

‘TAKING ADVANTAGE’ OF SUBSTANTIAL MARKET POWER, AND OTHER PROFIT-FOCUSED TESTS FOR UNILATERAL ANTICOMPETITIVE CONDUCT

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I INTRODUCTION

The prohibition against misuse of market power in s 46(1) of the *Competition and Consumer Act 2010* (Cth) (‘CCA’) (and its identical predecessor in the *Trade Practices Act 1974* (Cth)) has been the subject of debate throughout its 40-year history.¹ In 2015, the Competition Policy Review Panel (the ‘Harper Panel’) conducted the first wholesale review of Australian competition policy in over 20 years, and created significant controversy by recommending substantial changes to s 46(1).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 this recommendation, 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

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1 See, eg, George A Hay and Kathryn McMahon, ‘The “Duty to Deal” under Section 46: Panacea or Pandora’s Box?’ (1994) 17 *University of New South Wales Law Journal* 54; 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.

2 Ian Harper et al, *Competition Policy Review: Final Report* (March 2015) 335–47.

3 Ibid 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-20150407-1mf5xn>>; 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>>. 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.

the subject of inconsistent and uncertain judicial interpretation.⁵ In March 2016, the Prime Minister announced that the government intends ‘to repeal the current Section 46, and adopt the changes recommended by the Harper Review in full’.⁶

The ‘take advantage’ requirement has been the subject of ongoing commentary and doctrinal analysis over the decades.⁷ This article 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.⁸

Part II of this article briefly explains the nature of unilateral anticompetitive conduct and describes a category of ‘profit-focused’ tests for such 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 comparative analysis of these tests. This comparison is extended in Parts V and VI, which examine the likely errors under, and the certainty and

5 See, eg, Australian Competition and Consumer Commission, 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; Katharine Kemp, ‘Uncovering the Roots of Australia’s Misuse of Market Power Provision: Is It Time to Reconsider?’ (2014) 42 *Australian Business Law Review* 329, 344–9.

6 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/>>.

7 See above n 1; 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.

8 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.

'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

Competition laws generally permit a firm to possess a dominant position, or substantial market power, in a market.⁹ 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.¹⁰ One of the reasons that most jurisdictions tolerate the mere possession of substantial market power is that dominant firms¹¹ often acquire and preserve such power through superior efficiency, or 'competition on the merits', thereby increasing social welfare.¹²

It is, however, possible for a dominant firm to prolong or increase its market power by engaging in conduct that is not 'competition on the merits'. Entrenching market power in this way, through conduct that creates no benefit¹³ other than the preservation of the firm's market power, therefore goes against one of the

- 9 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 Report*).
- 10 See *CCA* s 46(3); *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374, 423 [136]–[137] (Gleeson CJ and Callinan J) (*'Boral'*); S G Corones, *Competition Law in Australia* (Thomson Reuters, 5th ed, 2010) 131–7.
- 11 In Australia, *CCA* s 46(1) refers to a firm with 'a substantial degree of power in a market'. In other jurisdictions, similar laws refer to firms with a 'dominant position' or to 'monopolists'. In this article, the term 'dominant firm' is frequently used for ease of reference, but it should be acknowledged that the Australian concept of 'substantial market power' does not require the firm to control or dominate the market: *CCA* s 46(3C)–(3D).
- 12 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: Andrew I Gavil, 'Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 33, 42, citing *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP*, 540 US 398 (2004); Herbert Hovenkamp, 'Exclusion and the *Sherman Act*' (2005) 72 *University of Chicago Law Review* 147, 163. See also Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 923 (Lionel Murphy, Attorney-General), distinguishing anticompetitive conduct from situations where a monopolist is simply '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'.
- 13 Or no proportionate benefit.

key reasons for tolerating the possession of substantial market power.¹⁴ Unilateral anticompetitive conduct rules are intended to prevent practices such as these, without unduly hindering beneficial competitive activity.¹⁵

The critical question is: what constitutes ‘competition on the merits’?¹⁶ Some courts and commentators have attempted to explain this concept by focusing on why the conduct in question was profitable for the dominant firm.¹⁷ In particular, they highlight the connection between the firm’s market power and the profitability of the relevant conduct for the firm.¹⁸ In this article, 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 known as ‘effects-based’ tests.¹⁹ 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’,²⁰ and those that would not. In short, they rely on the premise that exclusionary

14 See Independent Committee of Inquiry into Competition Policy in Australia, *National Competition Policy*, (1993) (‘Hilmer Report’) 62, stating that:

Firms with market power may be able to engage in conduct which exceeds the limits of vigorous competition, and thereby entrench their market positions to the detriment of the competitive process. ... The challenges are to define conduct which is ‘excessive’ in a policy sense, and to develop a mechanism which can identify practical instances of such ‘excessive’ conduct.

15 Ibid. 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, 4, stating that the challenge is to ‘deter anticompetitive behavior 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’.

16 Einer Elhauge, ‘Defining Better Monopolization Standards’ (2003) 56 *Stanford Law Review* 253, 264, refers to the ‘utter vacuity’ of this terminology.

17 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 8; Werden, above n 8. See case law discussion in Part III(D) below.

18 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.

19 See, eg, Steven C Salop, ‘Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard’ (2006) 73 *Antitrust Law Journal* 311.

20 Bork, above n 17, 144, referred to ‘a deliberate seeking of market power through means that would not be employed in the normal course of competition’.

conduct²¹ which generates profit that is dependent on the firm's market power²² is not competition on the merits. Conduct that would be profitable in the absence of such power should be regarded as competition on the merits, and protected as such.²³

In the US, profit-focused tests gained attention in the 1970s as a means of identifying certain limited categories of anticompetitive behaviour.²⁴ 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.²⁵ 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.²⁶

In Australia, misuse of market power is prohibited by s 46(1) of the *CCA*, which currently states:

A corporation that has a substantial degree of 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.²⁷

Thus, it is necessary for an applicant to prove that the firm in question possessed substantial 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

21 That is, conduct that damages, or deters competitive responses by rivals, as opposed to purely 'exploitative' conduct, such as charging higher prices to consumers.

22 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.

23 See Baumol et al, above n 15, 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'.

24 See, eg, Areeda and Turner, above n 17; Part III below.

25 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>.

26 See, eg, Baumol et al, above n 15; Salop, above n 19; Jacobson and Sher, above n 25; 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*').

27 *CCA* s 46(1).

intended to play a central role in distinguishing between vigorous, efficiency-enhancing competition and anticompetitive conduct.²⁸

The ‘take advantage’ standard has not been explained as a profit-focused test of the kind described here. However, in this article, 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.²⁹

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,³⁰ while in fact basing decisions on whether the conduct would be *profitable* in the absence of market power.³¹ Particularly since the judgment of the High Court majority in *Rural Press Ltd v Australian Competition and Consumer Commission* (*Rural Press*),³² 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.

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

28 See, eg. Philip L Williams, ‘Should an Effects Test Be Added to s 46?’ (Paper presented at the Competition Law Conference, Sydney, 24 May 2014) 2; Kemp, ‘Uncovering the Roots of Australia’s Misuse of Market Power Provision’, above n 5, 344.

29 See Part III(B) below.

30 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.

31 As explained in Part IV(B) below.

32 (2003) 216 CLR 53.

in 1975.³³ Predatory pricing is one example of unilateral anticompetitive conduct, or 'monopolisation', which is prohibited under s 2 of the US *Sherman Act*.³⁴ 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.³⁵ 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.³⁶ 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.³⁷ Nor is it sufficient that the firm sacrifices profits to achieve this result.³⁸ A dominant firm might sacrifice some revenue by reducing its price, while still pricing above its average costs. Areeda and Turner believed that such behaviour should be regarded as competition on the merits, akin to successful innovation or superior products or services.³⁹ These are practices that are likely to be 'an equally or more profitable choice quite apart from any exclusionary effects' that they might have.⁴⁰ Accordingly, such conduct is likely to be efficient because the exclusion of competitive constraints is not the sole source of profit from the conduct.⁴¹

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

33 Areeda and Turner, above n 17.

34 15 USC §§ 1–7 (1890) ('*Sherman Act*').

35 *Ibid* 698.

36 According to Baumol et al, above n 15, 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 Lawrence Anthony Sullivan, *Antitrust* (West Publishing Company, 1977) 113, quoted in Werden, above n 8, 422–3 n 37, noting that, '[p]erhaps the characteristic feature of such a predatory thrust is that the predator is acting in a way which will not maximize present or foreseeable future profits unless it drives or keeps others out or forces them to tread softly'.

37 Areeda and Turner, above n 17, 704–5. Melamed, above n 8, 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).

38 Areeda and Turner, above n 17, 704.

39 *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, arguing that above-cost pricing and mere threats to lower prices can constitute anticompetitive conduct.

40 Areeda and Turner, above n 17, 722.

41 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.

produced.⁴² Pricing below marginal cost also greatly increases the probability that competitors will be excluded for reasons unrelated to the superior efficiency of the monopolist,⁴³ 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,⁴⁴ should be presumed to have engaged in predatory pricing.⁴⁵

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.⁴⁶ But similar tests would soon be proposed to cover broader categories of conduct.

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.⁴⁷ 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'.⁴⁸

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'.⁴⁹ 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

42 Ibid 712. It would be 'a misuse of *capital* resources to devote them to a less profitable pursuit' (emphasis in original): at 723.

43 Ibid 712.

44 Given the difficulty of calculating marginal cost, AVC was recognised as a reasonable surrogate for marginal cost: ibid 716–18.

45 Ibid 712.

46 Jacobson and Sher, above n 25, 782.

47 Bork, above n 17, 144.

48 Elhauge, above n 16, 269.

49 Bork, above n 17, 144. Bork's reference to 'predation' was not intended to limit his discussion to predatory pricing and non-price behaviour akin to predatory pricing. Rather he 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).

detrimental to consumer welfare, predation is not to be classed as superior efficiency.⁵⁰

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 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.⁵¹ In an article that was to become highly influential, they 'proposed an economic definition of predation',⁵² which they intended as a 'unifying, general, and open-ended standard' for predatory behaviour.⁵³ 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'.⁵⁴

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*'.⁵⁵ 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 market.⁵⁶ The proposed standard would not penalise the incumbent for 'legitimate competitive responses' such as these.⁵⁷

50 Ibid.

51 Ordover and Willig, above n 17, 13–14, 52. The predatory behaviour to which Ordover and Willig referred extended beyond predatory pricing to other practices, including, eg, predatory product innovations.

52 Ibid 52.

53 Ibid 14.

54 Ibid 9–10 (citations omitted).

55 Ibid 9 (emphasis added).

56 Ibid 13: 'These inefficient firms can be induced to exit by actions that efficient firms find profitable regardless of their effects on rivals' viability.'

57 Ibid 10. In other words, it would not protect a rival that was incapable of prospering under competitive circumstances.

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.⁵⁸

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.'⁵⁹ 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.⁶⁰ However, Ordover and Willig emphasised that their proposed definition of predation was not itself a workable test for predatory practices, but that it provided a general and open-ended standard from which workable tests could be derived.⁶¹

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*

58 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. Under this standard, the predatory sacrifice was assessed on the premise of the continued viability of the rival. This potentially counterfactual premise assumes that the rival remains able to produce without incurring new start-up costs, whether or not the rival has actually ceased production. Thus, the continued-viability premise is equivalent to assuming the absence of reentry barriers, and a firm's action entails predatory sacrifice of profit if there is some alternative action that would yield greater profit if there were no reentry barriers.

59 Ibid 10.

60 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.

61 Ordover and Willig, above n 17, 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 17. On the other hand, 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, or whether the recovery of those costs depended on the incumbent increasing its monopoly power after the exit of the rival: at 28. Assuming that the rival remained in the market, and thus that the incumbent gained no further power to increase prices, was the actual practice at least as profitable as any less exclusionary alternative?

Co Ltd v Zenith Radio Corp ('*Matsushita*'),⁶² the US Supreme Court endorsed, in general terms, the below-cost pricing requirement advocated by Areeda and Turner.⁶³ 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'.⁶⁴

Again, in *Brooke Group Ltd v Brown & Williamson Tobacco Corp*,⁶⁵ 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.⁶⁶ The Court held that there must be proof of pricing 'below an appropriate measure of its rival's costs',⁶⁷ although it did not specify what that measure should be. Later, in *United States v AMR Corp*,⁶⁸ in determining whether prices had fallen below an 'appropriate measure of cost', the District Court of Kansas applied the Areeda-Turner test, using average variable cost as a proxy for marginal cost.⁶⁹

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'.⁷⁰

*Aspen Skiing Co v Aspen Highlands Skiing Corp*⁷¹ 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'.⁷² 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.⁷³ In the subsequent case of *Neumann v Reinforced Earth Co*,

62 475 US 574 (1986).

63 Jacobson and Sher, above n 25, 783 quoting *Matsushita*, 475 US 574, 589, 594 (1986).

64 *Matsushita*, 475 US 574, 588–9 (1986).

65 509 US 209 (1993).

66 *Ibid* 224.

67 *Ibid* 222.

68 140 F Supp 2d 1141 (D Kan, 2001).

69 *Ibid* 98–103. See also *Cargill Inc v Monfort of Colorado Inc*, 479 US 104, 122 n 17 (1986).

70 668 F 2d 1014, 1030 (9th Cir, 1981).

71 472 US 585 (1985).

72 *Ibid* 608.

73 Patterson, above n 17, 39; Testimony of Aaron Edlin, above n 25, 30–7.

Bork J also stipulated a profit-focused test for monopolisation,⁷⁴ outlining much the same definition of predation as he had put forward in *The Antitrust Paradox*.⁷⁵

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*.⁷⁶ The Antitrust Division stated that it often found it useful, in the 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’⁷⁷ (the ‘but for’ test), a test which bears a strong resemblance to that proposed by Bork.⁷⁸

The Antitrust Division advocated its ‘but for’ standard in a number of enforcement actions around that time.⁷⁹ In one of these cases, namely *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP* (*Trinko*),⁸⁰ 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*.⁸¹ 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’.⁸² 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.⁸³

74 786 F 2d 424, 427 (DC Cir, 1986):

predation involves aggression against business rivals through the use of business practices that would not be considered profit maximizing except for the expectation that (1) actual rivals will be driven from the market, or the entry of potential rivals blocked or delayed, so that the predator will gain or retain a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds threatening to its realization of monopoly profits.

75 Bork, above n 17, 144.

76 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 Policy, Fordham Corporate Law Institute, New York, 23 October 2003) <<http://www.usdoj.gov/atr/public/speeches/202724.htm>> 8.

77 Ibid.

78 See Part III(B) above.

79 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.

80 540 US 398 (2004).

81 Ibid 409. In *Trinko*, Ordoover 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 15, 6, 16, 18. This is explained further in Part VI(A) below.

82 *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 25, 31–3 argues that such claims are ‘revisionist’ and that the Supreme Court in *Aspen Skiing* actually conducted an effects-based analysis.

83 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.⁸⁴ There was, at this time, vigorous debate over what kind of test might be adopted as a universal standard for unilateral anticompetitive conduct.⁸⁵ While some, following the dicta of the DC Circuit in *Microsoft*,⁸⁶ proposed a test that considered the net effect of the conduct on competition in the relevant market(s),⁸⁷ 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'.⁸⁸ 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 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.⁸⁹

84 See, eg, Patterson, above n 17, 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 proposing a new standard which would focus on the substantive purpose of the monopolist and which would make the conduct illegal if it made 'no economic sense other than as a means of perpetuating or extending monopoly power'.

85 There was also debate concerning the appropriate tests for unilateral anticompetitive conduct in the European Union, 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.

86 253 F 3d 34, 58–9 (DC Cir, 2001).

87 See, eg, Salop, above n 19. The 'burden-shifting' approach outlined by the Court in *Microsoft* required the plaintiff to prove that the impugned conduct had an 'anticompetitive effect' in that it harmed the competitive process and thereby harmed consumers. If the plaintiff proved such an anticompetitive effect, the defendant monopolist could proffer a 'procompetitive justification' for the conduct, which should 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'. If the defendant establishes such a pro-competitive justification, the burden shifts back to the plaintiff to prove that the 'anticompetitive harm of the conduct outweighs its procompetitive benefit': *ibid* 58–9.

88 Melamed, above n 8, 1255, citing Einer Elhauge 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 292–3.

89 *Ibid*.

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 conduct⁹⁰ 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’⁹¹ as a result of the conduct’s exclusionary effect, since these would be benefits derived from maintaining or augmenting market power.⁹²

Importantly, ‘conduct [would] fail the sacrifice test only if it [generated] incremental costs for the defendant that [*exceeded*] the incremental revenues or cost savings’.⁹³ 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 condemn only conduct from which an anticompetitive intent can unambiguously be inferred’.⁹⁴

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.⁹⁵ 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’.⁹⁶ ‘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]’.⁹⁷ 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’.⁹⁸

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

90 Being the costs (including opportunity costs) that the defendant would not incur but for the conduct.

91 Melamed, above n 8, 1256 (eg because of a diminished need to provide customer services).

92 *Ibid.*

93 *Ibid* (emphasis added).

94 *Ibid* 1257. See also Piraino, above n 84, 826, 845, arguing that courts should focus on the ‘substantive competitive purpose’ of the impugned conduct.

95 Werden, above n 8, 413.

96 *Ibid* 414.

97 *Ibid* 415.

98 *Ibid* 416.

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.⁹⁹ This has particular relevance in cases of 'cheap' exclusion, as explained further in Part VI(D) below.

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.¹⁰⁰ 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).¹⁰¹ 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.¹⁰²

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

99 Ibid 425.

100 The first Australian case to expressly refer to the profitability of the conduct under the 'take advantage' element was *Australian Competition and Consumer Commission v Cement Australia Pty Ltd* 310 ALR 165, 509 [1899] ('*Cement Australia*'), explained further in Part VII(C) below.

101 Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 923 (Lionel Murphy, Attorney-General).

102 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* 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".'

real value for society).¹⁰³ 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*,¹⁰⁴ concerned an allegation that BHP had taken advantage of its position of control in the market for steel products.¹⁰⁵ 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.¹⁰⁶

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’.¹⁰⁷ Their Honours explained their finding that BHP had in fact taken advantage of, or used, its position of control as follows:

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.¹⁰⁸

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

103 See Trade Practices Consultative Committee, Parliament of Australia, *Small Business and the Trade Practices Act* (1979) vol 1, 69.

104 (1989) 167 CLR 177.

105 The *Trade Practices Act 1974* (Cth) 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.

106 *Queensland Wire Industries*, 182–5.

107 *Queensland Wire Industries* (1989) 167 CLR 177, 191 (Mason CJ and Wilson J) (emphasis added).

108 *Ibid* 192 (Mason CJ and Wilson J).

eroded its position in the steel products market without protecting AWI's position in the fencing materials market.¹⁰⁹

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?'¹¹⁰ 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 ...¹¹¹

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',¹¹² 'made possible',¹¹³ 'is able'¹¹⁴) 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.¹¹⁵

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*,¹¹⁶ 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'.¹¹⁷ That is, it would have eroded its position in the upstream market without creating

109 Ibid 202–3 (Dawson J).

110 Ibid 216 (Toohey J).

111 Ibid.

112 Ibid 192.

113 Ibid 202.

114 Ibid 216.

115 See the discussion of the 'possibility' strand of reasoning in Part VII(C) below.

116 *Queensland Wire Industries* (1989) 167 CLR 177, 192 (emphasis added).

117 Ibid 202–3.

profit through the resulting preservation of its market power in the downstream market.¹¹⁸ The 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: s 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.¹¹⁹ However, in 2003, the High Court majority in *Rural Press Ltd v Australian Competition and Consumer Commission* (‘*Rural Press*’)¹²⁰ appeared to indicate that courts were constrained to the narrower question whether a firm without substantial market power ‘could’ engage in the impugned conduct.¹²¹

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.¹²² 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;
- (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.¹²³

118 Cf Margaret Brock, above n 7, 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 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].

119 See the cases analysed in Part IV(B)(3)(5) of this article.

120 (2003) 216 CLR 53

121 *Ibid* 74–8 [49]–[56]. The *Rural Press* decision is explained in detail in Part VI(E) below.

122 *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.

123 *CCA* s 46(6A) (emphasis added).

Sections 46(6A)(a)–(c) are derived from the case law on 'taking advantage', as described below.¹²⁴ Sub-section (d) appears to create a broader category, requiring only that the conduct be 'related to' the firm's market power.¹²⁵ 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*,¹²⁶ 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'.¹²⁷ 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?'¹²⁸ 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.

Similarly, in the later case of *Melway*,¹²⁹ Gleeson CJ, Gummow, Hayne and Callinan JJ considered the approach adopted in *Queensland Wire Industries*¹³⁰ and held that a majority asked 'how [the defendant] would have been likely to behave in a competitive market',¹³¹ 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.¹³²

In *NT Power Generation Pty Ltd v Power and Water Authority ('PAWA')*,¹³³ 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.¹³⁴ 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.

124 See Part IV(B)(3)–(5) below.

125 CCA s 46(6A)(d). See also Part VI(E) below; Middleton, above n 7. Cf Reid, above n 7.

126 (1992) 34 FCR 109.

127 Ibid 144.

128 Ibid.

129 (2001) 205 CLR 1.

130 Ibid 22 [47], 23 [52]

131 Ibid 23 [50].

132 Ibid 26 [62].

133 (2004) 219 CLR 90.

134 Ibid 136 [124].

4 *Acting in Reliance Upon Market Power*

In *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Pty Ltd* ('*Natwest*'),¹³⁵ 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.¹³⁶ 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 reliance by the contravener upon its market power to insulate it from the sanctions that competition would ordinarily visit upon its conduct.¹³⁷

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*,¹³⁸ 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.¹³⁹

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 fact enjoys freedom from competitive constraint, and in fact refuses

135 (1992) 111 ALR 631.

136 *Ibid* 637.

137 *Ibid* 637.

138 (2001) 205 CLR 1.

139 *Ibid* 23 [51].

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.¹⁴⁰

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',¹⁴¹ 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.¹⁴²

In *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd* ('Safeway'),¹⁴³ 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 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'.¹⁴⁴ 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

140 Ibid 27 [67].

141 Ibid.

142 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.

143 (2003) 129 FCR 339.

144 Ibid 409 [330].

though that same conduct would not have been ‘absolutely impossible’ without that power.¹⁴⁵

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’).¹⁴⁶ 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

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, 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 firm’s objective *intent* in engaging in the conduct, and particularly whether it sought to profit only by suppressing the competitive responses of its rivals.¹⁴⁷ Some have also argued that conduct which fails the profit-focused tests is detrimental to social welfare, since such conduct wastes social resources; excludes competitors

145 Ibid 409 [333].

146 Ibid.

147 See, eg, Bork, above n 17, 144; Piraino, above n 84, 826, 845; Melamed, above n 8, 1257; Salop, above n 19, 354–7. Gavil, above n 12, 52, states:

Put another way, it asks whether there was any legitimate business reason for the conduct, which could be interpreted as little more than a test of ‘intent.’ The but-for test thus focuses exclusively on the incentives of the dominant firm, largely ignoring the effects of its conduct on rivals or consumers.

See also Donald Robertson, ‘The Primacy of Purpose in Competition Law: Part I’ (2002) 9 *Competition and Consumer Law Journal* 101, noting that there is no doubt an element of purpose in ‘taking advantage’ of market power: at 101–2. 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 ...

who are equally efficient; and increases market power in the absence of superior efficiency.¹⁴⁸

However, it is in explaining the requisite relationship between market power and profit that the Australian test diverges from the profit-focused tests proposed in the US. While the US tests ask whether the conduct would make business sense in the absence of the *resulting* market power,¹⁴⁹ 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,¹⁵⁰ 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.¹⁵¹ 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 downward (because, for example, of a diminished need to provide customer services) as a result of the exclusion of rivals'?¹⁵²

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

148 See Bork, above n 17, 144; Areeda and Turner, above n 17, 712, 723. See also Baumol et al, above n 15, 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.

However, Vickers, above n 85, 253–4, contends that the profit sacrifice test is better understood as a test of willfulness or intent, since 'it does not naturally yield a substantive standard of what behaviour is exclusionary': at 254.

149 Melamed, above n 8, 1257.

150 Or if the conduct occurred in a competitive market.

151 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].

152 Melamed, above n 8, 1256.

preservation of BHP's substantial market power in the fencing material market.¹⁵³ 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.¹⁵⁴ 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 competitive conduct, no matter the market conditions under which that conduct is in fact undertaken.¹⁵⁵

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.¹⁵⁶ 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.

153 In another example, in *Boral* (2003) 215 CLR 374, 465 [280], McHugh J stated, in 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. According to McHugh J, by engaging in the conduct with the intention to profit from the conduct through the later use of its discretionary pricing power, the firm takes advantage of its market power to engage in the conduct.

154 Williams, 'Should an Effects Test Be Added to s 46?', above n 28, 2. See also Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (Thomson Reuters, 4th ed, 2011) 293, explaining the connection between a firm's possession of significant market power and the likelihood that its practices will create anticompetitive effects.

155 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).

156 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 17, 10.

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*.¹⁵⁷

One of the key criticisms of Werden's 'no economic sense' test and Melamed's 'profit sacrifice' test is that they are under-inclusive.¹⁵⁸ In fact, Ordoover 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'.¹⁵⁹ 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'.¹⁶⁰

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.¹⁶¹ 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,¹⁶² they admit that their tests *are* under-inclusive. However, proponents argue both that their tests may be supplemented by other

157 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 Jonathon 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.

158 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 25, 781–6.

159 Baumol et al, above n 15, 6.

160 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.

161 *US Department of Justice Report on Single-Firm Conduct*, above n 26, 39–47.

162 Melamed, above n 8, 1260–1; Werden, above n 8, 425–8.

tests, and that an under-inclusive approach is justified.¹⁶³ 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 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.¹⁶⁴ In these circumstances, some contend that policymakers ought to err on the side of under-inclusiveness in constructing rules against unilateral conduct.¹⁶⁵

In Australia, s 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 s 46(1) cannot be supplemented with other standards in difficult cases, as proposed by Melamed and Werden,¹⁶⁶ at least not without substantial amendment to the legislation. On the other hand, unlike the position in the US, s 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 s 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.¹⁶⁷ 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.¹⁶⁸ These practices, they argue, will almost always have

163 Werden, above n 8, 415.

164 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.

165 Werden, above n 8, 432.

166 See Part VI(B) and (D) below.

167 See, eg, Gavil, above n 12, 52–5; Salop, above n 19, 356, 361; 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, 476.

168 Jacobson and Sher, above n 25; 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.

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.¹⁶⁹

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.¹⁷⁰ 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.¹⁷¹

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,¹⁷² Melamed claims to be able to identify conduct that depends upon an exclusionary effect for its profitability.¹⁷³ However, critics argue 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.¹⁷⁴

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:¹⁷⁵ 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.¹⁷⁶

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'¹⁷⁷ 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

169 Jacobson and Sher, above n 25, 781, 784, 788–92; Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct', above n 168, 11–12.

170 Werden, above n 8, 414.

171 Ibid 421, citing *LePage's Inc v 3M*, 324 F 3d 141 (3rd Cir, 2003) in particular.

172 Excluding any gains resulting from an increase in market power.

173 Melamed, above n 8, 1255–7.

174 See, eg, Salop, above n 19.

175 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.

176 Philip Williams, 'The Counterfactual Test in s 46' (2013) 41 *Australian Business Law Review* 93, 97–8.

177 *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, 135 [25].

market power. His Honour first adopted this approach in the dissenting judgment in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd*.¹⁷⁸ 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*,¹⁷⁹ and by the majority of the Full Federal Court in *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd*.¹⁸⁰ Where the firm has a legitimate 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.¹⁸¹ 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.¹⁸² 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.¹⁸³ 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.

178 (1999) 90 FCR 128, 135 [22]–[25], 136–7 [31]–[33].

179 (1999) 166 ALR 410, 440 [158].

180 (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 ‘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’.

181 Cf Elhauge, above n 16, 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.

182 See the discussion of unilateral conduct producing harms which are disproportionate to the resulting consumers’ benefits in Hovenkamp, *Federal Antitrust Policy*, above n 154, 298, 300–1; Salop, above n 19, 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.

183 See Harper et al, above n 2.

Unilateral conduct rules generally include a requirement that the defendant possess a 'significant' or 'substantial' degree of market power.¹⁸⁴ 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.¹⁸⁵

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.¹⁸⁶ 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,¹⁸⁷ 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.¹⁸⁸ 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 an incumbent with an objectively inferior, but widely adopted, product.¹⁸⁹ 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.¹⁹⁰ 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.

184 *ICN Report*, above n 9, 40, 59–60.

185 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 Louis Kaplow and Carl Shapiro, 'Antitrust' (2007) (Working Paper No 12867, National Bureau of Economic Research, January 2007) 101, 103. See also Williams, 'Should an Effects Test Be Added to s 46?', above n 28, 2.

186 See Part VI(D) below regarding 'cheap' exclusion.

187 See Alan Devlin, 'Analyzing Monopoly Power Ex Ante' (2009) 5 *New York University Journal of Law and Business* 153.

188 *Ibid* 180–3.

189 This illustration is derived from various scenarios suggested by Devlin: *ibid* 186.

190 *Ibid* 186–9.

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?¹⁹¹ The dominant firm would no longer be investing in establishing a network,¹⁹² 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.¹⁹³ Its conduct cannot therefore be said to be taking advantage, or using, its current market power. The dominant incumbent should, on this basis, be 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.¹⁹⁴ 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'.¹⁹⁵ 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

191 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.

192 There are diminishing marginal network effects beyond a certain level of consumer acceptance: Devlin, above n 187, 187.

193 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.

194 Salop, above n 19, 354–7; Baumol et al, above n 15, 18–9; Jacobson and Sher, above n 25, 784, 790–2; Elhauge, above n 16, 280–2; Gavil, above n 12, 56–7.

195 Susan A Creighton et al, 'Cheap Exclusion' (2005) 72 *Antitrust Law Journal* 975, 977.

involve little or no sacrifice of profits. Consider, for example, threats of predation made to deter the entry of a new rival;¹⁹⁶ abuse of standard-setting processes;¹⁹⁷ abuse of governmental processes;¹⁹⁸ 'fraudulent acquisition of a patent';¹⁹⁹ and 'gaming' of patent regulations to stall the introduction of generic rivals.²⁰⁰ Cheap exclusion is often also 'plain' exclusion,²⁰¹ meaning anticompetitive exclusion, which lacks any efficiency justification.²⁰²

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.²⁰³ 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 could be condemned as anticompetitive conduct under a separate rule, without the need for a sacrifice test, an effects-based test, or any other elaborate inquiry.²⁰⁴

Werden, on the other hand, 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.²⁰⁵

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.²⁰⁶

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)

196 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.

197 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>.

198 Bork, above n 17, 347–9.

199 Jonathon B Baker, 'Exclusion as a Core Competition Concern' (2013) 78 *Antitrust Law Journal* 527, 553.

200 Creighton, above n 195, 983–7.

201 *Ibid.*

202 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.

203 Melamed, above n 8, 1260.

204 *Ibid.* See also Patterson, above n 17, 42, who makes a similar suggestion, but also suggests ways in which 'cheap' exclusion may in fact sacrifice profits.

205 Werden, above n 8, 425–8.

206 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.

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'.²⁰⁷ 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 engage in that conduct.²⁰⁸ 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.²⁰⁹ Yet this is an exclusionary act, without any efficiency justification, which enhances a dominant firm's market power.²¹⁰

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.²¹¹ 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.²¹²

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'.²¹³ Non-dominant firms have also engaged in deceptive behaviour in the field of standard-setting in order to *acquire* monopoly power.²¹⁴ 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

207 (1992) 111 ALR 631, 637.

208 Ibid.

209 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 176, 96.

210 In fact, similar arson examples are often referred to by US commentators as illustrations of patently anticompetitive conduct: see, eg, Werden, above n 8, 426; Salop, above n 19, 315, 330.

211 See Donald Robertson, 'Causal Concepts in Competition Law and Economics' (2001) 29 *Australian Business Law Review* 382, 401.

212 As explained in Part IV(B).

213 Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct', above n 168, 33.

214 See, eg, the *Unocal* case, in which Unocal deceived a standard-setting body in order to *acquire* monopoly power in the market for producing a standard-compliant input: Kovacic, 'Market Forces, Competitive Dynamics, and Gasoline Prices', above n 197, 10–11.

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*,²¹⁵ 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).²¹⁶

Not surprisingly, this decision gave rise to some significant criticism.²¹⁷ 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

215 (2003) 216 CLR 53, 76 [51], [53].

216 *Rural Press* (2003) 216 CLR 53, 76. This principle was recently emphasised in *Cement Australia* (2013) 310 ALR 165, 576–7 511 [1907], 574 [2278], 666–7 [2680]–[2681].

217 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.

same conduct) than the threshold set by earlier cases (requiring proof only that a non-dominant firm *would* not engage in the same conduct).²¹⁸ 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.²¹⁹

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 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.²²⁰ 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.²²¹

His Honour noted, in particular, that market power must be distinguished from financial power,²²² 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.²²³ Section 46(6A)(d) is yet to be judicially

218 See, eg, Corones, ‘Characterisation of Conduct’, above n 1, 420; Brock, above n 7.

219 See Part IV(B) above.

220 For a fuller explanation of this argument see Kemp, ‘The Case Against “French J’s Arsonist”’, above n 206.

221 *Cement Australia* (2013) 310 ALR 165, 574 [2278] (emphasis in original).

222 *Ibid* 666 [2680].

223 Reid, above n 7, 50.

considered,²²⁴ but, if such views are accepted, s 46(1) will continue to permit instances of plainly anticompetitive conduct.

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.²²⁵ 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.²²⁶

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 to a reasonable compromise.²²⁷ 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.²²⁸ Similar arguments have been made in favour of the 'take advantage' test in Australia.²²⁹

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

224 *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.

225 Werden, above n 8, 416; Patterson, above n 17, 43.

226 Jacobson and Sher, above n 25, 781–3; Baumol et al, above n 15, 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.

227 Melamed, above n 8, 1252, 1257, 1266.

228 *Ibid* 1252, 1257.

229 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>>.

qualifications and additions erode the certainty claimed for the test as a universal standard.²³⁰

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’;²³¹ 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 manner in a competitive market.²³² 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,²³³ 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*,²³⁴ the High Court noted the difficulty of constructing such a counterfactual.²³⁵ In particular, it acknowledged that it was not apparent exactly how competitive the hypothetical market should be.²³⁶ Clearly it was not necessary to hypothesise a perfectly competitive market,²³⁷ but what level of competition would suffice for these purposes?

230 Jacobson and Sher, above n 25, 785.

231 Salop, above n 19, 352.

232 See, eg, *Melway* (2001) 205 CLR 1.

233 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.

234 (2001) 205 CLR 1.

235 *Ibid* 23–5.

236 *Ibid*.

237 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, all suppliers and consumers have perfect information, and there are no barriers to entry or exit. Such markets very rarely exist in reality. See Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 7–12.

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*,²³⁸ 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 market. ... [while leaving in place] the essential features of the actual market which did *not* give rise to [the dominant firm's] dominance.²³⁹

In the recent *Cement Australia* case, Greenwood J approved this approach to the 'take advantage' requirement under s 46(1).²⁴⁰

The intricacy of the proposed task is evident. In fact, some US courts have said that such a standard is impossible to apply.²⁴¹ 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.²⁴²

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 article, 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 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?

238 [2010] 1 NZLR 577.

239 Ibid 602 [38], [40].

240 *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 Pozzolan'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].

241 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).

242 See Australian Competition and Consumer Commission, above n 5, 79–81.

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'²⁴³ damaging a competitor,²⁴⁴ excluding a competitor,²⁴⁵ or excluding competitive behaviour.²⁴⁶ 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.²⁴⁷ This was the interpretation endorsed by the majority of the High Court in *Rural Press*.²⁴⁸

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*,²⁴⁹ and numerous other cases²⁵⁰, together with the 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.²⁵¹ The recent case of *Cement Australia* provides a pertinent example of the results of these inconsistencies.²⁵²

In *Cement Australia*,²⁵³ 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

243 *CCA* s 46(1).

244 *Ibid* s 46(1)(a).

245 *Ibid* s 46(1)(b).

246 *Ibid* s 46(1)(c).

247 *Rural Press* (2003) 216 CLR 53, 75–7 (emphasis added).

248 '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].

249 (1989) 167 CLR 177.

250 See the analysis of the case law in Part IV(B)(1)(5) above.

251 *Rural Press* (2003) 216 CLR 53, 76 [51], [53].

252 (2013) 310 ALR 165.

253 *Ibid*.

conduct for a firm with and without market power, in language reminiscent of Melamed and Werden's tests.²⁵⁴ 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*.²⁵⁵

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:

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.²⁵⁶

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'.²⁵⁷ 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].²⁵⁸

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*²⁵⁹ 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

254 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'.

255 *Cement Australia* (2013) 310 ALR 165 508 [1894] (emphasis in original).

256 Ibid 508 [1895] (emphasis in original).

257 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].

258 Ibid 515 [1927].

259 (2003) 216 CLR 53.

appeared to confirm that the ‘take advantage’ test is a profit-focused test of the kind described in this article.²⁶⁰

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.²⁶¹ 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.²⁶² 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*,²⁶³ 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.²⁶⁴ 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’.²⁶⁵ A non-dominant firm ‘could’ have done the same.²⁶⁶ 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.

VIII CONCLUSION

Profit-focused tests can be a valuable tool in unilateral conduct cases, particularly as a means of explaining and identifying certain predatory conduct and refusals to deal. However, in the US, the elevation of this tool to a more general standard

260 On its face, Greenwood J’s test actually bears some resemblance to that advocated by Ordovery and Willig: see Part 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 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).

261 (2013) 310 ALR 165, 606–7 [2418].

262 *Ibid* 665–6 [2673]–[2676], 738 [2971].

263 *Ibid* 511 [1906]–[1907], 668–9 [2688], 671 [2693–2694].

264 *Ibid* 574 [2278], 666–7 [2680]–[2681].

265 *Ibid* 668–9 [2688].

266 *Ibid* 668–9 [2687]–[2688].

for unilateral anticompetitive conduct has been resisted on the ground that it would be under-inclusive.

In Australia, 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. Further, as with the profit-focused tests proposed in the US, the 'take advantage' test considers the relationship between the profit gained from the conduct and the firm's market power.

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 intent 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.