effects. Unilateral conduct rules therefore target this method of maintaining or enhancing market power; that is, conduct which is designed to suppress rivalry.[149]

C. The Role of Objective Purpose in Characterising Unilateral Conduct

From these foundations, the proper role for purpose in unilateral conduct rules can be discerned. The mere fact that a dominant firm acts with the goal or purpose of achieving, maintaining or enhancing substantial market power should not be sufficient to attract condemnation. Moreover, evidence that the firm purported or intended to cause harm to its rivals is, in itself, irrelevant.

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[148] Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1038.

[149] See Chap 2 herein.

Competition law is not concerned with ethics, but with economic objectives.[150] Its central economic objective is to increase the welfare of society as a whole and consumers in particular.[151] In the context of unilateral conduct, the greatest threat to this goal occurs when firms with substantial market power adopt a certain method of protecting or enhancing that power, namely the suppression of competitive responses by rivals or potential rivals.[152]

The particular method adopted by a firm might be discerned by assessing the effect of the impugned conduct on the relevant market or markets.[153] If it is apparent that the conduct has substantially excluded competition without creating any proportionate benefits for consumers, it may be concluded that the firm has enhanced its market power by obstructing the competitive process.[154] But it is submitted that the firm's method may also be discerned by considering the *design* inherent in the impugned conduct itself: that is, by considering whether, objectively speaking, the conduct had the purpose of hindering the competitive process to prolong or enhance the firm's market power.[155] The firm's acts or omissions, in context, reveal their design.

For these reasons, a dominant firm should be prevented from engaging in conduct which has the objective purpose of suppressing the competitive responses of its rivals to prolong or enhance its market power. It is not sufficient to demonstrate that the firm acted with the purpose of protecting or increasing its market power alone; nor is it sufficient to prove that the firm intended to harm or eliminate its rivals.[156] What is required is proof that the dominant firm acted with the objective purpose of

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[150] Robertson, 'Primacy of Purpose – Part 2', above n 26, 42–3.

[151] See Chap 2 Part III(E) herein.

[152] See Chap 2 herein.

[153] As explained in respect of 'effects-based tests' for unilateral conduct in Chap 5 herein.

[154] See Chap 5 Part III(B), explaining Hovenkamp's 'disproportionality' definition.

[155] As explained further below, it is necessary to establish both the ultimate purpose (prolonging or enhancing market power) and the intermediate purpose (suppressing rivalry by competitors), for, it is submitted, the chosen method of achieving the ultimate purpose is a purpose in itself.

[156] See Nazzini, above n 15, 218; Liza Lovdahl Gormsen, A Principled Approach to Abuse of Dominance in European Competition Law (Cambridge University Press, 2010) 136'; *Ball Memorial Hospital, Inc v Mutual Hospital Insurance, Inc*, 784 F 2d 1325, 1339 (1986).

substantially suppressing rivalry by its competitors to prolong or enhance its market power.

D. How is an Objective Purpose Test Different to a 'Likely Effects' Test?

One further distinction is necessary. A test based on objective anticompetitive purpose may bear a strong resemblance to a test based on 'likely effect', since the question whether a firm engaged in conduct with the objective purpose of suppressing rivalry to extend its market power will depend to a significant extent on whether that conduct had the likely effect of achieving this end at the outset. In fact, one might ask whether there is any significant difference between a standard based on objective anticompetitive standard and a standard based on the 'likely effects' of the conduct.[157] It is submitted that these standards are different.

Under the Harper Proposal, the SLC test would condemn conduct if that conduct 'would … be likely to have the effect of, substantially lessening competition'. According to the interpretation of this phrase under other provisions of Part IV of the *CCA*, this element only requires the plaintiff to demonstrate that the conduct had a 'real chance or possibility' of substantially lessening competition in a market.[158] This assessment is made on an ex ante basis, having regard to the information available at the time the firm engaged in the conduct.[159] As explained in chapter 5, the effect of the Harper Proposal as a whole remains uncertain, given the uncertainty regarding the meaning of 'substantiality' requirement.[160] There are also limits on the extent to which efficiency arguments, or consumer benefits, could be taken into account under

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[157] See Paul G Scott, 'The Purpose of Substantially Lessening Competition: The Divergence of New Zealand and Australian Law' (2011) 19 *Waikato Law Review* 168, 192: 'It is inconceivable that a court would find no liability under the likely effect limb, but be able to find an objective anticompetitive purpose.'

[158] *Monroe Topple & Associates v The Institute of Charter Accountants* (2002) 122 FCR 110, 140 [111].

[159] See *Universal Music* 131 FCR 529, 586 [247]; *Seven Network* (2009) 182 FCR 160, 342.

[160] See Chap 5 Part V(C) herein.

the SLC test.[161] In this sense, the Harper Proposal and proposal outlined in this chapter are not equivalent.

But what if the 'likely effect' test were reframed to condemn conduct which, assessed from an ex ante perspective, gives rise to a real chance or possibility of enhancing or prolonging the corporation's substantial market power by suppressing the competitive responses of its rivals? Does the *objective anticompetitive purpose* standard proposed in this chapter differ in any significant respect from such a test? It is submitted that it does. In particular, a test based on the *likely effect* of suppressing rivalry may result in a rule which is over-inclusive and over-deterrent relative to an objective purpose standard.

A finding that conduct gave rise to a *real chance or possibility* that it would extend market power by suppressing rivalry is not equivalent to a finding that the *most likely explanation* for the conduct was an attempt to extend market power by suppressing rivalry. In particular, the former sets a lower threshold for liability than the latter. That is, it may be possible to argue, when the relevant conduct had an inherently unpredictable outcome at the outset, that there was a real chance or possibility of extending market power in this way, even though that was not the most likely explanation for engaging in the conduct.[162] In these circumstances, a 'likely effect' test may reduce dominant firm incentives to engage in behaviour which is generally beneficial to society.

It is submitted that, in the assessment of unilateral conduct, the critical task for the court is to discover the most plausible *explanation* for the exclusionary act in its context, to determine the end which that conduct is designed to achieve. If that end is alleged to be the creation of benefits for consumers, that claim must be tested by determining whether the conduct was a proportional means of achieving that end, as explained further below.

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[161] See Chap 5 Part V(E) herein.

[162] Eg, when the dominant firm invests in research and development or increased capacity.

Such an approach, it is submitted, likely to improve the social costs of the law relative to a standard based on the effect or likely effect of the conduct. Conduct which is initiated with an objective anticompetitive purpose is generally detrimental to social welfare, even if there are some cases where the anticompetitive plot does not succeed or where its actual effects cannot be proved on the balance of probabilities. Conduct with this purpose is likely to waste social resources; exclude competitors who are equally efficient; and increase market power in the absence of superior efficiency.[163]

On the other hand, conduct which is initiated *without* an objective anticompetitive purpose is generally unobjectionable conduct. Even if such conduct occasionally causes unpredictable harm to the competitive process and a net detriment to consumer welfare, the detriment from subjecting all conduct to an ex post effects analysis is likely to outweigh the benefit of capturing the occasional instance of anticompetitive effect.[164] The advantages of a standard which focuses on objective anticompetitive purpose are explained further below.

VI. AN OBJECTIVE ANTICOMPETITIVE PURPOSE STANDARD IS SUPERIOR TO PROFIT-FOCUSED AND EFFECTS-BASED ALTERNATIVES

A. 'Simple' Cases: Lower Error Costs and Lower Administration Costs

The optimal standard for unilateral anticompetitive conduct should accurately and cost-effectively characterise 'simple' cases at both ends of the competitive spectrum: that is, both plainly exclusionary conduct and plainly procompetitive, consumer welfare-enhancing conduct. It is submitted that a standard based on objective anticompetitive purpose is superior to both profit-focused and effects-based standards in achieving this goal.

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[163] See Bork, above n 51, 144. See also Baumol et al, 'Brief of Amici Curiae Economics Professors', above n 173, 5: 'In economic terms, the consequences must be economic inefficiency, for the action must generate more in economic costs than in consumer benefits and lawful concomitant business benefits. In sum, the practice could be presumed to diminish social welfare by lessening competition and by increasing monopoly power.'

[164] See Chap 5 Part VIII(C) herein.

With regard to 'plain' or 'naked' exclusion, profit-focused tests may give rise to false negatives.[165] Courts applying the 'take advantage' standard in Australia, for example, have found instances of plain exclusion by dominant firms not to infringe section 46(1) of the *CCA*, on the ground that the firm 'used' its financial resources, rather than its substantial market power, to engage in the conduct.[166] Such conduct has been absolved under section 46(1) even though its sole purpose and effect were to preserve the firm's market power without creating any benefit for consumers.[167]

Similarly, Melamed recognised that his profit sacrifice test might not capture certain 'cheap' exclusion,[168] in cases where it cannot be proved that the conduct resulted in a loss of profits for the dominant firm. However, Melamed argued that it was not fatal to a test that it might not cover every instance of unilateral anticompetitive conduct. In particular, he suggested that plain exclusion 'can be condemned as anticompetitive conduct without the need for a sacrifice test, market-wide balancing, or any other elaborate inquiry'.[169]

It is submitted that each of the profit-focused tests outlined in this dissertation represents one method of proving objective anticompetitive purpose, but by focusing on only one indicator of objective purpose they fail to capture all significant instances of unilateral anticompetitive conduct. By maintaining a focus on the central issue of objective anticompetitive purpose, the shortcomings of these tests can be avoided.

In the case of plain exclusion, proof of objective purpose does not depend on the costs incurred, or profits foregone, by the dominant firm with and without the conduct in question. Further, and in contrast to the 'take advantage' test, proof of objective

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[165] As explained in Chap 4 Part VI(D) herein.

[166] See the discussion of *Rural Press Ltd v ACCC* (2003) 216 CLR 53 in Chap 4 Part VI(E) herein.

[167] Ibid.

[168] A Douglas Melamed, 'Exclusionary Conduct under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal' (2005) 20 *Berkeley Technology Law Journal* 1247, 1260.

[169] Ibid.

purpose is not excluded simply because a non-dominant firm with substantial financial resources could or would engage in the same conduct.[170]

An objective anticompetitive purpose standard also has advantages relative to an *effects*-based standard in the context of plain exclusion. It is commonly recognised that the condemnation of plain exclusion should not depend on a detailed effects analysis or proof of causation of effects.[171] In situations where there is a clear objective anticompetitive purpose, the plaintiff should not be required to rule out the possibility, for example, that external factors may have caused a similar outcome in any event.[172] When firms plainly act with the object of hindering the competitive process in an attempt to maintain or enhance their market power, they waste society's resources, even if it is ultimately determined that the conduct was unlikely to achieve that purpose in light of intervening factors, or because some other factor might have independently created the same outcome.[173] Accordingly, it is appropriate to focus on the underlying purpose of plain exclusion rather than require proof that it caused a certain effect in the relevant market.

At the other end of the competitive spectrum, some profit-focused tests may be over-inclusive to the extent that they condemn a dominant firm for sacrificing short-term profits with the purpose of charging supracompetitive prices in the longer term, even if the rationale for this conduct is procompetitive.[174] This may occur, for example, where a dominant firm invests heavily in research and development with the purpose

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[170] See the discussion of *Rural Press Ltd v ACCC* (2003) 216 CLR 53 in Chap 4 Part VI(E) herein.

[171] See, eg, Steven C Salop and R Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft' (1999) 7 *George Mason Law Review* 617, 664, arguing that if the conduct amounts to 'naked exclusion', the court could engage in a truncated analysis of the conduct, which would take into account the very low error costs of wrongly condemning this type of conduct. See also Herbert J Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct' (Research Paper No 08-28, The University of Iowa College of Law, June 2008), 31.

[172] Cf Philip Areeda, 'The Changing Contours of the Per Se Rule' (1985) 54 *Antitrust Law Journal* 27, 28.

[173] See Bork, above n 51, 144. See also William J Baumol et al, Brief of Amici Curiae Economics Professors in Support of Respondent, Submission in Verizon Communications Inc v Law Offices of Curtis V Trinko LLP, No 02-682, 25 July 2003, 5.

[174] See Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311, 346; Elhauge, above n 8, 274–9.

of developing a product which is so superior that it will capture the whole market, or if it invests in constructing a new plant which might not succeed unless rivals are forced to reduce their own output.[175] Werden has recommended that there should be safe harbours for such conduct since it clearly enhances consumer welfare, even if it gives rise to a short term sacrifice which is only profitable because it preserves or enhances the firm's market power in the long term.[176]

It is submitted that the implicit rationale for this qualification is that the conduct in this case does not have an objective anticompetitive purpose. Even though the firm sacrifices short-term profits with the purpose of enlarging its market power, it does so by attempting to innovate or produce a superior product and not by suppressing the competitive responses of its rivals. Such conduct is consistent with the competitive process, representing a purported *increase* competition in innovation and quality, rather than an attempt to suppress rivalry.

B. 'Mixed' Conduct: Lower Error Costs, and Improved Certainty and Administrability

The more complex task for any unilateral conduct standard is the accurate characterisation of conduct with 'mixed' effects: that is, conduct that both enhances or preserves market power by restricting competition at the same time as it creates some benefits for consumers. Profit-focused tests tend to be under-inclusive in respect of such conduct. In particular, they may absolve conduct on the ground that it creates *some* profits which are not dependent on the preservation or enhancement of market power, even if the same conduct creates disproportionate harm to consumer welfare.[177]

In this context, the 'take advantage' test under section 46(1) relies on the presumption that conduct that would be profitable for a non-dominant firm poses no significant

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[175] Hovenkamp, 'The Harvard and Chicago Schools', above n 8, 115.

[176] Gregory J Werden, 'Identifying Exclusionary Conduct under Section 2: The "No Economic Sense" Test' (2006) 73 *Antitrust Law Journal* 413, 419–20.

[177] See Chap 4 Part VI(B) herein.

threat to the competitive process when adopted by a dominant firm.[178] This approach overlooks the fact that the likely exclusionary effect, and the profitability, of such conduct may be significantly greater where a firm possesses a substantial degree of market power. Similar conduct can have different rationales and very different results for the competitive process, even if it is profitable in both cases. A test based on objective anticompetitive purpose could take account of the insight offered by the 'take advantage' test – that conduct that is likely and profitable in a competitive market is generally efficient conduct – without treating this as an irrebuttable presumption.

Standards based on effects or likely effects, on the other hand, are criticised for creating unacceptable uncertainty for dominant firms and difficulties in administrability in the context of 'mixed' conduct. The SLC test proposed by the Harper Panel may require the court to balance the likely harm to the competitive process caused by a restriction on competition against a likely increase in competition in innovation, for example.[179] It may be argued that, in such circumstances, the likely effects are both unquantifiable and incommensurable.[180] How might a court determine the likely consequences of the conduct for competition in these circumstances?

A standard which focuses on objective anticompetitive purpose improves administrability in the context of 'mixed' conduct by permitting courts and dominant firms to focus on the *proportionality* of the impugned conduct, rather than engaging in any fine balancing of the mixed outcomes of that conduct. A number of commentators and authorities have advocated a proportionality enquiry in the characterisation of unilateral anticompetitive conduct.[181] Under a proportionality enquiry, it would be necessary to ask whether, at the time it engaged in the conduct, the firm's choice of

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[178] See Chap 4 Part VI(C) herein.

[179] See Chap 5 Part V(E) herein.

[180] See Richard D Cudahy and Alan Devlin, 'Anticompetitive Effect' (2010) 95 *Minnesota Law Review* 59, 65.

[181] See, eg, Salop, above n 174, 353; Hovenkamp, 'Monopolization Offense', above n 148, 1038; Andrew I Gavil, 'Exclusionary Distribution Strategies By Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 61–2; Nazzini, above n 15, 4, 94, 158, 167–9. See also Robertson, 'Primacy of Purpose – Part 2', above n 26, 61–5, advocating a proportionality enquiry under for multilateral conduct under the *CCA*.

strategy was proportionate to its claimed benefits, having regard to the risk, and extent, of any exclusion of rivalry.

From a compliance perspective, a proportionality inquiry provides dominant firms with a framework for assessing the legality of proposed conduct, which takes into account the reasonably foreseeable competitive impacts of their conduct, without requiring precise predictions about actual outcomes, which could be affected by factors beyond the firm's control. Adopting such a framework, dominant firms would consider at the outset:

- Whether the conduct plausibly creates any benefits for consumer welfare;
- Whether there are less restrictive alternatives which could achieve the same benefits;[182] and
- Whether any restriction of rivalry which might arise from the proposed strategy is disproportionate to the plausible improvements in long term consumer welfare which the strategy is designed to achieve.[183]

This last enquiry would not require firms to balance precisely the procompetitive and anticompetitive effects of the strategy, but to give proper consideration to the importance, extent and plausibility of the various potential consequences for competition in the market, bearing in mind the objective of protecting consumer interests.

A proportionality enquiry also provides courts with a framework for assessing the reasonableness of the firm's conduct; for determining whether, objectively speaking, the real purpose of the conduct was to restrict competition or to compete through superior efficiency. In the context of multilateral restraints of trade, Robertson has argued that conduct with mixed purposes or effects should not automatically be absolved. Instead, where the defendant claims that the purpose of its conduct was to achieve some procompetitive end, the credibility of that claim will depend in large

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[182] See European Commission, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2, 12 [30].

[183] See Robertson, 'Primacy of Purpose – Part 2', above n 26, 61, in the context of multilateral restraints.

part on whether the conduct in question was a reasonable means of achieving that end.[184] This requires consideration of several factors including:

- the necessity of the conduct in achieving that end (including whether there were less restrictive alternative methods of achieving the same end);[185] and
- whether the measures adopted were neither excessive nor disproportionate in the sense that the likely detriments outweigh the importance of the beneficial result sought through the conduct in question.[186]

It is submitted that these factors are also relevant to the question whether a dominant firm acted with the purpose of prolonging or enhancing its market power by suppressing rivalry.[187] If, for example, the dominant firm selected the conduct in question in preference to a realistic and profitable, less restrictive alternative, it may be inferred that its true purpose was the suppression of rivalry rather than the achievement of the beneficial goal.[188] Similarly, if the tendency of the conduct to exclude rivalry was disproportionate to its tendency to create consumer benefits, it may be concluded that the exclusion of rivalry was not a reasonable incident of a generally procompetitive strategy, but that the underlying purpose of the conduct was in fact the suppression of competitive responses.

The court's task is to discover the *real* economic objective of the conduct.[189] The critical question remains: what was the underlying purpose of the conduct which restricted the competitive responses of its rivals or potential rivals? Was the restriction of rivalry merely incidental to, and reasonably necessary for, the achievement of a

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[184] Ibid.

[185] Ibid 64–5.

[186] Ibid 69.

[187] See also Nazzini, above n 15, 94, 156–8, 165–9, 300–21.

[188] The less restrictive alternative should be a practical 'real-world alternative' which would be profitable for the dominant firm: Hemphill, above n 26, 60, 62.

[189] Hemphill, above n 26, 47, argues that some courts approach mixed conduct not by netting the anticompetitive effects of the conduct against the procompetitive effects, but 'by choosing between the two parties' stories' or 'conflicting narratives', assuming that these stories are mutually exclusive and that there is 'a negative correlation between the probability of anticompetitive effect and probability of procomeptitive effect'. This is a matter of 'choosing rather than summing'. Consider also the Microsoft case in which the court repeatedly avoided actually balancing any effects.

plausible benefit to consumers? Or was the real object of the restrictive conduct the suppression of competitive constraints which might otherwise be offered by rivals, with relatively minor incidental benefits for consumers?

C. Conduct with Unpredictable Outcomes: Less Deterrrence of Socially Beneficial Conduct

Opponents of effects-based tests have argued that such tests unacceptably reduce the incentives of dominant firms to engage in beneficial competitive conduct, and particularly innovative conduct.[190] They argue that, by exposing every unilateral act by a dominant firm to judicial scrutiny, effects-based tests may deter firms from engaging in competitive conduct even where that conduct would have resulted in substantial benefits for society.[191]

The SLC test proposed by the Harper Panel is likely to deter some beneficial conduct in this manner, by potentially subjecting all dominant firm conduct to an ex post effects analysis.[192] Having regard to the 'likely effect' limb of the SLC test, firms may also be deterred from engaging in conduct if there is a 'real chance or possibility' at the outset that the conduct would substantially lessen competition in a market,[193] even if that is not the most likely outcome of the conduct.

Salop advocates the application of an effects-based test for unilateral anticompetitive conduct on a case-by-case basis.[194] However, Salop adds a qualification to his effects-based test which takes some account of potential incentive effects. Acknowledging that some potentially beneficial conduct can have unpredictable results, he proposes that, in these situations, conduct should be evaluated from an ex ante perspective, having regard to the likelihood and magnitude of expected consumer benefits, based

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[190] See, eg, Josef Drexl, 'Real Knowledge is to Know the Extent of One's Own Ignorance: On the Consumer Harm Approach in Innovation Related Competition Cases' (2010) 76 *Antitrust Law Journal* 677.

[191] See Drexl, above n 190, 677.

[192] As explained in Chap 5 Part VIII(C) herein.

[193] Particularly given the uncertainty as to the 'substantiality' requirement: see Chap 5 Part VI(C) herein.

[194] See Chap 5 Part III(A) herein.

on the information reasonably available at the time that the firm made its investment decision.[195]

It is submitted that Salop's qualification implicitly recognises that the important task for the court in a unilateral conduct case is to determine the true economic nature of the conduct in question. Conduct which can be explained as a genuine attempt to innovate, or expand output, to the benefit of consumers is generally socially beneficial conduct. Such conduct should not be condemned simply because it resulted in an increase in market power by the exclusion of rivalrous behaviour which could not be predicted at the outset. To do so would deter valuable dominant firm conduct.

Focusing on the objective purpose, rather than the actual or likely effect, of conduct has the important benefit of concentrating attention on the information available to the dominant firm at the time it engaged in the impugned conduct. Under an objective purpose standard, the decisive factor would be the ex ante purpose of the conduct, objectively determined, rather than its ex post effect. Such a standard would allow firms to better predict the lawfulness of their conduct, since it would not require an accurate prediction of the *actual* effects of their conduct, which may be determined by factors beyond the firm's control. At the same time, it would not condemn conduct which had a 'real chance' of causing harm to the competitive process at the outset, if that was not the most plausible explanation for the conduct, as explained in the comparison of a 'likely effect' test above.

VII. CONCLUSION

In advocating an objective anticompetitive purpose approach to unilateral conduct this dissertation draws out a standard which has been present in the case law and commentary in this area for many years, but which has not been clearly articulated. It is submitted that this standard should be articulated and expressly adopted. To do so would resolve the two main, opposing concerns in the current debate regarding section 46(1), and unilateral conduct standards more broadly.

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[195] Salop, above n 174, 339, 341–2, 365–6.

On the one hand, it would preserve dominant firm incentives to engage in procompetitive conduct, by assessing conduct on the basis of information reasonably available to the firm at the outset, and removing the need for precise predictions. On the other hand, it would strengthen the law against misuse of market power by requiring an objective analysis of the conduct in its relevant context, taking into account its likely impact on the market.

In the assessment of unilateral conduct, it is submitted that the critical task for the court is to discover the most plausible explanation for the exclusionary act in its context, to determine the end which that conduct is designed to achieve and, if that end is alleged to be the creation of benefits for consumers, whether the conduct is a proportional means of achieving that end.

As Hovenkamp has argued, we should apply 'Occam's razor' to the conduct in question 'stripping away those explanations that are implausible or unproven until we have a "core" left that characterizes the practice as pro- or anticompetitive'.[196] It is necessary to understand the underlying rationale of the conduct, to determine whether the act in its context is in fact designed to extend the firm's substantial market power by stifling the competitive responses of rivals without creating proportionate benefits for consumers. This is the common thread running through the case law and commentary on unilateral anticompetitive conduct; and the standard for exclusionary conduct which should now be expressly acknowledged.

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[196] Hovenkamp, *Antitrust Enterprise*, above n 27, 108.

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