

***ACCC v. Boral* – the High Court awaits another s46 case!**

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Abstract

The recent decision of *ACCC v. Boral* [2001] FCA 30 has given new impetus to s46 of the *Trade Practices Act 1974* and, in particular, to matters involving allegations of predatory pricing. Whilst there have only been 4 decisions on predatory pricing in 27 years, this case potentially supports the regulator and small business taking a far more active role in policing the pricing policies of big business. However, the real importance of this case lies in its rejection of the overseas jurisprudence on predatory pricing and its implicit acceptance of a far wider ambit of the provision in the Australian business landscape. It is argued in this article that the Full Federal Court applied the wrong competitive test in determining whether there was a breach of s46. This conclusion is further supported by the decision of the High Court in *Melway v. Hicks*, [2001] HCA 13 where, by a majority, the court accepted that if the conduct in question had occurred, or been capable of occurring without market power, then the conduct was not challengeable simply because it occurred with market power. The Court's application of s46 to the facts of this case indicates that an appeal to the High Court in *ACCC v Boral* is likely to be successful. This article will review these two very significant cases and analyse the future direction of s46 jurisprudence.

Introduction

The recent Full Federal Court decision of *Australian Competition and Consumer Commission v Boral Ltd*¹ re-examined the principles of s46² of the *Trade Practices Act 1974* and their interrelationship with predatory pricing. The great significance of this decision lies in its rejection of the United States and European principles on this area and its adoption of a more legalistic and technical approach to the legislation. The court focussing on the intent and purpose of the conduct rather than an examination of economic principles of average variable costs and the possibility of recoupment by later imposition of supra-normal profits.

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¹ [2001] FCA 30.

² Section 46 of the *Trade Practices Act 1974* states as follows:

- (1) A corporation that has a substantial degree of power in a market shall not take advantage of that power 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.

There have now been four litigated decisions³ on predatory pricing – with a success rate of 50%. *ACCC v. Boral* clearly permits predatory pricing to be argued in a wider set of circumstances than was previously thought – divorced from the detailed and comprehensive overseas jurisprudence. Not only must the overseas authorities be treated with caution,⁴ but also their reliance on economic theory must be questioned given the different wording of the Australian legislation. To this end, the decision may ultimately be seen as a watershed in the impetus and direction that it provides s46. In addition, it serves as a foundation for a critical focus of the interrelationship of s46 with the pricing policies of big business. In essence, the anti-competitive provisions of the legislation, as interpreted by this case, can be seen as protecting the interests of small business.⁵ However, this decision must now be read in light of the High Court’s deliberations on s46 in *Melway v. Hicks*.⁶ The reasoning in this case almost guaranteeing an appeal to the High Court in *Boral*. This article will analyse these two cases and argue that the correct test to be applied in s46 applications has yet to be articulated by any court.

The relationship between predatory pricing and s46.

Market power provides leverage. It is the use of that leverage that allows a corporation to take advantage of the vulnerability of other participants in the market place. By the causal connection between the market power and the conduct in question for a proscribed purpose, a breach of s46 is established. In this context there is no doubt that one of the major signals of competition, if not the pre-eminent competitive element, is effective and established competition on price.⁷ “The antithesis of competition is undue market power, in the sense of the power to raise price and exclude entry.”⁸ Therein lies the difficulty in establishing price predation. How do you determine whether in fact the conduct in question is for an outlawed purpose rather than simply an example of brutal but effective competition? As noted by Mason and Wilson JJ. in *Queensland Wire v BHP*:⁹

“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 an inevitable consequence of the competition s46 is designed to foster.”

³ These cases being *Victorian Egg Marketing Board v. Parkwood Eggs Pty Ltd* (1978) ATPR 40-081; *TPC v. CSBP & Farmers Ltd* (1980) ATPR 40-151; *Eastern Express Pty Ltd v. General Newspapers Pty Ltd* (1992) ATPR 41-167 and *Australian Competition and Consumer Commission v. Boral Ltd* [2001] FCA 30.

⁴ See the comments by A. Scales, “Predatory Pricing Revisited”, (1998) 6 *TPLJ* 142 at 151.

⁵ Arguably similar to how *Queensland Wire Industries Proprietary Limited v. Broken Hill Proprietary Company Limited* (1988-1989) 167 CLR 177 was seen.

⁶ [2001] HCA 13.

⁷ *Queensland Co-operative Milling Association Ltd, Re* (1976) 25 FLR 169 at 188.

⁸ *Queensland Co-operative Milling Association Ltd, Re* (1976) 25 FLR 169 at 188.

⁹ *Queensland Wire Industries v. BHP* (1989) ATPR 40-925 at 50,010.

To resolve this dilemma, United States and European case law has established twin economic measures to determine whether the line has been breached. One element was pricing below avoidable cost, the second, opportunity for the price predator to recoup their losses.¹⁰ The decision of *ACCC v Boral* rejects this approach. “[I]t is not necessary for present purposes to consider the comparative American jurisprudence.”¹¹ The settled interpretation given to s46 by the High Court decision in *Queensland Wire* rendered unnecessary any recourse to overseas material.¹²

“The terms of s46 suggest that adoption of the test developed in the United States would frustrate the objects of the provision. It must also be remembered that in the United States antitrust legislation is concerned with constraining the behaviour of a monopolist. That is not the focus of s46... Moreover, under s46 there is no need to have recourse to a test such as ‘selling below cost plus recoupment’ because intent is at the heart of the offence.”¹³

Nevertheless it is this application of *Queensland Wire* which lies at the heart of any criticism of the *Boral* decision. To what extent was *Queensland Wire* correctly applied?

Section 46 seeks to protect the process of competition, rather than competition itself.¹⁴ The critical focus is now on the intent or purpose of the predator.¹⁵ Australian lawyers will no doubt rejoice as, largely untrained in economics, they no longer need to grapple extensively with concepts of oligopolies, marginal costs and diminishing returns. The criteria can now be delineated and segregated into jurisdiction, causation and purpose (a set of principles easily stated but which deceptively mask their difficulty in application):

- The market must be established (but this must be linked and looked at in light of the conduct under examination);
- The participant under examination must have market power (the first two points establishing the jurisdiction);
- That participant must take advantage of that power (the causal factor); and

¹⁰ *Matsushita Electric Industries Co, Ltd v. Zenith Radio Corp* 475 US 574 (1986); *Brooke Group, Ltd v. Brown and Williamson Tobacco Corp* 509 US 209 (1993) and *AZKO Chemie BV v. Commission of the European Communities* [1994] ECR I-3359 quoted by Merkel J. *ACCC v. Boral* [2001] FCA 30 at 186. A analysis of these economic measures can be found in K McMahon, “Predatory Pricing under Section 46 of the Trade Practices Act and the decision in *Eastern Express v General Newspapers – Parts I and II.*”, (1993) 1 *TPLJ* 75 and 130; R Smith and D Round, “Section 46: Oligopoly and Predatory Pricing” (1998) 6 *CCLJ* 112.

¹¹ *ACCC v Boral* [2001] FCA 30 at para 154.

¹² For example, see the comments by Beaumont J. *ACCC v Boral* [2001] FCA 30 at para. 130.

¹³ Per Finkelstein J. in *ACCC v. Boral* [2001] FCA 30 at para 262.

¹⁴ A point brought out in s2 of the Trade Practices Act 1974 where it is stated that “The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.”

¹⁵ See generally RA Posner, *Anti-trust Law – An Economic Perspective*, (The University of Chicago Press, Chicago, 1976).

- The taking advantage must be for a proscribed purpose (the intent or purpose of the predator).

The Facts of ACCC v. Boral

The application by the ACCC followed a period of difficulty for the construction industry in Victoria. There was a severe recession in the early 90's that led builders to being receptive to alternative products to concrete masonry. In mid-1993, a price war commenced amongst the manufacturers of masonry products and negotiations commenced between C & M and Boral for the acquisition of C & M's plant. C & M also negotiated with Pioneer. When these negotiations broke down, BBM (a subsidiary of Boral) reduced their prices for concrete masonry products to a level that was below the avoidable cost¹⁶ for a significant part of the period, 1994-1996. During this period, the prices of C & M and Pioneer were substantially above the respondents. The change in market structure over the period can be demonstrated from the following table of market share of sales (as was estimated by BBM)¹⁷:

¹⁶ His Honour provides the following example of avoidable cost: (1999) 166 ALR at para 104: The concept of avoidable cost may be illustrated by the following example. Assume that to make an article a firm has to pay \$6 for raw materials and incurs fixed costs of \$4. Thus a sale for any price above \$10 will return a profit. If the firm sells for \$8, it will sell below cost and accordingly make a loss. But it will recover its raw materials costs and make a contribution to its fixed costs. So the firm is better off making the article than not making it. But if the price received is less than \$6, the firm is worse off. It would be better not to make the article. In this example \$6 is the avoidable cost, the cost that will be avoided by not making the article. The term variable cost is often used as synonym for avoidable cost, and was in the present case. In strict economic theory there are differences, but they are not material for present purposes."

¹⁷ Taken from *ACCC v. Boral Ltd* [2001] FCA 30 at para115.

Date	Boral	Pioneer	Rocla	C & M	Budget
Late 1992	21%	26	21	9	15
February 1993	26				
June 1994	28	26	23	11	7
October 1994	33	24	24	8	4
May 1995	31	25	22	15	7
March 1996	28				
Mid 1997	42	32		21	

The ACCC alleged that this supply of concrete masonry products at a price less than the avoidable cost of production, the attempt to purchase the plant of C & M, together with the increase in capacity of the Boral plant were a taking advantage of market power, for a proscribed purpose, by a firm with a substantial degree of market power. It can be noted that there was one other significant competitor in the industry, this being Pioneer.

The Trial Judge, Heerey J.

The trial judge, Heerey J. dismissed the application by the ACCC, holding that the product market was not limited to concrete masonry products.¹⁸ Other alternatives were available for the construction industry and in this wider market, Boral/BBM lacked market power, a key feature under s46. Furthermore, the presence of Pioneer, the low barriers to entry (such as absence of any intellectual property rights; no brand loyalty; no confidential know-how; and access to raw materials, land, plant and equipment)¹⁹ rendered it impossible for BBM to recoup the losses incurred when it sold below the avoidable cost. The wording and interpretation of the legislation was paramount, the ideas that may be generated from the rich American jurisprudence on predatory pricing were not to be accorded significant weight. As McMahon comments: “[this] exposes an important judicial weakness in the

¹⁸ (1999) 166 ALR 410 at 436: “The evidence leads to the conclusion that there was a market in which builders (either directly or through sub-contractors such as blocklayers) acquired materials for use in the construction of walls and paving. Within that market there was not only the ever present threat (or promise) of potential substitution but actual substitution over the time with which this case is concerned.”

¹⁹ (1999) 166 ALR 410 at 438.

Australian judicial approach to the identification of predatory conduct.”²⁰ Predatory pricing may be carried out for strategic reasons, allied to the idea that a large market share will result from the conduct with the consequence that a ‘normal’ (rather than supra-normal) profit can be achieved over a longer period – thus ultimately leading to recovery of any losses.²¹ Indeed the strategic behaviour of BBM was expressly stated: their aim was “to drive at least one competitor out of the market”.²² The “long term solution to the market decline in Melbourne is for C & M to fail as a producer and one of the major producers to pick up the assets.”²³ Thus, if the other features of s46 had been established, the conduct of BBM would have been for a proscribed purpose.²⁴

Heerey J’s decision severely limited the operation of s46 – particularly in cases of predatory pricing. He did not see strategic behaviour, designed to remove small business and provide greater market share, as being a breach. A rational business decision would excuse the conduct. This was a significant victory for large businesses, and, not surprisingly, the matter went on appeal. However the majority of the High Court in *Melway v Hicks* has since impliedly supported Heerey J’s decision.

What is important in the ultimate victory by the Australian Competition and Consumer Commission in the Full Federal Court was its very explicit rejection of the United States economic philosophy on predatory pricing, and its resort to a legalistic traditional Australian analysis.²⁵ The Full Federal Court also rejected any ‘defence of a rational business decision’. However, in reversing the result they may have unintentionally provided a basis for small business to unfairly attack the pricing

²⁰ McMahan, above n 10 at 76. Though as noted by R. Steinwall, “The use of cost based tests and the test of recoupment by Australian courts in predatory pricing cases: Some further insights from the recent Federal Court decision in Boral Ltd” (1999) *CCLJ Lexis* 15 at 55: “Economists no doubt find the concept of obiter dictum quaint, even if somewhat frustrating. Lawyers however tend to view it more seriously. It is a fundamental tenet of the law that comments which are merely obiter dictum are not binding as precedent, regardless of their persuasive value. The statements made in all the Australian predatory pricing cases as to the applicability of the cost based tests and recoupment clearly fall into this category. We are therefore left with no conclusive principle as to their applicability.”

²¹ A. Bruce, “Whither Predatory Pricing”, (1999) Report 481 *Australian Trade Practices News* 1 at 4: “The problem with this reasoning (of Heerey J.) is that a firm without antecedent market power may be able to engage in strategic behaviour designed to erect barriers to entry in a post-conduct market which will enable it to recoup its losses. It is often the case that a firm engages in predatory conduct directed towards competitors that are able to act as competitive constraints in order to remove them. The predator firm then acquires market power by the removal of the constraint represented by the competitors.”

²² (1999) 166 ALR 410 at 445-6.

²³ (1999) 166 ALR 410 at 446.

²⁴ As noted by Heerey J. (1999) 166 ALR 410 at 446.

²⁵ *Queensland Wire v BHP* (1989) ATPR 40-925 at 50,011: “The essential notions with which s 46 is concerned and the objective which the section is designed to achieved are economic and not moral ones. The notions are those of markets, market power, competitors in a market and competition. The objective is the protection and advancement of a competitive environment and competitive conduct by precluding advantage being taken of a ‘substantial degree of market power’ in a market for any of the proscribed purposes. If the substantial degree of market power exists and is ‘take[n] advantage of’ for one or other of those purposes, it is not to the point that that degree of market power was acquired by praiseworthy means (for example, hard work, efficiency, product quality and service) or that the anti-competitive purpose is inspired by altruistic or even patriotic motives (for example, to avoid the consequences to

philosophies of large entities. Simply, the wheel may have turned too far. Perhaps the reason for this lies in the inability of the Court to correctly articulate the test from *Queensland Wire* in cases of predatory pricing.

The Decision of the Full Federal Court

Beaumont J.

His honour, in a largely factual analysis of the issues, accepted the ACCC's submission that the product market should not be considered wall and paving products generally. He agreed that the principle of market definition required that there be close competition and found that there was in fact a distinct demand for concrete masonry products.²⁶ Following from this limiting of the product market, Beaumont J. considered that BBM did have a substantial degree of market power²⁷ and that it had taken advantage²⁸ of this for a proscribed purpose.²⁹ After this factual critique, his honour unreservedly applied the decision in *Queensland Wire*. Accordingly, application of the American jurisprudence was unnecessary.³⁰ Further, there was no scope for application of an exception for rational business decisions, nor was there any room for the recoupment theory.³¹ However, this judgement did not explore the nuances of *Queensland Wire* that, arguably, was required.

Merkel J.

His honours judgment began by raising the issue squarely before the court: "[What is the] line that must be drawn between price competition that is promoted by Part IV of the TPA as an aspect of competitive conduct, and price competition that is prohibited by s46 of the TPA as a misuse of market power."³² He first rejected the approach of the Heerey J, finding that to adopt a test of below cost pricing plus recoupment, with a defence that 'my business decision was rational', was to limit the operation of s46 to cases involving a monopolist or an entity dominant in the market. The reason being that if there was the presence of another significant player in the market, as there was here (Pioneer), the ability to recoup the losses would be highly unlikely, if not impossible.³³ Furthermore, as s46 prescribes the elements of the offence, there is no need to add additional requirements derived from the American literature.³⁴ He found this rejection necessary because of the particular wording in the

the small trader of irrational and extreme price competition or to protect local standards and employment)."

²⁶ *ACCC v. Boral Ltd* [2001] FCA 30 at paras 112-119.

²⁷ *ACCC v. Boral Ltd* [2001] FCA 30 at paras 120-122.

²⁸ *ACCC v. Boral Ltd* [2001] FCA 30 at paras 123-126.

²⁹ *ACCC v. Boral Ltd* [2001] FCA 30 at paras 127-128.

³⁰ *ACCC v. Boral Ltd* [2001] FCA 30 at para 154.

³¹ *ACCC v. Boral Ltd* [2001] FCA 30 at para 154.

³² *ACCC v. Boral Ltd* [2001] FCA 30 at para 185.

³³ *ACCC v. Boral Ltd* [2001] FCA 30 at para 196.

³⁴ *ACCC v. Boral Ltd* [2001] FCA 30 at para 197-98.

Australian legislation, a phrasing designed to assist small businesses seeking protection from large entities, irrespective of whether that large entity is a monopolist or near monopolist.³⁵ Merkel J. agreed that the product market could be limited to concrete masonry products and that BBM's power had been used for a proscribed purpose. He found that there were four interrelated elements in BBM's use of power:

- Its ability to consistently engage in a price war and sell below cost;
- The increase in the capacity of the BBM plant to a position in excess of its requirements;
- BBM's position in a large vertically integrated company (Boral) and the opportunity that that provided: and
- BBM's election to lower prices on the basis that there would be some recoupment at a later stage.³⁶

“But, was the power used by BBM ‘market power’ and, if so, was that market power ‘substantial’?”³⁷ In answering this question in the affirmative, his honour concluded that to a significant extent, BBM was able to operate independently of competitive forces and that its behaviour was different from that which a competitive market would enforce on a firm in a similar situation.³⁸ This aspect lies at the heart of this judgment. However, to what extent is this the appropriate basis on which to judge conduct allegedly in breach of s46? Does this take into account questions such as: What are the constraints, if any, on this competitive market? To what extent can it make a rational business decision and not be in violation of s46? Does it retain any level of discretion in its decision-making processes, or is it permanently constrained by the legislation?³⁹

Finkelstein J.

His honour initially undertook a detailed examination of the economic literature on predatory pricing.⁴⁰ After this analysis, he concludes that the adoption of the United States material would frustrate the object of the legislation.⁴¹ Section 46 is not to be restricted to the activities of a monopolist and recoupment and below cost pricing are not elements within the Australian

³⁵ *ACCC v. Boral Ltd* [2001] FCA 30 at para 234.

³⁶ *ACCC v. Boral Ltd* [2001] FCA 30 at para 219.

³⁷ *ACCC v. Boral Ltd* [2001] FCA 30 at para 221.

³⁸ *ACCC v. Boral Ltd* [2001] FCA 30 at para 227.

³⁹ See the comments by R. Featherston and G. Edwards, “Recent Developments in Misuse of Market Power”, [2000] 8 *TPLJ* 79 at 81.

⁴⁰ *ACCC v. Boral Ltd* [2001] FCA 30 at para 241-42: “[It] is still necessary to determine when price cutting is lawful and when it is not... In the United States this task has been undertaken by economists and academic lawyers with an understanding of economics. Their influence on the judiciary has been enormous. Economics rather than law dominate antitrust litigation. Let me explain their influence, without attempting to find a cause.”

legislation.⁴² Finkelstein J. agreed that the product market was that of concrete masonry products and that BBM had considerable market power.⁴³ Strategic barriers to entry had been raised by BBM, in particular its predatory pricing,⁴⁴ and its decision to increase the capacity of its plant to an excess of its requirements.⁴⁵ Interestingly, his honour considered that “incurring losses as a means of putting excess capacity into operation may be justifiable competition, although cut throat and ruinous. On the other hand, a firm with a substantial degree of market power usually has no interest in setting prices at such a level... except to eliminate a competitor or to keep a potential competitor out of the market.”⁴⁶ The difficulty with this is establishing that line in the sand between justifiable competition and predatory pricing. Indeed Finkelstein J. considered that pricing below average variable cost would generally lead to an inference of predatory intent, unless there was a legitimate purpose.⁴⁷ Arguably, there is some logical inconsistency here, his honour accepting that eliminating a competitor may be legitimate, ‘although cut throat and ruinous.’ However, pricing below costs leads to an inference of predatory intent, which, undoubtedly, can be used to justify a breach of the legislation. As stated by his honour, “Vigorous competition will often harm rivals. The active pursuit of more business, or of increasing market share, will, if the pursuit is successful, prejudice competitors. That is the inevitable consequence of such conduct.”⁴⁸ Quoting from *Queensland Wire*, the issue evolved around whether BBM could behave differently (because of its market power) than if it had been in a competitive market.⁴⁹ It is this test, enunciated in particular by the latter two judges⁵⁰ that deserves closer consideration.

Reflections

The views of the High Court judges in *Queensland Wire* were considered and reviewed by Lockhart J. in *Dowling v. Dalgety Australia Limited*.⁵¹ This analysis led to the following declaration as to what is the principal issue that needs to be resolved when considering a s46 application.

⁴¹ *ACCC v. Boral Ltd* [2001] FCA 30 at para 262.

⁴² *ACCC v. Boral Ltd* [2001] FCA 30 at para 262.

⁴³ *ACCC v. Boral Ltd* [2001] FCA 30 at para 321.

⁴⁴ *ACCC v. Boral Ltd* [2001] FCA 30 at paras 344-46.

⁴⁵ *ACCC v. Boral Ltd* [2001] FCA 30 at para 347.

⁴⁶ *ACCC v. Boral Ltd* [2001] FCA 30 at para 267.

⁴⁷ *ACCC v. Boral Ltd* [2001] FCA 30 at para 269.

⁴⁸ *ACCC v. Boral Ltd* [2001] FCA 30 at para 296.

⁴⁹ *ACCC v. Boral Ltd* [2001] FCA 30 at para 330.

⁵⁰ These judges took a similar line in this case to that taken by them in *Robert Hicks Pty Limited (trading as Auto Fashions Australia) v. Melway Publishing Pty Limited* (1999) ATPR 41-668 (Merkel J. trial judge); *Melway Publishing Pty Limited v Robert Hicks Pty Limited (trading as Auto Fashions Australia)* (1999) ATPR 41-693 (Full Federal Court, Heerey, Finkelstein and Sundberg JJA).

⁵¹ (1992) ATPR 41-165.

“The central determinative question to ask 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 commercial environment.”⁵²

It is the application of this test that causes difficulties. It is submitted that it cannot be applied in the abstract. To ask simply whether BBM would have increased the capacity of their plant and priced below avoidable cost in a competitive environment fails to address the issue of whether there was some economically efficient reason for what they were doing. Was it simply attempting to increase its market share – an appropriate outcome of the competitive process - or was it using its market advantage for a proscribed purpose? In essence, the link between the conduct and the market power must be established – rather than simply considered against the hypothesis of what would have occurred in a highly competitive environment.⁵³ Featherston and Edwards make similar comments when discussing the full Federal Court decision of *Melway Publishing Pty Limited v Robert Hicks (trading as Auto Fashions Australia)* – a decision that, as indicated, subsequently went on appeal to the High Court.⁵⁴ They comment:

“We suggest that in order to arrive at the correct hypothetical competitive market by which conduct of a firm with market power should be assessed, one should first consider the market as it is and the characteristics of firms in that market, and remove only what is necessary to leave the focus firm without a substantial degree of market power. In other words, the correct hypothetical market is one where the focus firm has just less than a substantial degree of market power. We believe that this is the analysis which the High Court intended to stipulate in *Queensland Wire*.”⁵⁵

If we apply this to *Boral*, the issue is whether what BBM has done would have been acceptable if it had just less than a substantial degree of market power? This raises issues such as: Could BBM have decided that, given the recession facing Victoria and its effect on the building industry, they would cut prices to below average variable cost in an attempt to retain or increase market share? Would BBM still have had that discretionary ability to enter into a cost cutting war? Would BBM have taken the same approach if they were seen to have slightly less than a substantial degree of market power? After all, the law proscribes certain conduct by those entities with a substantial degree of market power – in no way does it seek to regulate the behaviour of those with slightly less than this.⁵⁶ The perfectly competitive market exists only in the models of the economists. If the Full Federal Court had undertaken this analysis perhaps the result would have been the same. However it is

⁵² (1992) ATPR 41-165 at 40,277.

⁵³ The same criticisms can be made of the judgements of Merkel J and Finkelstein J in the *Melway* decisions, above n 50. See also the comments made in relation to the *Melway* case by J. Duns, “Restrictive Trade Practices” (1999) 7 *TPLJ* 175 at 176.

⁵⁴ (1999) ATPR 41-693.

⁵⁵ Featherston and Edwards, above n 39 at 89.

⁵⁶ See the comments by Featherston and Edwards, above n 39 at 90.

still arguable that the approach taken by their Honours presupposes a perfectly competitive market⁵⁷ in which there a large number of players, with no individual having a dominant market share.

In summary, if the entity would engage in the same conduct, as a matter of business judgement when it had no significant degree of market power, then the same conduct must surely be permissible when the corporation does possess market power.⁵⁸ *Queensland Wire* requires subsequent courts to consider what the conduct of the player under question would have been in a competitive market. However, this competitive market is one of workable competition, not the perfectly competitive hypothesis that provides the extreme of economic models. The conduct of any firm with slightly less than a substantial degree of market power is never questioned, accordingly, when analysing the activities of a firm with a substantial degree of market power – it is this level which must be ascertained and used as a comparator.⁵⁹ Arguably, what we have seen in the High Court's decision in *Melway v. Hicks* is the genesis of the development of this test.

The facts of *Melway v Hicks*⁶⁰

Melway produced Melbourne street directories. Its retail market share was somewhere near 80-90% of the competing directories. Gregory had less than 5%, UBD between 2.5-5% with another player an insignificant share. However, for many years before it achieved this substantial market share it had maintained a system whereby it limited distribution of its product to only six distributors. Each of these distributors was allocated a particular market segment, and they did not compete amongst themselves for customers.

Hicks Pty Ltd had been a wholesaler distributor for that part of the retail market served by suppliers of automotive parts. Its appointment had been terminated following a breakdown in the business relationship of the two controllers of Hicks: Pawsey and Nagel. Melway preferring to deal with Nagel and it was his company that replaced Hicks Pty Ltd as the distributor for the automotive parts industry. After this termination, Hicks approached Melway seeking to purchase between 30,000 and 50,000 directories. Melway refused to supply Hicks after Hicks made it clear that it intended to sell a proportion of those directories in competition with the existing six distributors. Melway admitted that it would have been happy to supply the directories to a seventh distributor if it had agreed not to compete with the existing wholesale operators.⁶¹

Although there was not strong competition in the wholesale market (due to segmented distribution system) there was still strong competition in the retail market. Retail prices had tended to

⁵⁷ See the comments by Featherston and Edwards, above n 39 at 89.

⁵⁸ For a similar view see the dissenting judgement of Heerey J. in *ACCC v. Boral* (1999) ATPR 41-715.

⁵⁹ See the similar comments expressed by Featherston and Edwards, above n 39 at 89.

⁶⁰ [2001] HCA 13.

⁶¹ [2001] HCA 13 at para 8.

affect wholesale prices.⁶² As a result the distributors and Melway did not appear to have had excessive profit margins.⁶³

The decision at first instance (Merkel J)⁶⁴

Merkel J found that the market was the wholesale and retail market for street directories in Melbourne and that Melway had a substantial degree of power in that market. His honour also held that Melway had a proscribed purpose – to prevent Hicks from competing with its existing distributors and thus engaging in competitive conduct in the market for Melbourne street directories. These findings were not challenged by any of the higher courts.

The issue which formed the basis of the subsequent appeals was whether Melway had “taken advantage” of its market power by refusing to supply. Merkel J applied the test enunciated by the High Court in *Queensland Wire Industries v. BHP*.⁶⁵ Was Melway’s use of market power made possible by the absence of competitive conditions? Although Merkel J acknowledged that “not every supplier with substantial market power is required by s.46 to supply all persons who seek supply if it is not to the commercial advantage of the supplier to do so”,⁶⁶ he found that Melway had taken advantage of its market power, stating:

“It is only by virtue of its dominant position in the Melbourne directory market and the absence of a competitive market that Melway can afford, in a commercial sense, to withhold from supplying 30,000 – 50,000 directories at its usual wholesale price and terms to Auto Fashions. If Melway lacked substantial 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 Auto Fashions to secure its significant supply of directories from a competitor.”⁶⁷

Although Merkel J acknowledged that a corporation with market power may legitimately refuse to supply to a distributor where its distribution system is based on legitimate business factors (such as particular characteristics of the products being distributed, or cost and distribution efficiencies), his honour did not accept Melway’s argument on this issue. In essence, it was only because of their market power that they were able to refuse to supply 30-50,000 directories. In a competitive market they would have done so.

⁶² [2001] HCA 13 at para 12.

⁶³ [2001] HCA 13 at para 16.

⁶⁴ *Robert Hicks Pty Ltd v. Melway Publishing Pty Ltd* (1998) 42 IPR 627.

⁶⁵ (1989) 167 CLR 177.

⁶⁶ (1998) 1379 FCA at 17; (1999) ATPR 41-668; (1998) 42 IPR 627 .

⁶⁷ (1998) 1379 FCA at 14; (1999) ATPR 41-668; (1998) 42 IPR 627.

The Decision of the Full Federal Court (Sundberg, Finkelstein, Heerey JJA)⁶⁸

The majority judges (Sundberg and Finkelstein JJ) held that “in a competitive market for street directories, the appellant would not have refused supply, thereby voluntarily losing market share to a competitor.”⁶⁹ In coming to that conclusion Sundberg J. focused on the narrow conduct (that is, the refusal to supply), expressly rejecting reference to the wider conduct (the maintenance of the distribution system).⁷⁰ He expressly noted the difference between a refusal to supply such a large order when “the appellant had only 10 per cent of the market” and when it had “85 per cent of the market.”⁷¹ “While the needle on the market power monitor was creeping up, so was [Melway’s] capacity to engage in the proscribed conduct.”⁷² Thus the kernel of this judgement by Sundberg J. is that conduct that may be legitimate when there is an absence of market share may indeed be prohibited when market strength exists. Business must adapt as it becomes more successful in a competitive environment. The onus becomes higher, the greater the strength of market power.

Finkelstein J concurred on largely the same grounds, dismissing as irrelevant the fact that Melway had maintained its distribution network for many years.

“One way, perhaps the only way, in which such a system can be maintained is by refusing to supply directories to any person who intends to compete with the distributors. It follows that, if supply is refused in order to maintain the system, there can be no difference between the purpose for that refusal and its effect. That is, both the purpose and effect of the refusal will be to prevent competition.”⁷³

The argument that as the distribution system had been in place for many years, - thus demonstrating the lack of causal connection between the market power and the refusal to supply was without logical foundation.⁷⁴ The factors that allowed it to maintain its distribution system had nothing to do with the refusal to supply to a non-distributor.

“That is to say, there is no evidence that Melway refused to supply street directories to a person wishing to compete with its distributors whilst Melway was in the process of reaching the position where it had a substantial degree of power in the Melbourne street directory market. Could it have done so when it only had a small share of the market? Common sense says that it could not. The evidence points to the same conclusion.”⁷⁵

⁶⁸ *Melway Publishing Pty Ltd v. Robert Hicks Pty Ltd* (1999) 90 FCR 128.

⁶⁹ (1999) 90 FCR 128 at para 40 per Sundberg J.

⁷⁰ (1999) 90 FCR 128 at para 44.

⁷¹ (1999) 90 FCR 128 at para 44.

⁷² (1999) 90 FCR 128 at para 44.

⁷³ (1999) 90 FCR 128 at para 70.

⁷⁴ (1999) 90 FCR 128 at para 66.

⁷⁵ (1999) 90 FCR 128 at para 66.

Heerey J dissented, based largely on the fact that Melway had adopted its segmented distribution system when it commenced publishing the directory and had used the same system ever since. It followed that the operation of its segmented market system was not dependant on the possession of market power. “Put another way, the same activity, the maintenance of the segmented distribution system, cannot change its nature simply because a substantial degree of market power has been achieved.”⁷⁶ It is this argument that differentiates the majority from the minority. Does the change in market strength require the business entity to change the method of operation? As indicated in the discussion of *Boral*, the test is one of what the entity can do with slightly less than market strength. The law not seeking to regulate activity that falls below the threshold of s46. Thus, if the practice is adopted when the preconditions for s46 are not established – should the law intervene, when, as a result of that practice (which is arguably anticompetitive) market strength is obtained.

Like Finkelstein J, he considered the relevance of the absence of evidence as to what Melway would have done if an order for 50,000 directories had come in when Melway was not in a position of market strength. However, he came to the opposite conclusion, assuming that Melway would have refused to supply in similar circumstances when it did not have substantial market power. This was supported by the fact that Melway would not in fact be giving up additional sales by refusing to supply, as Auto Fashions was going to compete primarily with existing distributors’ customers. “So, in refusing to supply Auto Fashions, Melway was not denying itself sales which it would have been commercially compelled to make in a more competitive market”.⁷⁷

He found that Melway’s decision to refuse to supply in these circumstances could be justified because of efficiency, regardless of market power. Melway had, in fact, tendered a body of evidence as to why they had adopted this form of distribution system, including:

- Wholesalers were dealing with customers in a market they knew as specialists;
- Wholesalers had a good understanding of customer requirements and an ability to sell different types of products to customers, giving supply and selling efficiencies;
- Major retailers preferred “distributors of substance” who could service the product adequately;
- Wholesalers were given confidence to invest in marketing and customer development and especially promotion which was a critical element for Melway’s success;
- Wholesalers were permitted to maximise customer service and the meeting of customer needs including promotion.
- Wholesalers were able to service the public need for the product, including unprofitable small accounts.⁷⁸

It followed that there was no taking advantage of market power.

⁷⁶ (1999) 90 FCR 128 at para 18.

⁷⁷ (1999) 90 FCR 128 at para 21.

The Decision of the High Court (Gleeson CJ, Gummow, Kirby, Hayne, Callinan JJ)⁷⁹

The majority (Gleeson CJ, Gummow, Hayne and Callinan JJ) rejected Sundberg J's interpretation of the conduct as the narrow refusal to supply, noting that this involved an "element of over-simplification".⁸⁰ They pointed out "there was no legal obligation upon Melway to have any wholesale distributors at all. If it had chosen to do so, it could have supplied retailers directly itself, or it could have supplied the retail market through a single wholesale distributor."⁸¹ Importance was placed on the fact that "from Melway's point of view, what was contemplated was not that the respondent would go out and open up a new retail market...but that Melway would take sales from existing distributors."⁸² The critical issue could simply be stated: "What must be asked is whether Melway's wholesale distribution system involving, as it did, restriction of competition at the wholesale level, amounted to taking advantage of market power."⁸³

Thus extending their consideration to the entire wholesale distribution system, they were required to assess the distribution system likely to be used by Melway in a competitive market.

"The creation and maintenance of the appellant's distribution system, at a time when it did not have a substantial degree of market power, shows that its maintenance, when the appellant had market power, was not necessarily an exercise of that power. The respondent's contention that there was a use of market power required demonstration by other means."⁸⁴

Finally, the majority⁸⁵ considered that the trial judge and the Full Court were in error by referencing the current use of market power against the hypothesis of how Melway would have acted if it did not have a substantial degree of market power. Such arguments were flawed. Thus in purporting to apply the principles of *Queensland Wire v. BHP*,⁸⁶ they have significantly weakened the hypothetical competitive market test. The analysis is not of what they may have done in a competitive environment, but of what did occur – a critique of what possibly could have been done was beside the point – the causal link between the conduct and the power was fundamental. If the conduct in question existed in the absence of market power, it was not to be challenged when market power existed, even if the practice may, at every stage, have been anti-competitive. To this end, the test is comparative by

⁷⁸ (1999) 90 FCR 128 at para 31.

⁷⁹ [2001] HCA 13.

⁸⁰ [2001] HCA 13 at para 17.

⁸¹ [2001] HCA 13 at para 19.

⁸² [2001] HCA 13 at para 57.

⁸³ [2001] HCA 13 at para 57.

⁸⁴ [2001] HCA 13 at para 68.

⁸⁵ [2001] HCA 13 at para 68.

⁸⁶ [2001] HCA 13 at para 66.

nature – what would have happened in the market place where Melway had a percentage of market share that left it without market power. This is the test, suggested by the High Court in *Queensland Wire*, and it is this test which needs to be articulated. Today, providing the distribution system was in place before a significant market share existed, then the refusal to supply will be permissible under the Act when there is market power. The hypothetical market power test can be subjugated by what actually occurred if that evidence is available. Accordingly, to obtain market power by anti-competitive behaviour is permissible, where the behaviour has been engaged in when no market power existed.

Kirby J dissented, largely because of consumer-protection issues and with a focus on the narrower refusal to supply conduct.⁸⁷ He was of the opinion that Melway’s distributors were making large profits that were then paid for by the consumers.⁸⁸

The essence of Justice Kirby’s judgement was that it was unnecessary to consider the hypothesis of what would have occurred if Melway had been subject to effective competition. A textual analysis of the legislation supported this conclusion.⁸⁹ There is no doubt that the analysis of Kirby J. has an initial appeal. The legislation does not ask for a ‘before and after’ critique or ‘competitive v. non-competitive’ analysis. It can be seen simply as a factual question – has the corporation with market power refused supply for a proscribed purpose. However, if business is to operate under consistent and certain guidelines, should the policy of the law allow conduct to continue which existed when market power less than substantial was in existence. There is an ultimate policy question to be answered – as a society do we require a corporation to change its behaviour when it is successful? If the answer is yes, are we hindering the competitive process that is designed to injure and damage the competitor? Do we ultimately favour the competitive process, but only to a certain level – that level just below market power?

In summary, the crux of the majority decision seems to be that if a corporation engages in anti-competitive conduct prior to its obtaining market power, then this conduct cannot be the subject of a s46 action subsequent to its obtaining market power. This goes to the causation aspect of the s46 “taking advantage” test. In other words, if the corporation has engaged in similar conduct without the market power, this is evidence that market power is not a precondition to the corporation continuing in the conduct after obtaining a greater market share. The High Court following the reasoning of Heerey J’s dissenting judgment in the Full Court.⁹⁰ He commented that the “maintenance of the segmented distribution system could not change its nature simply because a substantial degree of market power had been achieved”.⁹¹

⁸⁷ [2001] HCA 13 at para 80.

⁸⁸ [2001] HCA 13 at para 90.

⁸⁹ See his honours analysis at [2001] HCA 13 at paras 99-114.

⁹⁰ [2001] HCA 13 at para 62.

⁹¹ [1999] FCA 664 at para 18.

Conclusion

As indicated the High Court decision in *Melway* has almost guaranteed an appeal to those same bench from the Full Federal Court decision in *ACCC v. Boral*. The majority in *Melway* indicated that the s46 test of *Queensland Wire* is to be applied. However, and interestingly, it may be the case that the test enunciated in *Queensland Wire* has been subtly amended (and weakened) by the High Court in *Melway*. Whilst the latter High Court accepted that, consistent with the approach of *Queensland Wire*, “argument was directed to a consideration of how Melway would have been likely to behave, if it had lacked the power it had”⁹² - this hypothesis was not to be considered in the abstract. Commercial business considerations must now be taken into account and it is this aspect that arguably represents the retreat, albeit slight, from the seminal decision on s46, *Queensland Wire*. Why Melway sought to maintain the distribution system is the critical focus, not what they may have done if they did not have the market power. Critically, “[t]he only purpose of the hypothesis is to seek to test whether Melway has taken advantage of its degree of market power. It is one thing to compare what it has done with what it might be thought it would do if it lacked that power. It is a different thing to compare what it has done with what it would do in circumstances that are completely divorced from the reality of the market.”⁹³ The test is one of comparison, but this is ameliorated where the factual analysis can be provided by the case itself, rather than by an academic hypothesis. Thus, the reason for the refusal to supply is relevant in determining whether there has been a taking advantage of market power.

“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 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.”⁹⁴

In essence, the corporation may be engaged in efficient conduct. This is the issue that must be addressed.

The authors conclude that *Boral* will be on appeal to the High Court, with the likelihood that the appeal will succeed. Our criticism with the decision in *Boral* lays not so much in the result, but in the unqualified application of a test of what the entity would do in a perfectly competitive environment. The test cannot be that. Corporations are surely entitled to possess market power – that is concomitant with a competitive economy. Successful, efficient firms will survive, less successful, inefficient businesses will die. The issue is whether the conduct by the person with market power would have

⁹² [2001] HCA 13 at para 44.

⁹³ [2001] HCA 13 at para 58.

⁹⁴ [2001] HCA 13 at para 67.

been any different if they could be considered to have had slightly less than this share. Or conversely, have they engaged in economically efficient conduct. It is this examination that needs to be undertaken. It is this examination that the Full Federal Court failed to undertake in *Boral*. It is this test, which needs to be articulated by the High Court in the appeal from that case.