

Submission in Response to
The New Zealand MBIE Issues Paper on the
Targeted Review of the Commerce Act 1986

**A Third Way:
Objective Anticompetitive Purpose**

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1 Summary

This submission was originally drafted in response to the Discussion Paper on ‘Options to Strengthen the Misuse of Market Power Law’ released by the Australian Treasury in December 2015 (‘the Australian Discussion Paper’). In particular, it offers a potential compromise, or third way, in the current debate concerning the amendment to section 46(1) of the *Competition and Consumer Act 2010* (Cth) (‘CCA’) proposed by the Competition Policy Review Panel in its Final Report dated March 2015 (‘the Harper Proposal’).

Given the similarities between section 46(1) of the CCA and section 36(2) of the *Commerce Act 1986*, as well as the MBIE’s express intention to have regard to the progress of the Australian debate, the submission made to the Australian Treasury is largely repeated here. However, the MBIE has, in its Issues Paper, raised questions not specifically raised in the Australian Discussion Paper. These issues are addressed in the boxed text in the relevant sections.

The Australian Treasurer has expressed concern that the debate over section 46(1) has become ‘binary’, with the key parties respectively insisting on two diametrically opposed approaches, either ‘the full Harper or the no Harper’.¹ Accordingly, the Treasury Discussion Paper released in December 2015 sought to reinvigorate debate on the Harper Proposal, ‘with a view to bringing parties closer together on the misuse of market power provision’. The respective positions are briefly as follows.

Under the current provision, the ‘take advantage’ standard focuses on the profitability of the impugned conduct for the dominant firm, and particularly the connection between that profitability and the firm’s substantial market power, to determine whether conduct is anticompetitive. The Harper Panel reached the conclusion that the ‘take advantage’ requirement has proved uncertain and under-inclusive as a standard for unilateral anticompetitive conduct: it is not ‘fit for purpose’.² This submission supports that view. (As explained in Section 4.)

The Harper Proposal, by contrast, would allow courts to focus on the effect or likely effect of the impugned conduct on rivalry in a market. Large retailers have argued that this test creates uncertainty for dominant firms, who cannot be expected to predict accurately the actual outcome of every strategy and cannot be certain of how a court may interpret the mixed outcomes of conduct after the fact, even if the strategy was an attempt to ‘compete on the merits’. This submission acknowledges that the Harper Proposal may reduce dominant firm incentives to engage in some socially beneficial conduct. (As explained in Section 5.)

¹ Fleur Anderson, ‘Scott Morrison to Consider ‘Part-Harper’ Option For the Effects Test’, *Australian Financial Review* (24 November 2015).

² Competition Policy Review Panel, *Competition Policy Review: Final Report* (2015) 335–45.

As a third way, it is submitted that it is preferable for unilateral conduct rules to focus on whether the impugned conduct had an ‘objective anticompetitive purpose’: that is, whether, *assessed objectively*, the conduct had the purpose of enhancing or prolonging the dominant firm’s market power by suppressing rivalry in the market, without creating any proportionate benefits for consumer welfare. (As explained in Section 8.)

Importantly, an objective anticompetitive purpose approach takes into account common features of a desirable unilateral conduct rule, which can be distilled from the case law and commentary in this area, including that such rules should:

- Target conduct which prolongs or enhances a dominant firm’s substantial market power by suppressing rivalry, rather than by enhancing efficiency;
- Require an objective analysis, which takes into account the likely effect of the impugned conduct on the relevant markets;
- Have regard to the information reasonably available to the dominant firm³ at the time it engaged in the conduct, especially in respect of conduct which may be inherently unpredictable at the outset;
- Not depend on the dominant firm’s actual state of mind, but take into account whether there is a plausible efficiency-enhancing rationale for the conduct;
- Not depend on any fine balancing of mixed effects, but consider the proportionality of any exclusion relative to its plausible benefits; and
- Condemn conduct which amounts to ‘naked’, unjustifiable exclusion of rivalry by competitors, without the need for any detailed effects analysis.

In the interests of a concise submission, arguments are generally made in brief form, with references to external sources for further explanation. A comparison of the different types of tests is provided in a table in the appendix.

2 Objective of Section 46(1) of the CCA

It is submitted that the objective of section 46(1) of the CCA is to protect the competitive process, with the further objective of enhancing long-term consumer welfare. While the objects clause of the CCA refers to a broader range of goals,⁴ Part IV of the CCA is particularly concerned with the preservation of the competitive

³ CCA, s 46(1), refers to a firm with ‘a substantial degree of market power’. In other jurisdictions, similar laws refer to firms with a ‘dominant position’ or to ‘monopolists’. In this submission, 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.

⁴ The purpose of the CCA is ‘to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’: CCA, s 2.

process.⁵ However, given that the competitive process advances a number of potentially-conflicting ends, the goal of protecting the competitive process lacks content unless a further objective is identified.⁶

In the case of section 46(1), it is submitted that that further objective is long-term consumer welfare for the following reasons:

- The High Court has emphasized that section 46(1) is intended to protect the competitive process, having regard to consumer interests in particular;⁷
- The focus of the misuse of market power prohibition may be distinguished from the broader focus of the authorisation provisions, with the latter specifically requiring administrative consideration and balancing of a range of public interest, or ‘total welfare’, factors;⁸
- It would be against the tenor of Part IV to permit conduct which causes significant harm to consumer welfare on the basis that it creates even more substantial gains in producer welfare for the dominant firm;
- Gains in producer welfare for a dominant firm will often be countered by losses in producer welfare for its smaller rivals – the decisive objective should be the protection of competitive conduct which enhances long term consumer welfare; and
- The promotion of long-term consumer welfare tends to increase the welfare of Australians in general.

The legislative objective outlined here is consistent with the purpose stated in section 1A of the *Commerce Act 1986*, namely ‘to promote competition in markets in New Zealand for the long-term benefit of consumers’.

⁵ *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 191 (per Mason CJ and Wilson J); 194 (Deane J) (*QWI*); *Rural Press Ltd v Australian Competition and Consumer Commission* (2003) 216 CLR 53, 94 [100], 101[125] (per Kirby J) (*Rural Press*).

⁶ See Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 16-7 (arguing that it is not possible to define what the ‘competitive process’ means in a market context without reference to a further objective).

⁷ See the references in n 5 above.

⁸ *Cf Re Qantas Airways Ltd* (2004) ATPR P 42-027, 42,871-5 (re the modified ‘total welfare’ standard in authorisation cases).

3 The Relevant Harm and the Rationale for Conduct Rules

3.1 Market Power Harm and Exclusionary Conduct

Section 46(1) is limited in its application to corporations that possess a substantial degree of market power ('SMP'). 'Market power' is the ability of a firm to exercise control over price:⁹ that is, to maintain price above the competitive level (or quality below the competitive level) for a sustained period without being undermined by consumers switching or competitors entering the market.¹⁰ While almost all firms in modern markets have some ability to control the price they charge,¹¹ unilateral conduct laws generally only apply to firms with a substantial degree of market power. Australian law provides no definition of, or concrete guidance about, when market power becomes 'substantial'. Rather, this is a question of fact in each case, requiring a 'large' or 'considerable' degree of power, but something *less* than 'monopoly or near monopoly power' or a position of substantial control.¹²

The MBIE Issues Paper suggests that 'market power may also manifest itself through other conduct such as refusing to supply or dictating non-price terms of supply' (section 2.3.1). Particularly in the US case law on monopolization, it is sometimes said that market power is 'the power to control prices or exclude competition'. However, it is submitted that the better view is that market power is power to price above the competitive level (or reduce quality below the competitive level), and that a firm can price above the competitive level in one of two ways, either by restricting its own output or by restricting the output of its rivals.

See Krattenmaker, Lande and Salop, "Monopoly Power and Market Power in Antitrust Law" (1987) 76 *Georgetown Law Journal* 241, 247-51.

⁹ See Louis Kaplow and Carl Shapiro, 'Antitrust' (2007) Working Paper 12867, NBER Working Paper Series, 3, available at <http://www.nber.org/papers/w12867>; Geoff Edwards, 'The Hole in the Section 46 Net: The Boral Case, Recoupment Analysis, the Problem of Predation and What to Do About It' (2003) 31 *Australian Business Law Review* 151, 157-8, 161; *QWI* (1989) 167 CLR 177, 188 (Mason CJ and Wilson J).

¹⁰ Gunnar Niels, Helen Jenkins and James Kavanagh, *Economics for Competition Lawyers* (Oxford University Press, 2011) [3.1].

¹¹ Kaplow and Shapiro, above n 9, 3; Einer Elhauge, 'Defining Better Monopolization Standards' (2003) 56 *Stanford Law Review* 253, 330.

¹² See CCA, s 46(3), (3C); *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374, 423 [136]–[137] (Gleeson CJ and Callinan J); Corones SG, *Competition Law in Australia* (6th ed, Thomson Reuters, 2010) 132-150.

To understand the harm addressed by unilateral conduct laws it is important to understand the threat posed by the possession of SMP per se, as well as the reasons competition laws in general nonetheless permit the possession of SMP per se.

A firm's possession of SMP is considered to pose several **threats to the competitive process and ultimately consumer welfare** as follows:

- Such firms can limit output and thereby increase price above the competitive level, reducing consumer surplus: that is, some consumers who would otherwise pay a lower price will be forced to pay more for the same product, up to their reserve price (or the limit of their individual willingness to pay). There is a wealth transfer from the consumer to the producer.¹³
- More importantly, some consumers who were willing to compensate the producer for the cost of producing the product (including a normal profit) will no longer purchase the product at all as the price set by the producer exceeds their reserve price. This type of loss enriches no one. It reduces the producer's sales at the same time as reducing the number of consumers whose wants and needs are satisfied by their product, resulting in a 'deadweight loss' for society.¹⁴
- Further, relative to competitive markets, monopolies create productive inefficiency and X-inefficiency (or managerial slack).¹⁵
- Some argue that market power also reduces innovation, or dynamic efficiency (the rate at which new products come to market); that 'the push of competition generally spurs innovation and investment more than the pull of monopoly'.¹⁶

Notwithstanding these threats from SMP, **competition laws in general do not prohibit the possession of SMP per se** for several reasons:

- As a practical matter, it would be very difficult to determine a level at which market power should be limited: the breaking up of powerful firms would often be arbitrary and prone to dissipate socially beneficial efficiencies.¹⁷
- Some argue that monopolistic markets actually spur innovation even more than competitive markets.¹⁸
- Importantly, the prospect of pricing above the competitive level gives firms an incentive to outcompete their rivals by making better and cheaper products, and to invest in crucial innovation, to the benefit of society in general and consumers in particular.¹⁹

¹³ See Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 9.

¹⁴ Ibid; Niels et al, above n 10, 14-5.

¹⁵ See Nazzini, above n 6, 35-7; Niels et al, above n 10, 15.

¹⁶ See Jonathon B Baker, 'Beyond Schumpeter vs Arrow: How Antitrust Fosters Innovation' (2007) 74 *Antitrust Law Journal* 575, 583-6; Jonathon B Baker, 'Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement' (2010) 76 *Antitrust Law Journal* 605, 619.

¹⁷ Herbert Hovenkamp, *The Antitrust Enterprise* (Harvard University Press, 2005) 37, 63.

¹⁸ Joseph A Schumpeter, *Capitalism, Socialism and Democracy* (3rd ed, 1950) 84-92, 99-106; David S Evans and Keith N Hylton, 'The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust' (2008) 4 *Competition Policy International* 203.

¹⁹ Ibid; *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP*, 540 US 398 (2004) para 2 (Scalia J).

- SMP is often in fact achieved and maintained by a corporation's superior efficiency, innovation and ability to meet consumer desires.
- In any case, over time, new or existing rivals will outcompete the dominant firm for the 'top spot', or at least force it to compete more vigorously: the market will self-correct.²⁰

However, not all threats from SMP can be left to the self-correcting forces of the market. While some firms with SMP succeed by offering a better price or product, **it is possible for firms to maintain or extend their market power through conduct which suppresses the rivalry of their competitors, without creating any, or any proportionate, benefit for consumers** ('unilateral anticompetitive conduct'). Such conduct effectively blocks the self-correcting forces of the market and deprives consumers of innovative and superior offers from would-be challengers.²¹

A 'suppression' of rivalry does not occur simply because a rival loses a given sale or sales to the dominant firm. The better view is that the suppression of rivalry occurs when the dominant firm's conduct significantly impairs its rivals' ability and/or incentive to compete for future sales, or for sales other than those captured directly by the dominant firm.²² This suppression of rivalry tends to preserve or enhance market power and reduce long-term consumer welfare.

Inefficient monopoly-preserving conduct wastes the resources of both the excluding firm and the excluded firm.²³ It also protects or enhances the dominant firm's SMP, such that the firm can act contrary to consumer interests, undeterred by the constraints previously imposed by rivals or potential rivals. Competition laws therefore generally target unilateral anticompetitive conduct on the part of firms with SMP.

Having regard to the objective of section 46(1) and the underlying rationale for unilateral conduct laws, the general rule against unilateral anticompetitive conduct under the CCA should target conduct which protects or extends SMP by suppressing rivalry, without creating proportionate benefits for consumer welfare. At the same time, the rule should leave dominant firms free to exclude rivals through superior efficiency or innovation.²⁴

²⁰ Frank H Easterbrook, 'When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?' (2003) *Columbia Business Law Review* 345, 353; Fred S McChesney, 'Talkin' 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law' (2003) 52 *Emory Law Journal* 1401, 1412.

²¹ See Hovenkamp, *Antitrust Enterprise*, above n 17, 156. See also Jonathon B Baker, 'Exclusion as a Core Competition Concern' (2013) 78 *Antitrust Law Journal* 527, 557; Thomas G Krattenmaker and Steven C Salop, 'Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price' (1986) 96 *Yale Law Journal* 209.

²² B Douglas Bernheim and Randal Heeb, 'A Framework for the Economic Analysis of Exclusionary Conduct' in Roger D Blair and D Daniel Sokol (eds), *The Oxford Handbook of International Antitrust Economics: Volume 2* (Oxford University Press, 2014) 4, 5, 26.

²³ See Richard Posner, 'The Social Costs of Monopoly and Regulation' (1975) 83 *Journal of Political Economy* 807, 807-8; Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (4th ed, Thomson Reuters, 2011) 21.

²⁴ Niels et al, above n 10, 16.

The MBIE Issues Paper asks whether it has accurately described, in section 2.1.2, the type of conduct that countries typically seek to prohibit. One further point might be mentioned in addition to the rationale outlined above. It is customary to begin discussions on unilateral anticompetitive conduct rules by acknowledging that these rules do not prohibit dominance per se, as if the advantage of this approach is self-evident. But it is worth remembering that eminent antitrust scholars and economists have advocated breaking up companies with substantial and enduring market power. It is impossible to appreciate fully the rationale for unilateral conduct rules without understanding why dominance per se is tolerated, as outlined above.

See, eg, Daniel A Crane and Herbert Hovenkamp (eds) *The Making of Competition Policy: Legal and Economic Sources* (Oxford University Press, 2013) 319, 360-1, 445-60.

3.2 Exploitative Conduct or Excessive Pricing

Since SMP refers to the power to increase price above the competitive level, it might be thought that misuse of market power laws would target supra-competitive pricing by dominant firms. In fact, in some jurisdictions – for example, the European Union and South Africa – unilateral conduct laws do prohibit such ‘exploitative’ conduct, or ‘excessive pricing’.²⁵ However, even in these jurisdictions, competition authorities rarely pursue excessive pricing cases, for the same reasons that the prohibitions have not been adopted in other jurisdictions.²⁶ In particular, it is very difficult to define when a price becomes ‘excessive’ or ‘exploitative’; high prices are often a socially useful reward for superior efficiency and innovation; and courts are not well-suited to the role of price regulators. Accordingly, unilateral conduct rules tend to target ‘exclusionary’ conduct which unjustifiably protects the firm’s ability to charge supra-competitive prices, rather than the supra-competitive pricing itself.

4 The Flawed ‘Take Advantage’ Standard

4.1 Understanding ‘Profit-Focused’ Tests

The prohibition of misuse of market power in s 46(1) of the CCA relies in particular on the ‘take advantage’ element to distinguish vigorous, efficient competition, from inefficient conduct that suppresses the rivalry.²⁷ This submission supports the Harper Panel’s view that the ‘take advantage’ element has not been ‘fit for purpose’.

²⁵ See Jones and Sufrin, above n 13, 531-8; Philip J Sutherland and Katharine Kemp, *Competition Law of South Africa* (LexisNexis, looseleaf, 2005-) 7-36 – 7-49 [7.9].

²⁶ Jones and Sufrin, above n 13, 531.

²⁷ See Katharine Kemp, ‘The Case Against “French J’s Arsonist”’ (2015) 43 *Australian Business Law Review* 228, 238-9, available [here](#).

To appreciate its advantages and disadvantages, the ‘take advantage’ standard is best understood as a ‘profit-focused’ test, which bears important similarities to certain tests for unilateral anticompetitive conduct advanced in US case law and commentary, including the ‘no economic sense’ test and the ‘profit sacrifice’ test.²⁸ All of these tests focus on the profitability of the impugned conduct for the dominant firm, and particularly the connection between the profitability of the conduct and the firm’s market power, rather than focusing on the likely impact of the conduct on the relevant markets.

4.2 The Wisdom of Profit-Focused Tests: Objective Purpose or Rationale

Profit-focused tests share a similar rationale for focusing on the connection between profit and market power: that is, this connection explains the dominant firm’s **objective purpose** in engaging in the conduct, and particularly whether it sought to profit only by suppressing the competitive responses of its rivals.²⁹ To be clear, profit-focused tests do not address the more general question whether the impugned conduct had an objective anticompetitive purpose, as defined in this submission. Rather, each of these tests represents *one method* of identifying such a purpose, in *some* cases, but they do not uncover all significant instances of objective anticompetitive purpose.

Profit-focused tests do not focus on the purpose of the relevant conduct by enquiring after the firm’s subjective state of mind when it engaged in the conduct, but assess whether, objectively speaking, having regard to the relevant economic circumstances, the conduct *must* have been designed to enhance market power by suppressing rivalry rather than improving efficiency.

The intuition that the underlying purpose or rationale of unilateral conduct is critical to its characterization is evident elsewhere in the case law on unilateral anticompetitive conduct, particularly with regard to predatory pricing and considerations of ‘legitimate business purpose’. In the context of **predatory pricing**, courts and commentators generally advocate a test which considers whether the dominant firm has priced below an appropriate measure of cost. Put simply, the underlying rationale of this test is that a firm that prices below cost is incurring a loss, and that such loss-making is not rational behaviour for a profit-maximizing firm unless the firm intends to recoup that loss by supracompetitive pricing once its rivals are excluded from the market. That is, objectively speaking, the purpose of the conduct is to increase the firm’s market power by suppressing rivalry.

²⁸ Explained in more detail in Katharine Kemp, ‘“Taking Advantage” and Other “Profit-Focused” Tests for Unilateral Anticompetitive Conduct’ (2016) 41(3) *Monash University Law Review* (forthcoming).

²⁹ See, eg, Robert H Bork, *The Antitrust Paradox* (Basic Books, 1978) 144; A Douglas Melamed, ‘Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal’ (2005) 20 *Berkeley Technology Law Journal* 1247, 1257; Steven C Salop, ‘Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard’ (2006) 73 *Antitrust Law Journal* 311, 354–7; Thomas A Piraino, ‘Identifying Monopolists’ Illegal Conduct Under the Sherman Act’ (2000) 75 *New York University Law Review* 809, 845. See also Donald Robertson, ‘The Primacy of Purpose in Competition Law: Part 1’ (2002) 9 *Competition and Consumer Law Journal* 101 (noting that there is no doubt an element of purpose in ‘taking advantage’ of market power).

In both the US,³⁰ and Australia,³¹ courts have also asked whether there is an alternative explanation, or ‘**legitimate business purpose**’, for allegedly anticompetitive unilateral conduct such that it should be absolved. The requisite explanation has been variously described as a ‘normal business purpose’; a ‘valid business reason’; a ‘legitimate business rationale’; and a ‘legitimate business justification’.

All of these labels make clear that the courts are concerned to discover the underlying purpose or rationale of the impugned conduct. And yet, in the absence of further explanation as to the *type* of purpose which should absolve a dominant firm, these phrases merely beg the question. What is it that makes a purpose ‘normal’ or ‘valid’ or ‘legitimate’ in this context? The fact that it is considered to be a ‘business’ purpose cannot be determinative. Anticompetitive practices are undertaken in the course of ‘business’ as surely as procompetitive practices.

It is submitted that a business purpose is ‘legitimate’ if it directly or indirectly enhances consumer welfare, for example, through improved quality, innovation or efficiency.³² On the other hand, if conduct is designed to prolong market power by suppressing rivalry, without creating any proportionate benefit for consumers, the business purpose is ‘illegitimate’.

4.3 The Under-Inclusiveness of Profit-Focused Tests

Notwithstanding the usefulness of profit-focused tests in identifying some types of anticompetitive conduct, in the US, these tests are generally acknowledged to be under-inclusive as a *general* standard for unilateral anticompetitive conduct.³³

³⁰ See, eg, *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 US 585 (1985); *Data General Corp v Grumman System Support Corp*, 36 F 3d 1147, 1183 (1st Cir 1994).

³¹ *QWI* (1989) 167 CLR 177, 193 (Mason CJ and Wilson J); *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128, [22]-[25], [31]-[33] (‘*Melway*’), citing *Aspen*; *Australian Competition and Consumer Commission v Boral Ltd* (1999) 166 ALR 410, [158]. In *Safeway* (2003) 129 FCR 339, 408, 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 market power, is relevant* ... (latter emphasis added)

³² This concept is explained further in section 8 below. As the First Circuit of the US Court of Appeal explained in *Data General Corp v Grumman System Support Corp*, 36 F 3d 1147, 1183 (1st Cir 1994):

In general, a business justification is valid if it relates directly or indirectly to the enhancement of consumer welfare. Thus, pursuit of efficiency and quality control might be legitimate competitive reasons ..., while the desire to maintain a monopoly market share or thwart the entry of competitors would not.

³³ There is also an argument that some profit-focused tests are over-inclusive in respect of conduct – eg, investing in a new factory or a product innovation – which depends on an increase in market power for its profitability, but which also benefits consumers: see, eg, US Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (2008), 41, <<http://www.usdoj.gov/atr/public/reports/236681.pdf>>

The authors of one profit-focused test vigorously opposed the use of their ‘profit sacrifice’ test as a general standard in monopolization cases, stating that, ‘there undeniably are circumstances where business conduct can be damaging to the public welfare even though it passes the sacrifice test’.³⁴ 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’.³⁵

The Antitrust Division of the US Department of Justice, while acknowledging the usefulness of the ‘no economic sense’ and ‘profit sacrifice’ tests in some circumstances, ultimately declined to adopt a profit-focused test for all unilateral conduct cases.³⁶ In particular, these tests concentrate only on the impact of the impugned conduct on the dominant firm, and the dominant firm’s intentions, and may absolve some practices that is likely to have an anticompetitive impact on the relevant market(s) and ultimately consumer welfare.

It is submitted that, in some respects, the *Australian ‘take advantage’ test is even less inclusive than its US counterparts* due to an important difference in the underlying principle, explained in the following section.

4.4 Flawed Assumptions of the ‘Take Advantage’ Standard

In brief, US profit-focused tests – such as the ‘no economic sense’ test and the ‘profit sacrifice’ test – ask whether the conduct in question would still be profitable for the dominant firm even if the conduct resulted in no increase in the firm’s market power.³⁷ If the conduct would still be profitable absent this increase in market power, it is assumed that the conduct’s profitability stems from its superior efficiency rather than the extension of the firm’s market power.

In contrast, the Australian ‘take advantage’ test (at its most inclusive) has been interpreted to ask whether the conduct would be profitable if the firm did not possess SMP in the first place. If the conduct would still be profitable in a competitive market, it is assumed that the conduct’s profitability stems from its superior efficiency. The underlying premise of this approach is that firms in a competitive market are likely to engage in efficient conduct since non-efficient conduct will be sanctioned by the competitive process: thus conduct that is likely in a competitive market is efficient conduct.

While at this theoretical level, the ‘take advantage’ standard uses a ‘competitive market’ as the benchmark for competitive conduct, in practice, the Australian courts have also used the conduct of firms with less-than-substantial market power as a

³⁴ 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, 6.

³⁵ Ibid 16. Also at 18 ff, listing instances of unilateral conduct not captured by the ‘profit sacrifice’ test.

³⁶ ‘US Department of Justice Report on Single-Firm Conduct’, above n 33, 39-43.

³⁷ See Melamed, above n 29; Gregory J Werden, ‘Identifying Exclusionary Conduct Under Section 2: The “No Economic Sense” Test’ (2006) 73 *Antitrust Law Journal* 413.

benchmark.³⁸ In particular, the courts have variously judged impugned conduct against the conduct of the same firm before it possessed SMP; the same firm in markets where it has less than SMP; and smaller rivals of the firm with SMP.

Thus the **assumption underlying the ‘take advantage’ requirement is that conduct that is profitable (or possible) for a firm with less-than-substantial market power must be procompetitive, no matter the market environment in which it occurs.** This assumption is flawed for three reasons.

First, nondominant firms *can* engage in anticompetitive conduct. In this respect, it should be understood that the SMP requirement in unilateral conduct rules acts as a *screen*, restricting government intervention to the unilateral conduct of firms which are most *likely* to create an anticompetitive effect.³⁹ SMP is not an economic concept, but a legal construct, which focuses on the substantiality of a firm’s market power to determine whether the firm’s conduct is worthy of scrutiny.⁴⁰ SMP is *not* a precise or definable degree of market power above which anticompetitive conduct becomes possible and below which all conduct is procompetitive.

It is possible, and even profitable, for firms with less-than-substantial market power to engage in anticompetitive conduct in certain circumstances.⁴¹ It is for this reason that the US law of monopolization extends liability to anticompetitive conduct by which a firm *acquires* monopoly power, in addition to anticompetitive conduct by which a firm maintains its monopoly power.⁴² In fact, Markovits argues that, as a matter of economic theory, there is a weak correlation between a firm’s pre-existing monopoly or market power and its ability to engage in anticompetitive conduct.⁴³

Examples of conduct which may be anticompetitive on the part of both dominant and nondominant firms include threats of predation made to deter the entry of a new rival;⁴⁴ abuse of standard-setting processes;⁴⁵ abuse of government processes;⁴⁶

³⁸ See *Melway* (2001) 205 CLR 1, 23-5, 26; *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 (‘*Cement Australia*’).

³⁹ Applying unilateral conduct rules to all firms, regardless of market power, would require far more resources for enforcement and compliance, and it is generally believed that the extra cost could not be justified. See Philip L Williams, ‘Should an Effects Test Be Added to s46?’ (Paper presented at the Competition Law Conference, Sydney, 24 May 2014) 2; Kaplow and Shapiro, above n 9, 101, 103; Hovenkamp, *Federal Antitrust Policy*, above n 23, 293; Elhauge, above n 11, 335.

⁴⁰ See Kaplow and Shapiro, above n 9, 20.

⁴¹ Liza Lovdahl Gormsen, *A Principle Approach to Abuse of Dominance in European Competition Law* (Cambridge University Press, 2010) 38 (referring to ‘Post-Chicago’ scholarship, indicating that market failures are not necessarily self-correcting and that firms can take advantage of imperfections to produce inefficient results even in competitive markets).

⁴² Elhauge, above n 11, 331-2.

⁴³ Richard S Markovits, *Economics and the Interpretation and Application of US and EU Antitrust Law: Volume I* (Springer, 2014) chap 4, 528.

⁴⁴ Baker, ‘Exclusion as a Core Concern’, above n 21, 538-539, 542; *Rural Press* (2003) 216 CLR 53.

⁴⁵ See, eg, the *Unocal* case in Kovacic WE, US Federal Trade Commission, ‘Market Forces, Competitive Dynamics, and Gasoline Prices’ (Statement to the Subcommittee on Oversight and Investigations, US House of Representatives) 22 May 2007.

⁴⁶ Bork, above n 29, 347 ff.

fraudulent acquisition of a patent;⁴⁷ and ‘gaming’ of patent regulations to stall the introduction of generic rivals.⁴⁸ These are all examples of conduct which may preserve or enhance a dominant firm’s market power by suppressing the rivalry of competitors or potential competitors, but they might also be profitably adopted by a firm with less-than-substantial market power.

Second, in some circumstances, conduct which is competitive on the part of a nondominant firm is likely to cause an anticompetitive effect when undertaken by a dominant firm.⁴⁹ A dominant firm and a nondominant firm may engage in the same conduct for different reasons and with different consequences for the competitive process.⁵⁰ Accordingly, in the US, the law of monopolization does not require proof that the dominant firm ‘used’ its market power to engage in the conduct in question.⁵¹

In a market characterized by network effects, for example, a dominant firm may price below cost to deter entry by a new rival with a superior product; while the entrant may initially price below cost to establish the network necessary to introduce its superior product.⁵² Alternatively, a dominant firm may bid up the price of an essential input to deter entry by a new rival, and thereby escape the competitive constraints that would be imposed by such rivalry; while the new entrant may bid aggressively for the same input to gain entry and to compensate suppliers for the risk of switching supply away from the dominant incumbent.⁵³ Similar conduct can have different rationales and very different results for the competitive process, even if it is profitable in both cases.

Third, under the ‘take advantage’ standard, Australian courts continue to distinguish between the use of SMP and the use of ‘financial power’, such that a dominant firm is entitled to protect its dominance by engaging in inefficient conduct which suppresses rivalry, so long as it ‘uses its financial resources’ to do so.⁵⁴ Such an approach cannot

⁴⁷ Baker, ‘Exclusion as a Core Concern’, above n 21, 553.

⁴⁸ Susan A Creighton et al, ‘Cheap Exclusion’ (2005) 72 *Antitrust Law Journal* 975, 983 ff.

⁴⁹ See *Eastman Kodak Co v Image Tech Services Inc*, 504 US 451, 488 (1992) (Scalia J, dissenting) (‘[B]ehavior that might otherwise not be of concern to the antitrust laws-or that might even be viewed as procompetitive can take on exclusionary connotations when practiced by a monopolist.’). See also Elhauge, above n 11, 327; Jones and Sufrin, above n 13, 366.

⁵⁰ JM Cross, J Douglas Richards, Maurice E Stucke and Spencer Weber Waller, ‘Use of Dominance, Unlawful Conduct, and Causation Under Section 36 of the New Zealand’s Commerce Act 1986: A United States Perspective’ (2012) 18 *New Zealand Business Law Quarterly* 333.

⁵¹ George A Hay, ‘Book Review: Economic Essays on Australian and New Zealand Competition Law’ (2005) 50 *The Antitrust Bulletin* 299, 306-307; Cross et al, above n 51, 337-340.

⁵² Eg, Devlin points out that, particularly in ‘new economy’ markets which display powerful network effects, it is now recognized that fringe firms may profit from conduct that was previously considered profitable only as a predatory strategy on the part of a dominant firm: Alan Devlin, ‘Analyzing Monopoly Power Ex Ante’ (2009) 5 *NYU Journal of Law and Business* 153, 180-3, 186 ff.

⁵³ Niels et al, above n 10, 118-9. Cf it is apparent from *Cement Australia* [2013] FCA 909 [2291]-[2296] that it is not necessary to have regard to the different motives of a firm attempting to gain entry and a dominant incumbent seeking to protect its substantial market power.

⁵⁴ *Rural Press* (2003) 216 CLR 53; *Cement Australia* [2013] FCA 909 [2278], [2680]-[2681], [2687]-[2688].

be justified. There is no apparent reason in logic or in theory that ‘deep pockets’ should make the fortification of a dominant position by inefficient conduct legitimate.

The MBIE Issues Paper notes that, in New Zealand, the courts have required plaintiffs to prove that the impugned conduct would not take place in the counterfactual competitive market, rather than following the Australian courts in making comparisons with the behaviour of firms with less-than-substantial power, to establish the ‘take advantage’ element.

On the one hand, as the Issues Paper notes, the complex task of constructing the relevant counterfactual market likely adds to the cost and uncertainty of litigation under section 36(2), and the cost and uncertainty faced by dominant firms in planning their strategies. On the other hand, the New Zealand courts might be said to have adopted a more ‘pure’ form of the ‘take advantage’ standard, given the underlying premise of the standard (that is, that firms in a competitive market are likely to engage in efficient conduct since non-efficient conduct will be sanctioned by the competitive process).

Nonetheless, it is submitted that the standard adopted in New Zealand remains under-inclusive as a general standard for unilateral anticompetitive conduct, particularly in respect of the second point raised above.

It is important to bear in mind that the threat addressed by unilateral conduct rules is not that dominant firms might behave differently to firms in competitive markets (although this may be one reason to suspect that conduct is anticompetitive). The threat addressed by unilateral conduct rules is that dominant firms may protect or enhance their substantial market power by suppressing rivalry without creating any proportionate benefit for long-term consumer welfare. This may occur even when similar conduct would occur in a competitive market, or when a plaintiff fails to construct the necessary counterfactual.

New Zealand’s current ‘take advantage’ standard is an under-inclusive conduct rule, which is relatively complex, difficult and costly to administer.

4.4 Inconsistent and Uncertain Application of the ‘Take Advantage’ Standard

The Australian case law on the meaning of ‘taking advantage’ has also produced uncertain and inconsistent interpretations. Most importantly, there is doubt over whether it is necessary to show that a dominant firm ‘used’ its SMP (as opposed to its financial resources, for example) to engage in the conduct such that a nondominant firm *could* not engage in the same conduct; or that the firm’s possession of SMP made the conduct more profitable; or that the conduct was profitable because it enhanced or protected the firm’s SMP.⁵⁵

⁵⁵ As explained in Kemp, ‘French J’s Arsonist’, above n 27, 239-42.

The concept of ‘misuse of market power’ lacks certainty and clarity in Australian law. ‘Misusing’ or ‘taking advantage’ of market power is not an observable fact. It is an inference drawn by the court about how or why a firm engaged in certain conduct. More than forty years after the provision was enacted, the courts have not established with any certainty or consistency what the relevant inference should be.

4.5 Conclusion on ‘Take Advantage’

In Australia, the ‘take advantage’ standard has been poorly understood, and inconsistently applied. Properly understood, the ‘take advantage’ test, like other ‘profit-focused’ tests, is based on the insight that the objective rationale or purpose of impugned unilateral conduct is critical to the proper characterization of that conduct. At its best, the ‘take advantage’ test is based on the premise that conduct that is not profitable, and unlikely to occur, in a competitive market is likely to be inefficient, since competitive markets generally force efficient responses. A dominant firm that engages in such conduct *must* have sought to profit by anticompetitive means.

However, while this test may be useful in uncovering objective anticompetitive purpose in *some* cases, it fails to capture significant categories of conduct that enhance or prolong SMP by suppressing rivalry. For these reasons, it is submitted that the ‘take advantage’ standard is not appropriate as a general standard for unilateral anticompetitive conduct.

The MBIE Issues Paper asks what justifications there can be for requiring that a firm with a substantial degree of market power ‘take advantage’ of that power (para 2.3.3, Q 4). As will be clear from the foregoing arguments, it is submitted that the ‘take advantage’ requirement cannot be justified as a necessary element in every case of unilateral anticompetitive conduct.

The firm’s market power need not be the ‘cause’ of the impugned conduct in the sense that, but for that market power, the firm could not or would not have engaged in the conduct. Rather the relevant harm is that the firm’s substantial market power is perpetuated, not by efficiency-enhancing conduct, but by conduct which suppresses rivalry without creating any proportionate benefits for long-term consumer welfare.

It is interesting to note the **origins of the Australian ‘take advantage’ requirement** in this respect. It seems most likely that the ‘take advantage’ wording in the *Trade Practices Act 1974* (Cth) was adopted from the ‘take advantage’ requirement in the *Trade Practices Act 1965* (Cth). However, under the Bill which was to become the 1965 Act, the original clause provided that monopolization occurred if a person ‘in a dominant position’ engaged in certain specified conduct ‘by virtue of, or for the purpose of maintaining, his dominant position’, *or* ‘takes advantage of his dominant position’ in fixing prices or terms of trade. However, during the debates in the House of Representatives, Attorney-General Billy Snedden removed the former reference to ‘maintaining’ a dominant position and replaced it with the phrase ‘takes advantage of his dominant position’, without any debate and without any apparent awareness of the significance of the change.

See 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, 343-4, available [here](#).

5 Weaknesses in the Harper Proposal

5.1 The Harper Proposal is Potentially Over-Deterrent in Some Respects

Given the failings of the ‘take advantage’ element as a general standard for unilateral conduct, in its Final Report, the Harper Panel proposed a test which focused on the competitive impact of a dominant firm’s conduct in the relevant market. In the interests of certainty and consistency, it also adopted a familiar phrase used in other provisions of Part IV of the CCA, namely a ‘substantial lessening of competition’ (‘SLC’).

At the outset, it is submitted that claims made against the Harper Proposal in the media have been overstated. Samuels and King, for example, have suggested that the Proposal would prohibit ‘a highly efficient business from profitably out-competing its rivals by offering better products at a lower price’ and ‘protect poor competitors from [the competitive] process’.⁵⁶

⁵⁶ Graeme Samuels and Stephen King, ‘Competition Law: Effects Test Would Have Shackled Competition’ *Australian Financial Review* (9 September 2015).

Under other provisions in Part IV of the CCA, the ‘SLC’ standard has been interpreted in the case law to require a comparison of rivalry in the market with and without the impugned conduct, to determine whether that rivalry is substantially reduced by the conduct.⁵⁷ Better products and lower prices are the very essence of increased rivalry, and would generally pass the ‘SLC’ test with ease, regardless of the fact that they eliminate ‘poor’ competitors. Australian courts do not establish the existence of competition by a mere headcount.

It is well established that the SLC test is not concerned with conduct that harms competitors per se, but with conduct that harms the competitive process. While the conduct must have an impact on actual or potential rivals, rivalry is not lessened simply because one or more competitors are harmed or even removed from the field of play.⁵⁸ What must be lessened is the ‘future field of rivalry’,⁵⁹ or ‘rivalrous market behaviour’,⁶⁰ and this is ‘a process rather than a situation’.⁶¹

Under the SLC test, the courts have emphasized that the restraints under consideration prevented rivals from offering a better price-product-service package than the firms imposing the restraint.⁶² In these cases, the incumbent’s method of winning in the competition for custom was to impair the ability of rivals to compete for that custom. The incumbents interfered with competition by ‘freezing out realistic competitive offers’,⁶³ and insulating themselves from the effects of competition.⁶⁴ The exclusion of rivalry in these circumstances is likely to lead to higher prices and/or lower quality offerings than those which would be made in the absence of the conduct.⁶⁵

It is submitted that the weaknesses in the Harper Proposal are more subtle than those claimed in the popular press. There are four:

- *Absence of an ‘exclusionary’ element:* The proposed prohibition does not specify that the conduct must be likely to exclude, deter or impair rivalry on the part of existing or potential competitors.

⁵⁷ *Cement Australia* [2013] FCA 909, [3013].

⁵⁸ See, eg, *Stationers Supply Pty Ltd v Victorian Authorised Newsagents Associated Ltd* (1993) 44 FCR 35, 56; *Universal Music Australia Pty Ltd v ACCC* (2003) 131 FCR 529, 585 (‘*Universal Music*’); *Re Qantas Airways Ltd* (2004) ATPR P42-027, 42936, 42944 (‘*Qantas Airways*’); *Cement Australia* [2013] FCA 909, [3013].

⁵⁹ *Cement Australia* [2013] FCA 909, [3013].

⁶⁰ *Re Queensland Co-Operative Milling Association Limited and Defiance Holdings Limited* (1976) 25 FLR 169, 188 (‘*QCMA*’).

⁶¹ *Ibid* 189.

⁶² *Gallagher v Pioneer Concrete (NSW) Pty Ltd* (1993) 113 ALR 159, 205-6 (‘*Gallagher*’).

⁶³ *ACCC v Baxter Healthcare Pty Ltd (No 2)* (2008) 170 FCR 16, 68-9, 100, 102.

⁶⁴ *Gallagher* (1993) 113 ALR 159, 204.

⁶⁵ *Rural Press* (2003) 216 CLR 53 (Gummow, Hayne and Heydon JJ, Kirby J concurring); *Cement Australia* [2013] FCA 909, [3087]-[3088]. Also [3014], [3072], [3178]-[3180], [3226]-[3227].

- *Exposure of all conduct to ex post effects analysis*: Under the ‘effect’ limb, the proposal exposes all types of dominant firm conduct to the same potential liability on the basis of its actual effects. The *risk* of liability under this limb may reduce incentives for dominant firms to engage in some socially beneficial practices, even if those practices would not ultimately be captured by the SLC test.
- *Low threshold of ‘likely effect’ limb*: The interpretation of a ‘likely effect’ as ‘a real chance or possibility’ of SLC sets a low threshold for liability, particularly for firms considering inherently unpredictable, but potentially beneficial, plans.
- *Uncertain interpretation of ‘substantiality’*: The question of what amounts to a ‘substantial’ lessening of competition has not been adequately explained in the case law on the SLC test to date.⁶⁶

5.2 The Absence of an ‘Exclusionary’ Element

Fisse rightly points to the absence of an ‘exclusionary’ element as a flaw in the Harper Proposal.⁶⁷ As noted earlier, the critical threat posed by unilateral conduct is that a firm may preserve or extend its SMP through conduct which is not efficient but which suppresses the rivalry of its competitors.

In the absence of a reference to this exclusionary element, it is possible that the Harper Proposal would capture socially beneficial conduct which involves no exclusion of rivals in a market in which the firm possesses SMP. This might occur, for example, where a firm initially possesses SMP as a supplier of an input to manufacturers in a downstream market, but later withdraws from that business in order to use the entire output of its own product as an input in a separate downstream market.⁶⁸ In these circumstances, the firm’s action may substantially reduce rivalry in the market for the supply of the input as well as in the original downstream market, but the conduct does not preserve or extend the firm’s market power in any market by suppressing rivalry. Instead, the firm profits by entering, or creating, a new market where the input is used in a way that potentially improves social welfare and consumer welfare. The relevant harm is not present.

Perhaps this omission was an oversight on the part of the Harper Panel. Or perhaps the Panel intended to leave open the possibility that small suppliers of powerful retailers could use the amended provision in situations where those retailers exploited their buying power without reducing rivalry. But in the latter case it would be necessary to explain the rationale for the prohibition, one that condemns conduct which exploits small businesses even if that exploitation does not protect or enhance

⁶⁶ See Brent Fisse, ‘The Australian Competition Policy Review Final Report 2015: Sirens’ Call or Lyre of Orpheus?’ (Paper presented at the New Zealand Competition Law & Policy Institute, 26th Annual Workshop, Auckland, New Zealand, 16 October 2015) 12, 16-20.

⁶⁷ Ibid 11-13.

⁶⁸ Ibid.

the dominant firm's market power to the detriment of consumers. How do we determine where the protection of small businesses should begin and end, in the absence of plausible harm to consumer welfare?

5.3 Disincentive Effects of Exposing All Conduct to an Ex Post Effects Analysis

Under the 'effect' limb of the Harper Proposal, all dominant firm conduct would be equally open to condemnation on the basis that it ultimately had the effect of SLC. According to the interpretation of the SLC standard in the case law, such an effect is only established where, on the balance of probability, rivalry in the relevant market would be substantially less in the presence of the conduct than it would have been in the absence of the conduct.

As noted earlier, such a finding is not likely to be made merely because some competitors are eliminated from the market. Rivalry in various aspects of the 'price-product-service' package may have intensified, even if the absolute number of competitors has decreased.⁶⁹ Australian courts have also acknowledged that innovation is an important aspect of competition.⁷⁰

Nonetheless it is conceivable that the Harper Proposal would have an effect on dominant firm incentives to engage in certain socially beneficial conduct ('disincentive effects'). The reason for these disincentive effects is two-fold:

- First, firms may be uncertain of how their conduct will be interpreted by the courts in light of the broad scope of the ex post effects analysis. For example, under the Harper Proposal, a dominant firm's price-cutting strategy might be subjected to judicial scrutiny even if the firm's prices are not below cost.⁷¹ While a dominant firm could advance a number of strong arguments against the condemnation of above-cost price-cutting, it is conceivable that the *possibility* of such litigation or liability might create some hesitation.
- Second, firms may be uncertain at the outset of the actual effect that proposed conduct will have, especially where the conduct has a plausible competitive explanation but is inherently unpredictable in its market outcomes. This may be particularly relevant in respect of innovative conduct. It is conceivable, for example, that a product innovation which was designed to benefit consumers

⁶⁹ See, eg, *Seven Network Ltd v News Ltd* (2009) 182 FCR 160, 283-4, 307 ('*Seven Network*'); *Gallagher* (1993) 113 ALR 159, 205, 206; *Fortescue Metals Group Ltd* [2010] ACompT 2 (30 June 2010).

⁷⁰ *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012), quoting from *Duke Eastern Gas Pipeline*. See also *Fortescue Metals Group Ltd* [2010] ACompT 2 (30 June 2010); *Seven Network* (2009) 182 FCR 160, 283-4, 307.

⁷¹ While the law and commentary on predatory pricing generally holds that low prices should only be condemned where price is below some measure of costs, there are strong arguments that, in certain limited circumstances, predation may occur even where the dominant firm's prices are above cost: Faull and Nikpay, Jonathan Faull and Ali Nikpay, *The EU Law of Competition* (Oxford University Press, 3rd ed, 2014) 401-6.

might ultimately create greater exclusionary effects than long term benefit (for instance, by creating incompatibility with rival complementary products), but exposing such conduct to liability may deter conduct which has a very high value to society.⁷²

With regard to the latter point, lest any parties become overly concerned by the prospect that highly valuable, innovative conduct by dominant firms might be deterred, it should be acknowledged that this value is also present in innovative conduct by smaller rivals. Society has an equal, or greater, interest in preventing dominant firms from shutting out efforts by small rivals to mount competitive challenges through innovation.⁷³ This potential disincentive effect for dominant firms does *not* weigh in favour of retaining section 46(1) in its existing form.

5.4 Limitation of Disincentive Effects under Other Effects-Based Tests

In its Final Report, the Harper Panel noted that the adoption of an effects test would bring Australia's law into line with unilateral conduct laws in other jurisdictions. It is interesting to note, however, that in some jurisdictions where an effects-based analysis is adopted, unilateral conduct rules have been adjusted to reduce the disincentive effects mentioned above. In the US, for instance, the D C Circuit in *United States v Microsoft*,⁷⁴ set out a four-step effects-based analysis for assessing claims of monopolization under section 2 of the Sherman Act. However, **not all unilateral conduct in the US is subjected to an effects-based analysis.**

For example, according to the principle in *Brooke Group Ltd v Brown & Williamson Tobacco Corp*,⁷⁵ there can be no finding of predatory pricing where prices remain above the relevant cost measures. This is not because above-cost pricing can never be anticompetitive, but because it is considered that the difficulties in assessing when such pricing is predatory, and the loss from potential disincentive effects of antitrust scrutiny, outweigh the potential benefits of condemning the occasional case of above-cost price predation.⁷⁶ For the same reasons, Hovenkamp argues that product design changes should not be prohibited under section 2 unless they are a 'sham' intended only as an impediment to competition.⁷⁷ Product design changes *may* be anticompetitive, but such innovative conduct in general is so beneficial to social welfare that it should only be subjected to antitrust scrutiny in very limited circumstances.⁷⁸

⁷² See Herbert Hovenkamp, 'The Monopolization Offence' (2000) 61 *Ohio State Law Journal* 1035, 1039.

⁷³ See, eg, Hovenkamp, *Antitrust Enterprise*, above n 17, 292-4.

⁷⁴ 253 F 3d 34, 58-9 (DC Cir, 2001).

⁷⁵ 509 US 209 (1993).

⁷⁶ Herbert J Hovenkamp, 'The Obama Administration and Section 2 of the Sherman Act' (December 2010) *University of Iowa Legal Studies Research Paper No. 10-05*, College of Law, University of Iowa, 1644; Hovenkamp, *Antitrust Enterprise*, above n 17, 159-167.

⁷⁷ Hovenkamp, 'Monopolization Offence', above n 72, 1039.

⁷⁸ See also *Foremost Pro Color Inc v Eastman Kodak Co*, 703 F 2d 534, 544-5 (9th Cir 1983); *United States v Microsoft*, 253 F 3d 34, 65 [27].

It is important to take into account the context of Hovenkamp's views in this respect. In particular, in the US, section 2 cases may be determined by a jury trial and result in the award of treble damages; in Hovenkamp's words, 'a truly miserable way to make economic policy'.⁷⁹ Accordingly, the extent to which US courts and commentators advocate the categorization of unilateral conduct and the application of multiple tests is explained to a significant degree by the desire to limit the extent to which firms are exposed to treble damages awarded by lay juries. But even when cases are decided by generalist or specialist judges, there is still an argument for reducing the extent to which socially beneficial conduct is exposed to antitrust scrutiny and/or liability.

In **South Africa**, where there is a **legislated effects test** for abuse of dominance and proceedings are brought before a specialist tribunal, **not all dominant firm conduct is exposed to the same degree of liability**.⁸⁰ The South African legislation lists five categories of specific conduct that will amount to an abuse of dominance, if the plaintiff proves that the conduct had an anticompetitive effect, unless that effect is outweighed by 'any technological, efficiency or other pro-competitive gains'.⁸¹ For this specified conduct the Tribunal may impose a substantial financial penalty for a first-time contravention.⁸² The legislation also prohibits a residual category of unspecified exclusionary conduct if it has an anticompetitive effect which outweighs any procompetitive gains,⁸³ but the Tribunal may not impose a financial penalty for a contravention under this residual category, unless it is essentially a 'repeat offence'.⁸⁴

So, for example, a dominant firm in South Africa could be liable to pay the relevant penalty if it were found to have engaged in predatory pricing below average variable cost, since this is one of the categories of specified conduct.⁸⁵ A dominant firm might also be found to have abused its dominance by engaging in *above-cost* predatory pricing,⁸⁶ or an anticompetitive product design change, but the firm could not be liable for an administrative penalty in respect of this conduct, unless it amounted to a repeat offence. While, admittedly, a dominant firm might still be liable for civil

⁷⁹ Hovenkamp, *Antitrust Enterprise*, above n 17, 4.

⁸⁰ See Katharine Kemp, 'The South African Example: A Legislated Effects-Based Test and Efficiency Defence for Misuse of Market Power', Submission to the Competition Policy Review, 29 April 2014, at http://competitionpolicyreview.gov.au/files/2014/06/Kemp_K.pdf; Philip J Sutherland and Katharine Kemp, *Competition Law of South Africa* (LexisNexis, looseleaf, 2005-) Chap 7.

⁸¹ *Competition Act 1998* (South Africa), s 8(d). These specified acts can be summarized as exclusive dealing, including inducement not to deal; refusal to supply scarce goods to a competitor; tying or bundling; predatory pricing; and buying up scarce resources.

⁸² *Competition Act 1998* (South Africa), s 59(1)(a), (2).

⁸³ *Competition Act 1998* (South Africa), s 8(c).

⁸⁴ An administrative penalty may only be imposed for a prohibited practice in terms of s 8(c) 'if the conduct is substantially a repeat by the same firm of conduct previously found by the Competition Tribunal to be a prohibited practice': s 59(1)(b).

⁸⁵ *Competition Act 1998* (South Africa), s 8(d)(iv). Assuming proof of anticompetitive effect.

⁸⁶ See, eg, *Competition Commission of South Africa v Media 24 Ltd* (CT Case No 013938/CR154Oct11, 8 September 2015).

damages,⁸⁷ the absence of a substantial administrative penalty may lessen the disincentive effects of this prohibition.

Salop has also advocated an effects-based analysis under section 2 of the Sherman Act. Salop terms this a **‘consumer harm’ test**, which focuses ‘directly on the anticompetitive effect of exclusionary conduct on price and consumer welfare’.⁸⁸ Unlike profit-focused tests, which have regard to the impact of the conduct on the defendant firm, the ‘consumer harm’ test concentrates on evaluating the net impact of the conduct on consumers in each case.⁸⁹ According to this approach, unilateral conduct would violate antitrust laws ‘if it reduces competition without creating a sufficient improvement in performance to fully offset these potential adverse effect on prices and thereby prevent consumer harm’.⁹⁰

Salop acknowledges that such a test may have disincentive effects where conduct is inherently unpredictable at the outset. His solution is that, in these circumstances, the conduct should be **evaluated from an ex ante perspective**, based on the information reasonably available at the time that the dominant firm made its investment decision.⁹¹ The consumer harm test would therefore only require the firm ‘to make a good-faith effort to estimate the expected impact of its conduct on consumers’,⁹² and the court to ‘evaluate the likelihood and magnitude of expected consumer benefits or harms based on the information reasonably available at the time that the conduct was undertaken’.⁹³

In comparison to these effects-based approaches, the ‘effects’ limb of the Harper Proposal is a somewhat blunter instrument, which would apply an ex post effects analysis to all dominant firm conduct without adjustment for potential disincentive effects.

⁸⁷ Sutherland and Kemp, above n 80, 12.3.7.

⁸⁸ Salop, above n 29, 313-4. See also Nazzini, above n 6, 92.

⁸⁹ Salop, ‘Flawed Profit-Sacrifice’, above n 29, 318, 331, 345.

⁹⁰ Ibid 330.

⁹¹ Ibid 339.

⁹² Ibid 365-6.

⁹³ Ibid 341-2.

The MBIE Issues Paper refers to unilateral conduct rules in other jurisdictions, and asks whether it has properly characterized the approach taken in those jurisdictions (section 2.2.2, Q 2). It is submitted that a distinction between jurisdictions that follow a ‘purpose’ approach and those that follow an ‘effects’ approach may not be the most useful way to describe the landscape of unilateral conduct rules.

It is true that in many jurisdictions outside Australia and New Zealand, courts condemn unilateral anticompetitive conduct based on an analysis of the effects of the conduct. However, there are substantial variations between these ‘effects-based’ approaches, both with regard to the extent to which they engage in a case-by-case analysis of effects, and the extent to which they make adjustments to the rule itself, or the applicable penalty, to reduce the risk of deterring dominant firms from engaging in conduct which generally improves long term consumer welfare. There is not a homogenous category of ‘effects-based’ tests.

For example, at one end of the spectrum, the South African abuse of dominance provisions require a case-by-case analysis of anticompetitive effects and efficiency gains in every case, but the risk of over-deterrence is reduced by varying the applicable penalty (as described above). In the EU, the authorities have adopted an effects-based analysis in some abuse of dominance cases, but, in other cases, there remains an essentially per se condemnation of certain categories of exclusionary conduct, without any case-by-case analysis of effects. In the US, an effects-based, or rule of reason, analysis is adopted in some cases, but the US courts have essentially developed multiple rules for different types of unilateral anticompetitive conduct, making adjustments to take into account the risks of over-deterrence. There is a theme of effects-based analyses with many variations.

See, eg:

Oxera, ‘Agenda – 10 Years: Reform of Article 82: Where the Link Between Dominance and Effects Breaks Down (Revisited)’ (April 2015) available [here](#).

Thomas A Lambert, ‘Defining Unreasonably Exclusionary Conduct: The ‘Exclusion of a Competitive Rival’ Approach’ (2014) 92 *North Carolina Law Review* 1175.

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.

5.5 Relatively Low Threshold for ‘Likely Effect’

It might be thought that the potential disincentive effects of the ‘effect’ limb of the Harper Proposal could be avoided by limiting liability to conduct which has the ‘likely effect’ of SLC. This view holds some promise given that ‘likely effect’ has been interpreted under other provisions in Part IV of the CCA to require assessment of the relevant conduct on an ex ante basis, having regard to the circumstances existing at the time the firm engaged in the conduct.⁹⁴ This ex ante assessment may improve certainty for dominant firms particularly where the conduct ultimately has unpredictable effects. But there are some weaknesses in this approach.

⁹⁴ *Universal Music* (2003) 131 FCR 529, 586 [247]; *Seven Network* (2009) 182 FCR 160, 342.

At the outset, the interpretation of ‘likely effect’ in the case law has resulted in a relatively low standard of proof, namely that, at the time the firm engaged in the conduct, the conduct had ‘a real chance or possibility’ of SLC in a market.⁹⁵ This implies a threshold probability which is significantly less than a requirement that the effect was likely or ‘more probable than not’. The problem for dominant firms is that some highly beneficial conduct is inherently unpredictable at the outset, such that it may be arguable that the conduct gave rise to ‘a real chance or possibility’ of SLC. In these circumstances, courts will face the task of balancing the likelihood of anticompetitive effects against the likelihood of procompetitive effects, as explained in section 8.2 below.

5.6 Authorisation Should be Permitted, But Does Not Overcome Other Weaknesses

The Harper Panel has recommended that firms with SMP should be permitted to seek authorisation for conduct which might otherwise contravene section 46(1). As explained in more detail elsewhere,⁹⁶ the original rationale for excluding unilateral conduct from the authorisation process is based on superseded theories and outdated circumstances. If the Harper Proposal were adopted, the possibility of authorisation would be an important accompaniment to the amendment, so that a dominant firm might establish the legality of a strategy which is, on balance, socially beneficial.

However, the availability of such authorisation is not a complete answer to the weaknesses in the Harper Proposal outlined above. For example, some business strategies, especially those relating to price, cannot reasonably be put on hold for extended periods pending the outcome of an authorisation application. To the extent possible, it would be preferable to adjust the legal standard itself to reduce the risk of liability for conduct that is, on balance, likely to improve long-term consumer welfare.

6 The Treasury Alternative: Subjective Purpose of SLC

6.1 Advantage of Focusing on Rationale and Addressing ‘Plain Exclusion’

In the Discussion Paper, Treasury raises the possibility of a prohibition which targets only dominant firm conduct which has the ‘purpose’ of SLC. There are some advantages to this approach. At the outset, like the profit-focused tests and the case law on ‘legitimate business purpose’,⁹⁷ it acknowledges **the relevance of rationale** in characterizing unilateral conduct. Dominant firms would not be exposed to the risk of liability for unpredictable and unintended consequences of their conduct. The Treasury proposal also trims down the broader, potentially procompetitive, purposes

⁹⁵ *Monroe Topple & Associates v The Institute of Charter Accountants* (2002) 122 FCR 110, 140 [111].

⁹⁶ 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, 333-5, available [here](#).

⁹⁷ Explained in section 4.2 above.

currently proscribed under section 46(1). Whereas the current provision extends liability to conduct which has the purpose of ‘eliminating or substantially damaging a competitor’, the Treasury’s proposal focuses on the more relevant purpose of SLC, or substantially reducing rivalry in a market.

A further advantage of liability based on the ‘purpose of SLC’ is that it would condemn **‘plain’ exclusion**, without the need for an analysis of actual effects. In antitrust commentary, there is little serious opposition to the view that unilateral conduct rules should condemn a practice that is directed *solely* at suppressing rivalry so as to as preserve an incumbent’s SMP, without any efficiency justification.⁹⁸ Such conduct is sometimes referred to as ‘naked’ or ‘plain’ exclusion.⁹⁹ It is ‘conduct unabashedly meant to exclude rivals, for which no one offers any efficiency justification’.¹⁰⁰ *Rural Press* provides a useful example of ‘plain’ exclusion.¹⁰¹

There is also substantial consensus that ‘plain’ exclusion should be condemned without the need for a detailed analysis of its actual or probable effects.¹⁰² In short, such conduct is so lacking in any value to society that a less costly, truncated analysis is justifiable: there is a negligible risk that imposing liability in these cases will deter beneficial behaviour.¹⁰³

Some commentators have set this type of exclusion apart, arguing that naked exclusion ‘may be easily condemned without reference to any test for unreasonably exclusionary conduct’;¹⁰⁴ or that plain exclusion could be captured by a very simple, separate rule which prohibits monopoly-enhancing conduct which has no procompetitive justification.¹⁰⁵ But it is submitted that this exceptional treatment of plain exclusion misses an important opportunity. It is precisely when all parties agree that ‘of course’ such conduct should be condemned that we should enquire after the norm on which we all rely. In this case, **the unspoken norm is that a dominant firm should not be permitted to engage in conduct which, objectively assessed, has no purpose other than the suppression of rivalry to preserve market power**: that is, an objective anticompetitive purpose.

⁹⁸ See, eg, Baker, ‘Exclusion as a Core Concern’, above n 21, 544, 586; Nazzini, above n 6, 59.

⁹⁹ *Ibid.*

¹⁰⁰ Eric B Rasmusen, J Mark Ramseyer and John S Wiley Jr, ‘Naked Exclusion’ (1991) 81 *American Economic Review* 1137, 1137. Susan A Creighton et al, ‘Cheap Exclusion’ (2005) 72 *Antitrust Law Journal* 975, 982.

¹⁰¹ In *Rural Press* (2003) 216 CLR 53, the High Court found that the conduct of a near-monopolist in coercing a new rival to leave the market by making repeating threats of predation, was not a misuse of market power.

¹⁰² See Nazzini, above n 6, 60-1, 101, 189-90; Andrew I Gavil, ‘Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance’ (2004) 72 *Antitrust Law Journal* 3; Popofsky, above n 74, 447-8, 464; A Douglas Melamed, ‘Exclusionary Vertical Agreements, Remarks Before the ABA Section of Antitrust Law’, available at <http://www.usdoj.gov/atr/public/speeches/1623.htm>; Salop, ‘Flawed Profit Sacrifice’, above n 29, 317; Salop and Romaine, above n 74, 664.

¹⁰³ Herbert J Hovenkamp, ‘The Antitrust Standard for Unlawful Exclusionary Conduct’ (June 2008) *University of Iowa Legal Studies Research Paper No. 08-28*, College of Law, University of Iowa, 31.

¹⁰⁴ Thom Lambert, ‘Defining Unreasonably Exclusionary Conduct: The “Exclusion of a Competitive Rival” Approach’ (2014) 92 *North Carolina Law Review* 1175, 1183.

¹⁰⁵ Melamed, above n 29, 1260.

However, a fundamental weakness in the ‘purpose of SLC’ approach is that, as presently interpreted under Part IV of the CCA, ‘purpose’ refers to the firm’s actual or **subjective purpose**, and subjective purpose does not target the relevant harm in unilateral conduct cases, as explained in the following section.

6.2 Subjective Purpose of SLC Does Not Target the Relevant Harm

Having regard to the interpretation of ‘purpose’ under other provisions of Part IV of the CCA, a reference to ‘purpose’ in section 46(1) would almost certainly be interpreted as a reference to subjective purpose. It is submitted that a focus on the dominant firm’s actual or subjective purpose is not in keeping with the objectives of the CCA or the prohibition of unilateral anticompetitive conduct. In particular, liability for unilateral anticompetitive conduct should not depend upon the dominant firm’s own subjective assessment of the competitive impact of its conduct, which may be indeterminate, mistaken, self-preferring or the product of simple inattention. Rules against unilateral anticompetitive conduct are intended to regulate objective economic consequences, not the hearts and minds of dominant firms. An objective analysis of dominant firm conduct is preferable to focus attention on the relevant harm.

An analysis of the case law on ‘purpose’ under Part IV gives rise to two important conclusions. First, a subjective approach to purpose has been preferred largely as a matter of the interpretation of the current wording of the legislation. Implicitly, the legislature must have intended to distinguish the concept of ‘purpose’ from the concepts of ‘effect’ and ‘likely effect’.¹⁰⁶ Since the determination of effect and likely effect require an objective analysis of the impact of the conduct, it was unlikely that the legislature intended to create an additional ground of liability based on objective purpose, which would also require an objective analysis of the impact of the conduct. This approach overlooks the important differences between effect, likely effect and objective purpose (explained in section 8.2 below). It also advances no normative argument in favour of a subjective purpose approach.

Second, and in some contrast, in the High Court, those judges preferring an objective approach to purpose, have advanced an important normative argument in favour of an objective approach: that is, given the economic goals of the legislation, a corporation should not escape liability for conduct which is, by its nature, objectively anticompetitive, on the basis of its own actual but misguided assessment of the competitive nature of the conduct.¹⁰⁷

¹⁰⁶ See *South Sydney* (2003) 215 CLR 563, 586-7 [63] (Gummow J):

[T]here is a danger that an examination of the objective purpose of a provision will give undue significance to the substantive effect of the provision, as opposed to the effect that the parties sought to achieve through its inclusion.

¹⁰⁷ Or where the anticompetitive conduct was the product of inattention by the firm, as when the firm has no considered reason for engaging in the conduct: see C Scott Hemphill, ‘Less Restrictive Alternatives in Antitrust Law’ (Public Law and Legal Theory Research Paper Series Working Paper No 15-28, New York University School of Law, November 2015) 58.

6.3 Subjective Purpose with Objective Evidence is Not the Same as Objective Purpose

To be sure, under the ‘subjective purpose’ standard, objective factors *are* taken into account to determine the actual purpose of the firm engaging in the conduct. However, while the evidence may be objective, it is nonetheless used to reach a conclusion about the subjective intent of the relevant firm; ‘the purpose of the particular respondent’.¹⁰⁸ In this case, the focus is on testing the plausibility of any direct evidence regarding subjective purpose.¹⁰⁹

In a given case, the court may be satisfied that the direct evidence establishes that the subjective purpose of the particular corporation was not anticompetitive: for example, where there is ‘a single directing mind’ and clear evidence of his or her purpose.¹¹⁰ If the direct evidence of the corporation’s subjective purpose is strong, the fact that the conduct *by its nature* has an anticompetitive purpose will not be determinative: a corporation may escape liability for conduct which is, by its nature, objectively anticompetitive, on the basis of its own actual but misguided (or self-preferring erroneous) assessment of the competitive nature of the conduct.

The MBIE Issues Paper asks after the justifications for a purpose-based approach, and why Australia adopted such an approach with its *Trade Practices Act 1974* (Q 5). In answer to the latter question, as originally passed, section 46(1) of the *Trade Practices Act 1974* (Cth) did not use the word ‘purpose’ and arguably required proof of effects. The provision was amended in 1977 to include the words ‘for the purpose of’. The amendment was promoted by the new Liberal-Country Party Government, to ‘clarify’ that the prohibition only applied to ‘purposive conduct’. This legislative history is explained in more detail elsewhere.

See 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, 335-40, available [here](#).

¹⁰⁸ See *Universal Music* (2003) 131 FCR 529, 589 [256]:

That inference, however, is as to the purpose of the particular respondent, not of some hypothetical bystander. That said, the objective circumstances will be of considerable (often critical) probative value in assessing whether to draw the inference.

¹⁰⁹ *Universal Music* (2003) 131 FCR 529, 588-9:

Of course, proof of the required purpose is not limited to direct evidence as to those purposes. Further, the court is not bound to accept such evidence. Indeed, it will normally be critically scrutinised; it is often *ex post facto* and self-serving.

¹¹⁰ *Universal Music* (2003) 131 FCR 529, 587. See also *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 143, where there was apparently satisfactory direct evidence of the parties’ subjective purposes.

7 Signposts to Objective Anticompetitive Purpose in Existing Law

It is submitted that the existing case law and commentary on the characterization of unilateral anticompetitive conduct repeatedly point to the importance of objective anticompetitive purpose in this process, although this is rarely articulated. As explained throughout this submission, the common thread of objective purpose can be discerned in the following areas:

- Profit-focused tests – including the ‘take advantage’ test, the ‘no economic sense’ test, the ‘profit sacrifice’ test and the Areeda-Turner test for predatory pricing – each represent *one method* of proving objective anticompetitive purpose in some cases, but they do not cover the field.¹¹¹
- References in the case law to ‘legitimate business purposes’ or ‘valid business reasons’ highlight the significance of the underlying purpose or rationale of the conduct, but generally fail to articulate what makes a business purpose legitimate or illegitimate.¹¹²
- Advocates of an ‘effects’ test, or ‘consumer harm’ test, recognise that an ex ante assessment, having regard to information reasonably available to the dominant firm at the time it engaged in the conduct, may be required in cases where the outcomes of conduct are unpredictable at the outset. This is not because the direct effect of such conduct is necessarily less harmful to consumers, but because it is desirable to protect conduct which, objectively speaking, was initiated with a procompetitive purpose.¹¹³
- There is general consensus that ‘naked’ or ‘plain’ exclusion should be condemned without the need for any detailed effects analysis. This is not because, as some assert, ‘no test is needed’ in these cases, but because courts and commentators are applying an unspoken test, based on objective anticompetitive purpose.¹¹⁴
- Courts applying a subjective purpose test have increasingly focused on the objective evidence of purpose to the extent that they have been criticized for applying what is essentially a test of objective purpose.¹¹⁵

¹¹¹ See section 4.2 above.

¹¹² See section 4.2 above.

¹¹³ See section 5.4 above.

¹¹⁴ See section 6.1 above.

¹¹⁵ See, eg, Kathryn McMahon, ‘Church Hospital Board or Board Room?: The Super League Decision and Proof of Purpose under Section 4D’ (1997) 2 *Competition and Consumer Law Journal* 129, arguing that, in certain cases, Australian courts have failed to take this approach, essentially applying an objective purpose under a ‘subjective purpose’ label.

8 Objective Anticompetitive Purpose

8.1 A Standard Based on Objective Anticompetitive Purpose

This submission argues that a standard based on objective anticompetitive purpose is preferable to both profit-focused test and effects-based tests. In particular, it reflects the combined wisdom of case law and commentary in this area, and offers a compromise which may reduce the concerns raised on each side of the current debate in Australia.

To be clear, the mere fact that a dominant firm acts with the goal or purpose of achieving, maintaining or enhancing substantial market power should not be sufficient to attract condemnation. Moreover, evidence that the firm purported or intended to cause harm to its rivals is, in itself, irrelevant. What is important is the method adopted by the firm in pursuit of these goals. One method (superior performance and efficiency) gives rise to benefits for society, while another (suppression of competitive responses by rivals) is detrimental to society. The social disadvantages inherent in substantial market power should only be tolerated if that power is achieved by the former method, with its redeeming side effects. If market power is achieved by the latter method, both the process and the end result are harmful.

The particular method adopted by a firm might be discerned by assessing the effect of the impugned conduct on the relevant market or markets (as in the Harper Proposal). If it is apparent that the conduct has had the effect of substantially excluding competition, without creating any proportionate benefits for consumers, it may be concluded that the firm has sought to enhance its market power by obstructing the competitive process.¹¹⁶ But it is submitted that the firm's method may also be discerned by considering the *design* inherent in the impugned conduct itself: that is, by considering whether, objectively speaking, the conduct had the purpose of suppressing rivalry to prolong or enhance the firm's market power.¹¹⁷

Objective purpose should be distinguished from subjective purpose. 'Subjective purpose' means the end which the relevant person (or corporation) actually seeks to achieve. Proof of subjective purpose requires direct or indirect evidence of that person's actual state of mind.¹¹⁸ 'Objective purpose', on the other hand, refers to a purpose determined objectively, without the need to refer to the person's mental state. It is possible to bypass claims concerning a person's actual state of mind and to 'attribute a purpose to an artificial or notional mind that is deemed responsible for some act or omission'.¹¹⁹

¹¹⁶ See the definition of 'exclusionary conduct' in Hovenkamp, 'Monopolization Offence', above n 72, 1038; Phillip E Areeda and Herbert Hovenkamp, *3 Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Aspen 2d ed 2002) 72 [651a].

¹¹⁷ As explained further below, it is necessary to establish both the ultimate purpose (prolonging or enhancing market power) and the intermediate purpose (suppressing rivalry by competitors), for, it is submitted, the chosen method of achieving the ultimate purpose is a purpose in itself.

¹¹⁸ *Dandy Power* (1982) 64 FLR 238, 276-7 (Smithers J).

¹¹⁹ *South Sydney* (2003) 215 CLR 563, 580 (McHugh J). See also *South Sydney* (2003) 215 CLR 563, 605-6 (Kirby J), advocating an objective 'characterisation' or 'classification' of the relevant purpose.

A focus on objective purpose is consistent with the economic objectives of the CCA. As Robertson argued with regard to the ‘primacy’ of objective purpose in the characterization of multilateral conduct:

However irrelevant ‘intent’ is in the [subjective, eliminatory sense], objective purpose *is* relevant for this focuses our analysis on the protection of the economic *process* of competition and the ends sought to be achieved by the economic agents. ... By focusing on the objective issue the court is focused on the real point of the analysis, namely, the economic behaviour in its economic context, in particular the relevant market characteristics. In this sense, the focus on an objective test is ‘a bridge between economic theory and legal assessment’.¹²⁰

This type of purpose may be deduced from the nature of the act or omission, and the surrounding circumstances, without regard to the express purposes or intentions of the corporation’s representatives.¹²¹

A focus on objective purpose is not only a more appropriate method of assessing the competitive quality of conduct in light of the economic objectives of the CCA,¹²² it also overcomes complaints that difficulties in proving subjective purpose have prevented the prosecution of significant cases under section 46(1). While objective anticompetitive has often served as an unspoken norm in unilateral conduct cases, it is submitted that it should be properly articulated and used as an express guide.

8.2 Objective Anticompetitive Purpose is More Appropriate than ‘Likely Effect’

A test based on objective anticompetitive purpose may bear a strong resemblance to a test based on ‘likely effect’. Indeed, to an economist, they may seem indistinguishable. But, while the outcome of an objective purpose test would often depend on economic evidence concerning the likely effect of conduct, this does not make it equivalent to a ‘likely effect’ test.

First, and by contrast, the ‘likely effect’ approach may require some balancing or weighing of the opposing effects of impugned conduct, at least in cases with ‘mixed’ consequences. Taken with the legislative guidance included in the Harper Proposal, the assessment of a ‘real chance or possibility’ of SLC would presumably take into account the extent to which there was a real chance or possibility that the conduct would increase competition in the market by enhancing efficiency, innovation, product quality or price competitiveness, balanced against the real chance or possibility that the conduct would lessen competition in the market by preventing, restricting or deterring the potential for competitive conduct or new entry.

¹²⁰ Robertson, ‘Primacy of Purpose – Part 2’, above n 96.

¹²¹ See *Dandy Power* (1982) 64 FLR 238, 276-7.

¹²² As McHugh J stated in *News Ltd v South Sydney District Rugby League Football Club Ltd* (2003) 215 CLR 563, 579 [38], an objective approach to purpose

seems more in accord with the Act's object of promoting competition, an object that is weakened if what is objectively anti-competitive conduct escapes proscription only because the parties did not in fact intend to achieve such a proscribed purpose.

Such a **balancing exercise may present some difficulty, particularly given the incommensurability of the potential effects** on each side of the scale.¹²³ If a dominant firm's product design change, for example, excluded rivalry in the market for complementary products, the court would need to decide how to balance the real possibility of a decrease in price competitiveness against the real possibility of an increase in competition by innovation.

While these difficulties should not be overstated,¹²⁴ it is submitted that it is **preferable to have regard to the proportionality of conduct** in unilateral conduct cases; to ask whether, at the time it engaged in the conduct, the firm's choice of strategy was proportionate to its claimed benefits, having regard to the risk, and extent, of any exclusion of rivalry. A proportionality enquiry points to the relevance of objective purpose.

A number of commentators and authorities in the US and the EU have advocated a proportionality enquiry in the characterization of unilateral anticompetitive conduct.¹²⁵ Such an approach provides courts with a framework for assessing the reasonableness of the conduct, and assessing whether, objectively speaking, the true purpose of the conduct was to restrict competition or compete through superior efficiency.

A proportionality inquiry also provides dominant firms with a framework for assessing the legality of proposed conduct, which takes into account the reasonably foreseeable competitive impacts of their conduct, without requiring precise predictions about actual outcomes which could be affected by factors beyond the firm's control. Under a proportionality approach, dominant firms should consider at the outset:

- Whether the conduct plausibly creates any benefits for consumer welfare;
- Whether there are significantly less restrictive alternatives which could achieve the same benefits;¹²⁶ and
- Whether any restriction of rivalry which might arise from the proposed strategy is disproportionate to the plausible improvements in long term consumer welfare which the strategy is designed to achieve.¹²⁷

This last enquiry does not require firms to balance precisely the procompetitive and anticompetitive effects of the strategy, but to give proper consideration to the importance, extent and plausibility of the various potential consequences for

¹²³ Gavil, above n 102, 72; cf Donald Robertson, 'The Primacy of "Purpose" in Competition Law – Part 2' (2002) 10 *Competition and Consumer Law Journal* 42 ('Primacy of "Purpose" – Part 2').

¹²⁴ See the explanation of the balancing approach in Salop, above n 29, 330-1.

¹²⁵ See, eg, Hovenkamp, 'Monopolization Offence', above n 72, 1038; Gavil, above n 102, 61-2; Nazzini, above n 6, 4, 94, 158, 167-9. See also Robertson, 'Primacy of "Purpose" – Part 1', above n 29; Robertson, 'Primacy of "Purpose" – Part 2', above n 123, advocating a proportionality enquiry under the 'SLC' test for multilateral conduct under Part IV of the CCA.

¹²⁶ See European Commission, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* [2009] OJ C 45/2, 12 [30].

¹²⁷ See Robertson, 'Primacy of "Purpose" – Part 2', above n 123, in the context of multilateral restraints.

competition in the market, bearing in mind the objective of protecting long-term consumer welfare.

In short, a proportionality enquiry provides greater certainty and fairness for dominant firms, in that it does not require any ‘crystal ball’ skills in predicting actual outcomes, or determining the likely effect on competition as a result of mixed outcomes. This improved certainty is likely to reduce the disincentive effects of the legal standard.

At the same time, a proportionality approach ensures that a dominant firm will not be permitted to rely on an efficiency justification for its conduct where it was apparent at the outset that the firm was, in effect, using a sledgehammer to crack a nut - that its strategy would tend to cause disproportionate harm to consumer welfare as a result of its tendency to restrict rivalry, relative to its tendency to create benefits for consumer welfare. Of course where there is no plausible efficiency justification for conduct, it should be condemned without the need for any proportionality enquiry.¹²⁸

As the MBIE notes in its Issues Paper, one of the problems with the current counterfactual test for ‘taking advantage’ in New Zealand is that ‘courts have not considered whether the efficiencies the defendant is seeking to achieve through its conduct could be achieved in a way that had fewer or less harmful anti-competitive effects’ (section 2.5.1). In short, one of the current problems is that courts do not consider the proportionality of the conduct.

A further difference between a ‘likely effect’ test and an objective purpose standard is that, under a ‘likely effect’ test, evidence of likely effects would be used to determine the net likely impact of the conduct on rivalry in the market, whereas, under an objective purpose standard, evidence of likely effects would be used to determine the most likely explanation for the conduct.

It is submitted that, in the assessment of unilateral conduct, **the critical task for the court is to discover the most plausible *explanation*** for the exclusionary act in its context, to determine the end which that conduct is designed to achieve and, if that end is alleged to be the creation of benefits for consumers, whether the conduct is a proportional means of achieving that end. As Hovenkamp has argued, the court should

use Occam’s razor to strip away the unproven or implausible explanations until we are left with the core that characterizes the practice as anticompetitive or procompetitive.¹²⁹

It is necessary to understand the underlying rationale of the conduct, to determine whether the act in its context is in fact designed to extend the firm’s substantial market power by stifling the competitive responses of rivals.

¹²⁸ As explained in section 6.1.

¹²⁹ Hovenkamp, *Antitrust Enterprise*, above n 17, 108.

9 Conclusion

In advocating an objective anticompetitive purpose approach to unilateral conduct this submission draws out a standard which has been present in the case law and commentary in this area for many years, but which has not been clearly articulated. It is submitted that this standard should be articulated and expressly adopted.

To do so would resolve the two main, opposing concerns in the current debate regarding section 46(1). On the one hand, it would preserve dominant firm incentives to engage in procompetitive conduct, by assessing conduct on the basis of information reasonably available to the firm at the outset, and removing the need precise predictions. On the other hand, it would strengthen the law against misuse of market power by requiring an objective analysis of the conduct in its relevant context, taking into account its likely impact on the market.

The MBIE Issues Paper suggests that one criterion for an appropriate unilateral conduct rule in New Zealand is that it should be aligned with comparable rules in other jurisdictions. However, the gains to be had from this kind of alignment are limited in two ways.

First, for the numerous jurisdictions that adopt an ‘effects-based’ approach to unilateral anticompetitive conduct, there are substantial **variations between jurisdictions** in the extent to which courts are permitted or required to engage in a case-by-case analysis of effects, as well as the manner in which potential disincentive effects are addressed. Outside the EU, the method of characterising unilateral conduct varies from country to country. The most that can be said is that there is a trend towards characterising conduct on the basis of objective economic analysis, having regard to the likely impact of the conduct on the relevant market, as outlined in section 1 above.

Second, even **within jurisdictions**, there remains substantial uncertainty and debate over the correct approach to characterizing unilateral conduct.

In the EU, for instance, the European Commission is essentially engaged in a war of attrition, attempting to steer the General Court and the European Court of Justice towards an analysis of unilateral conduct based on economic effects, as opposed to the per se, or formalistic, condemnation of certain types of conduct. However, the European courts continue to take the latter approach in some cases, partly as a result of the particular objectives of EU competition law.

In the US, opinions remain divided: in the last days of the Bush Administration, the US Department of Justice released a report on single-firm conduct which advocated an intentionally under-inclusive approach, but this report was promptly contradicted and withdrawn in the first days of the Obama Administration. The uncertainty is unlikely to be resolved by judicial interpretation of the law: it is now extremely rare for the US Supreme Court to grant certiorari in monopolization cases, and authority between federal circuits is fragmented.

In Australia, as the MBIE knows, lobby groups and political parties are currently engaged in a seemingly intractable dispute over whether to retain the ‘take advantage’ standard to preserve ‘certainty’ for dominant firms, or to replace it with an ‘effects test’ to ‘strengthen’ the law as requested by small business groups.

In light of the ongoing disputes and uncertainty in other jurisdictions, the MBIE might consider an alternative approach. Rather than attempting to align itself with the law in any of the major jurisdictions, New Zealand could benefit from its inherent advantages in this area. That is, in New Zealand, change does not depend on incremental shifts in the case law or attempts to create consistency between independent federal courts; the objective of the competition law and the unilateral conduct provision is clear and coherent; and amending the relevant legislation is a real possibility.

Rather than following approaches shaped by the historical objectives of the EU, or the market circumstances and political bargains of the US, or the products of successive lobbying in Australia, New Zealand might take the opportunity to create that rarest of things: a rational unilateral conduct rule.

Type of Test	Strengths	Weaknesses	<u>How Objective Anticompetitive Purpose Focus Resolves</u>
Profit-Focused (including 'take advantage')	Identifies <i>some</i> anticompetitive conduct on the basis of its objective purpose, by explaining the connection between the profitability of the conduct and the firm's market power.	Under-inclusive. Fails to capture significant instances of anticompetitive conduct because it ignores other methods of proving objective purpose and it does not take account of the likely impact of the conduct on the market. Eg: <ul style="list-style-type: none"> • Rural Press – preserving monopoly by predatory threats; • Cement Australia – preserving monopoly by bidding up the price of an essential input. 	Takes into account the likely impact of the conduct on the market, based on information reasonably available to the firm at the time it engaged in the conduct, thereby targeting anticompetitive conduct more effectively.
Actual Effect	Focuses on conduct which actually causes harm to the competitive process and ultimately consumer welfare.	May be over-deterrent and relatively complex to administer. May be difficulties in discerning ultimate effects and attributing effects to different causes; as well as balancing mixed effects. Requires a dominant firm to predict with some accuracy the market outcomes of conduct where some elements are beyond the firm's control. May therefore weaken incentives to engage in some socially beneficial conduct if uncertain of outcome and no safe harbours. Eg: <ul style="list-style-type: none"> • Some low, but above-cost, price-cutting; • Product design changes. 	Does not depend on proof of actual effects, or proof that the conduct (and not some other factor) caused the alleged effects. Avoids any fine balancing of mixed effects by focusing on the proportionality of any restriction on rivalry. Reduces disincentive effects by focusing on information reasonably available to dominant firm at the time it engaged in the conduct, and the most likely explanation for the conduct at the outset.

Likely Effect	Focuses on the likely impact of the conduct on the market <i>and</i> based on information reasonably available to the dominant firm at the time it engaged in the conduct.	<p>May be over-deterrent and somewhat difficult to administer (but less so than ‘actual effect’).</p> <p>Under Pt IV, ‘likely effect’ may set a low threshold for liability, requiring only ‘a real chance or possibility’ of the relevant harm.</p> <p>Focuses on weighing likely (mixed) impacts of conduct.</p> <p>Conceivable that ‘likely effect’ would capture some conduct with a procompetitive purpose but unpredictable outcomes.</p>	<p>Takes into account the likely impact for the purpose of determining the most likely <i>explanation</i> for conduct.</p> <p>Focuses on the <i>proportionality</i> of the strategy selected by the dominant firm, rather than attempting to weigh the probable impacts.</p>
Subjective Purpose	Focuses on the rationale or purpose of the conduct <i>and</i> does not require costly proof of effect or likely effect in cases where there is no plausible efficiency justification for the conduct.	<p>Under-inclusive. Focuses on the firm’s subjective state of mind, rather than the objective quality of the conduct.</p> <p>May absolve conduct on the basis of the dominant firm’s lack of attention to the competitive impact of conduct; its own self-preferring erroneous assessment of conduct; or the plaintiff’s failure to establish the firm’s actual purpose on the evidence.</p>	<p>Focuses on the objective quality of the conduct, the relevant market circumstances, and the expectations of a reasonable firm in those circumstances, rather than the dominant firm’s subjective assessment of its strategy.</p> <p>Therefore more effective and better aligned with the purposes of the CCA.</p>

