Legal notes

Three key section 46 cases

Recently, and in the space of less than four weeks, there have been three noteworthy s. 46 decisions that have considerably broadened the application of the section and raised its value to the Commission and the business community — particularly small businesses.

Section 46 of the Act proscribes the misuse of market power by corporations that have it to a substantial degree. Three criteria essential for establishing misuse are:

- a substantial degree of market power;
- taking advantage of that power; and
- the fact that advantage is taken of that power for a proscribed purpose (the purpose may be to substantially damage or eliminate a competitor, prevent the entry of a new competitor into the market, or to prevent or deter anyone from engaging in competitive conduct in the market).

ACCC v Boral Ltd & Anor

This decision was handed down by the Full Court of the Federal Court (consisting of Beaumont, Merkel and Finkelstein JJ) on 27 February 2001.

The case is significant because it reinforces the view that in appropriate circumstances the court can be expected to reject overly wide definitions of the relevant market and it clarifies the circumstances when predatory pricing could constitute a misuse of market power under s. 46.

Predatory pricing is an extreme form of price discrimination, typically a business deliberately reducing its prices to such a low level (perhaps even below manufacturing costs) that competitors will be forced out of the market. Ordinarily the business does this expecting to quickly recoup its losses later by significantly increasing prices. This is called the 'recoupment' argument, and is a necessary condition for establishing predatory pricing under US antitrust law, which is aimed at monopolistic power.

The facts

C&M Bricks Pty Ltd is a private company that manufactured concrete masonry products in Bendigo, Victoria. It established a new manufacturing operation on the outskirts of Melbourne in February 1994 using highly efficient 'state of the art' technology, which increased production capacity and reduced costs significantly. At the time, the industry included several major players with a national presence (primarily Boral Besser Masonry (BBM), one of Boral's subsidiaries, and Pioneer) as well as some medium sized players (Budget and Rocla). The building and construction market was, however, severely depressed and production levels were relatively low and prices for concrete masonry products were also low because of fierce competition.

Perhaps not surprisingly prices for concrete masonry products fell even further in Melbourne after C&M entered the market. However, BBM's prices on average fell below its average avoidable cost (i.e. the incremental cost of manufacture) and remained there for about 22 months. Also, despite the significantly reduced demand for building products, BBM increased capacity at its plant and widely publicised the fact to its competitors. The Commission argued that BBM was selling its concrete masonry blocks below their manufacturing cost for the proscribed purpose of eliminating competition or substantially damaging other competitors in the market, and to deter them from engaging in competitive conduct in the market.

Over the period of the allegations BBM increased its market share from about 18 per cent to about 30 per cent, and two competitors exited the market.

Decision at first instance

At its first hearing before the Federal Court, Heerey J found that there had not been a contravention of s. 46 because BBM did not have the requisite degree of market power in the relevant market to establish a contravention. In dismissing the Commission's submission that the relevant market was limited to concrete masonry products, Heerey J took the view that the relevant market was one in which builders acquired materials for use in the construction of walls and paving in the Melbourne metropolitan area. He stated, 'A wall is a wall, whether it is made of concrete blocks or tilt-up or concrete bricks or clay bricks. The only need of the builder is to have a wall which will perform as a wall, and for the lowest possible cost.' This expansive view opened up the opportunity for many other building products to be seen as part of the relevant market.

Heerey J further held that low barriers to entry in that market and the existence of strong competitors meant that BBM did not have power to behave independently of competitive forces and thus did not have market power in this wider relevant market.

However, the court did find that BBM had engaged in pricing below manufacturing costs to deter new entrants and drive the more efficient C&M out of the market — that is, there had been established a proscribed (anti-competitive) purpose within the meaning of s. 46.

In an obiter statement [not essential to the decision], Heerey J went on to consider the recoupment argument and stated that an essential element to predatory pricing was the recoupment of losses suffered during the predatory pricing by the subsequent charging of prices that were higher than would ordinarily be charged in a competitive market. He also observed that selling below manufacturing cost could be a rational business decision which was not, of necessity, consistent only with taking advantage of market power for the purposes of predatory pricing.

The Commission appealed to the Full Court of the Federal Court.

Full Court decision.

The three judges wrote separate decisions which varied in their reasoning processes. However, their unanimous decision was that BBM had contravened s. 46. They overturned Heerey J's findings on the appropriate market definition, whether or not BBM had a substantial degree of power in the relevant market, and whether BBM took advantage of that power.

Market definition: The Full Court took a much narrower view of the relevant market, which was determined to be the Melbourne market for concrete masonry products — Merkel J for example, took the view that the trial judge placed undue emphasis on function rather than substitution in defining the relevant market. Beaumont J held that this more limited market was the only one in which there was 'close' competition between products. He saw a distinction between competition and close competition, and the evidence before the court did not support a conclusion that concrete masonry products competed closely enough with other building products, for those other products to be considered as part of the same market.

Substantial degree of market power: For various different reasons the Full Court then held that BBM had a substantial degree of power in that market even though it had a relatively low market share for much of the relevant time. It was able to behave independently of competitive forces within the market — as evidenced primarily by successfully engaging in pricing below manufacturing cost and signalling to the market that it was willing to continue indefinitely its pricing behaviour, bearing whatever losses may result. In his judgment Beaumont J said:

> In short [BBM] was able to sell below cost for long periods and double its production capacity because ... [BBM] could afford it in a commercial sense.

Finkelstein J said:

> ... when [BBM] decided to increase its capacity at Deer Park, it publicised that fact to exert 'psychological pressure' on its rivals. What was that 'psychological pressure'? [BBM] intended to signal to its rivals that it was willing to continue to wage the price war for some time and that it would bear whatever losses may result.
> The case for a strategically erected barrier could not be more clear.

Merkel J concentrated on the question of barriers to entry in the relevant market and concluded that, although structural barriers to entry were low, there were other barriers that existed. In particular, he focused on the low market prices being experienced in the market, and the excess capacity, which together made it irrational for a new player to enter the market. He echoed the 'strategic barrier' argument put by Finkelstein J.

Taking advantage of market power: Beaumont and Merkel JJ followed *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Limited* 167 CLR 177, and held that 'take advantage' means use, without a hostile intent inquiry or purpose qualification.

There was also some consideration of the applicability of the recoupment test. Finkelstein J held that the terms of s. 46 indicated that an adoption of the recoupment test would frustrate the objects of the section: 'our section is aimed at regulating a firm with a substantial degree of market power, which would include, but is not limited to, a monopolist'. Because the section has wider applicability than monopolists, and given that recoupment would not be possible by firms with less than monopoly power, Finkelstein J concluded that the recoupment test was not a necessary element of conduct contravening the section.

Beaumont and Merkel JJ explained the differing approach in Australia by reference to the stated objectives of the 1986 amendments to s. 46 as set out in the second reading speech, which were in part to ensure that small businesses are given a measure of protection from the predatory actions of powerful competitors who include major participants in an oligopolistic market and in some cases a leading firm in a less concentrated market.

Purpose — the smoking gun documents: A firm with substantial market power can use that power without breaching s. 46 so long as it does not have a proscribed (anti-competitive) purpose. It is accepted that purpose may be inferred from conduct, although generally the courts have been wary of interpreting in a literal sense business statements about putting rivals out of business. In this case, however, there were some dramatic 'smoking gun' documents which could not be ignored. At first instance, Heerey J's finding of a proscribed purpose was primarily based on statements in BBM's business papers, particularly statements in its strategic business plan such as, 'Our aim through 1996/97 and 1997/98 is to drive at least one competitor out of the market. The new plant gives us the ability to do this'.

During the hearing of the appeal BBM challenged Heerey J's finding based on these 'smoking gun' documents, but the Full Court dismissed the argument, accepting Heerey J's findings with little elaboration.

Comments

The wide ranging judgment is significant for various reasons, but primarily because it provides more certainty for determining when predatory pricing could constitute a misuse of market power, particularly that:

- below cost pricing can be a misuse of market power, even in markets where there is more than one large player; and
- the recoupment test does not apply to s. 46.

ACCC v Rural Press Limited

This was a decision handed down by Mansfield J of the Federal Court on 1 March 2001.

The case is significant because the principles that it enunciates make it easier for small businesses to attract the benefit of s. 46 and enhances their ability to enter and compete in markets with much larger competitors.

The facts

The case relates to the not uncommon occurrence of a business attempting to extend its operations by expanding into a new area, and coming up against a powerful incumbent willing to use its overall market power to prevent the other's expansion by threatening its prime or traditional area of business.

South Australian based Waikerie Printing House publishes a regional newspaper in the Riverland area called *The River News*. *The River News*' traditional circulation area is centred on Waikerie. Waikerie Printing was effectively controlled by Paul and Darnley Taylor who were also responsible for publishing two other regional newspapers, *The Murray Pioneer* and *The Loxton News*, in other parts of Riverland.

After a redistribution of district council boundaries, Waikerie Printing extended its circulation area in July 1997 to include the town of Mannum, which became part of the new Mid Murray Council district. The company appointed a local resident to report on news and events occurring in and around Mannum, and to attract advertising revenue in the area. Mannum was part of the traditional circulation area of the *Murray Valley Standard*, which was centred on the nearby town of Murray Bridge. The *Standard* was owned by Bridge Printing Office, a subsidiary of Rural Press Limited, a large national publishing house of regional newspapers and agricultural magazines.

The court found that:

- from July 1997 to April 1998 senior representatives of Rural Press had let Waikerie Printing know on various occasions that it did not want it covering news occurring in and around Mannum or soliciting advertising for *The River News* in the Mannum area;
- the representatives threatened to introduce a free opposition newspaper into the Riverland district, which would compete directly with *The River News, The Murray Pioneer* and *The Loxton News* in their traditional prime circulation areas; and
- Rural Press had also begun the groundwork to introduce the free newspaper into the Riverland area.

As a result of these threats Waikerie Printing advised Rural Press it would withdraw the *River News* from the Mannum area and did so in May 1999.

The arguments and findings

Market definition: The Commission argued that the relevant market for the exercise of s. 46 was the provision of regional newspapers in the Murray Bridge district. Rural Press did not dispute the geographic element of the market but argued that the product market was too narrow, because it did not account for competition between regional newspapers and regional radio — particularly, for this case, the Murray Bridge radio station 5MU. The Commission led evidence from the former general manager of 5MU to the effect that regional newspapers and regional radio were not in close or direct competition, and expert opinion evidence to the effect that the two forms of regional media were not substitutable. His Honour found in favour of the Commission's narrower market definition, for both product and geographic extent.

Market power: The Commission argued that a wide variety of circumstances had a bearing on whether Rural Press and Bridge Printing had substantial market power. The expert opinion evidence before the court was to the effect that the barriers to entry in the market were high, and His Honour accepted that to enter the market for regional newspapers in the Murray Bridge District would incur costs that could not be recoverable in exiting the market. These included establishing systems for the collection of news, marketing, arranging distribution, providing news of sufficient quality to establish local credibility, and direct production costs. Significantly, His Honour found that Rural Press was a very large enterprise, with substantial facilities in South Australia that would enable it to carry out its threat to publish an opposition newspaper in the Riverland. In light of the above, and the fact that Rural Press and Bridge Printing are related corporations for the purposes of the Act (s. 4A(5)), His Honour also accepted that Rural Press had substantial power in the market.

Taking advantage: Rural Press argued that neither they nor Bridge Printing took advantage of any market power they possessed, on the basis that the purported threat did not amount to 'taking advantage' of their market power. The Commission argued that the threat did, because of the very significant economic and financial resources at the disposal of Rural Press and, therefore, their clear capacity to immediately carry out such a threat. His Honour found that the power of Rural Press and Bridge Printing in the market should be measured as including the financial resources and strength of Rural Press as well as their existing publishing resources and expertise. He then found that the threats were made to Waikerie Printing only because that market power existed, and that the threats were made to preserve and maintain that market power. The credibility of the threat only existed because of that market power.

Comment

The decision is significant because:

- a threat was deemed sufficient in the circumstances of this case to be a misuse of market power; and
- the court rejected the overly wide market definition suggested by Rural Press in favour of the narrower definition suggested by the Commission.

There has been some criticism of the case on the grounds that the threatened action did not appear to have any direct connection with the power Rural Press had in the market in which the *Standard* was published, that is, the Murray Bridge District. The threat related to the introduction of a new newspaper into the Riverland District — although that could be seen as the strength of the decision.

Melway Publishing Pty Ltd v Robert Hicks Pty Ltd

This was a decision on appeal to the High Court of Australia, and was handed down on 15 March 2001. It represented only the second occasion that the High Court had the opportunity to consider the substantive elements of s. 46 — the other being the Queensland Wire Industries case more than 10 years ago.

Melway has for 30 years published the *Melway street directory* for the Melbourne metropolitan area. The directory accounts for 80–90 per cent of the retail market for Melbourne street directories. Except for a 16-month period in 1989–1990, Melway has always distributed the directory through wholesalers who each dealt exclusively with a specific segment of the retail market.

Robert Hicks (trading as Auto Fashions) was a distributor for the automotive parts retailer segment. In February 1995 Melway gave notice of termination of Auto Fashions' distributorship.

In March 1995 Auto Fashions offered to acquire 30 000–50 000 Melway directories per annum on the basis that it would sell to any retailer, irrespective of segment. Melway refused to supply its directory to Auto Fashions.

The decision at first instance

At first instance Merkel J of the Federal Court found that Melway had acted in breach of s. 46 in refusing to supply to Auto Fashions.

Melway subsequently appealed the whole of the judgment of Merkel J to the Full Federal Court.

The appeal to the Full Federal Court

It was accepted on appeal that Melway had a substantial degree of power in the wholesale and retail market for Melbourne street directories.

The Full Court also unanimously agreed with Merkel J that Melway's purpose in preserving the existing distribution system and thereby preventing competition by a would-be distributor against existing distributors was a proscribed purpose.

The majority of the Full Court agreed with the trial judge and found that Melway had taken advantage of its substantial market power in breach of s. 46. Melway subsequently made application for special leave to appeal the whole of the judgment of the Full Federal Court.

The appeal to the High Court

The case was finally heard by the High Court. The central issue before it was whether Melway, in refusing to supply Robert Hicks, took advantage of its substantial market power.

The Commission sought and was granted permission to intervene at the hearing.

High Court decision

The High Court handed down its decision on 15 March 2001.

In upholding its decision in *Queensland Wire Industries* the court held that the expression 'take advantage' does not mean anything materially different from 'use' and does not require conduct which is predatory or morally blameworthy.

The Commission submitted that the conduct of a firm may 'take advantage' of a substantial degree of market power within the meaning of s. 46 if the conduct is materially facilitated or made easier by that market power. In light of this submission the court went on to clarify that:

> ... in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s. 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.

This type of analysis will ordinarily require consideration of the constraints that a more competitive market would impose upon the firm if it lacked the market power it had. In considering how this analysis should be conducted the court further clarified that an absence of a substantial degree of market power does not mean the presence of an economist's theoretical model of perfect competition. It only requires a sufficient level of competition to deny a substantial degree of power to any competitor.

In applying these principles to the facts the court noted that in this case Melway had created and maintained its distribution system at a time when it did not have a substantial degree of market power. This meant that the maintenance of the distribution system after Melway had obtained market power was not **necessarily** a use of that power.

The court ultimately found that Auto Fashions had not demonstrated that Melway had taken advantage of its market power.

Comment

In this decision the High Court has lowered the threshold for establishing whether a taking advantage of substantial market power has occurred, and has made it clear that potentially contravening conduct will be examined in the context of the reality of the market in which it occurred.

Gathering and presenting evidence to the court to establish that potentially contravening conduct of a firm has been materially assisted or made easier by the existence of substantial market power will be an important aspect of future s. 46 investigations and litigation undertaken by the Commission.

While the fact that Melway had created and maintained its distribution system at a time when it did not have market power was significant in this case, every member of the High Court quoted with approval the remarks made by Scalia J in the Supreme Court of the United States when he said:

> Where a defendant maintains a substantial market power, his activities are examined through a special lens: Behaviour 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.

Claim that TPA overrides legal professional privilege upheld

In a much anticipated decision the Full Court of the Federal Court in Sydney, on 16 March 2001, upheld the claim by the Commission that its powers under s. 155 of the Trade Practices Act to gain access to documents extend to ones subject to legal professional privilege.

The decision is noteworthy because the court determined that a person or company under investigation by the Commission cannot refuse to provide information to it by relying on legal professional privilege. The Commission has always maintained that the proper investigation and effective enforcement of the Act required the powers in s. 155 to be interpreted this way.

Wilcox J, with whom Lindgren J agreed, said:

> Conduct that involves a contravention of the Trade Practices Act, often comprises many separate acts, some of which may be effected through lawyers. Without information about contacts between the person under investigation and that person's lawyer, it may be impossible for ACCC to see the whole picture.

Similar comments were made by Moore J.

Despite the favourable decision, Commission Chairman Professor Allan Fels, said that there would be no real change in the Commission's enforcement activities:

> The ACCC has rarely sought to override legal professional privilege to seek documents during the course of an investigation. However, this decision means that the ACCC will be able to properly investigate alleged breaches of the Act and determine the seriousness of any breaches without relevant information, documents or evidence being withheld from it under the cloak of legal professional privilege.