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Katharine Kemp, '"The Big Chill"? A Comparative Analysis of Effects-Based Tests for Misuse of Market Power' (2017) 40(2) *University of New South Wales Law Journal* (Advance).

'THE BIG CHILL'? A COMPARATIVE ANALYSIS OF EFFECTS-BASED TESTS FOR MISUSE OF MARKET POWER

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I INTRODUCTION

In March 2016, the Prime Minister made the controversial announcement that the Cabinet would move to amend the prohibition of misuse of market power in section 46(1) of the *Competition and Consumer Act 2010* (Cth) ('*CCA*') to incorporate an 'effects test', consistent with the recommendations of the Competition Policy Review Panel ('Harper Panel').[1] The Government described this as 'a vital economic reform'.[2] The former Chairman of the Australian Competition and Consumer Commission ('ACCC'), Allan Fels, applauded the decision as the adoption of 'an economically rational and sensible principle'.[3] In contrast, the Federal Opposition called the proposal a 'multi-billion dollar disaster waiting to happen',[4] and the Chief Executive of the Retail Council argued that it was 'simply bad policy and the consumer is the loser'.[5] In December 2016, the Federal Government introduced the Competition and

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

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

3 Allan Fels, 'Effects Test: The Case For', *The Australian Financial Review* (online), 17 March 2016 <http://www.afr.com/news/policy/effects-test-the-case-for-20160317-gnld5b>.

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

5 Hutchens, 'Turnbull Government', above n 2.

Consumer Amendment (Misuse of Market Power) Bill 2016 ('Misuse of Market Power Bill'), which would amend section 46(1) of the *CCA* to incorporate the proposed effects-based test, the 'substantial lessening of competition' test ('SLC test').[6]

Those who oppose an 'effects test', or 'effects-based test'[7] for misuse of market power argue that it would deter firms with substantial market power ('dominant firms')[8] from engaging in conduct which is actually procompetitive and in the interests of consumers.[9] They contend that the proposed amendment would create unacceptable uncertainty for dominant firms, and make them less likely to reduce prices or introduce beneficial innovations.[10]

This article analyses the claim that the adoption of an effects-based test for misuse of market power in Australia would 'chill' competition.[11] These arguments are not peculiar to the current debate in Australia. There has been vigorous debate concerning the appropriate test for misuse of market power, or unilateral anticompetitive conduct,[12] in and between a number of competition law jurisdictions for decades.[13] Certain questions are repeated across jurisdictions. How can the theory that firms with market power are able to harm competition be translated into a standard that allows courts to reliably identify such conduct? How can tests avoid capturing or discouraging conduct that results

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6 The history leading to the Harper Panel recommendations and the Misuse of Market Power Bill is explained in Part II(B) below, and the substance of the Bill, and subsequent amendments to the Bill, are explained in Part VI below.

7 As defined in Part II(A) below. Such tests are sometimes referred to as 'effects tests', particularly in the Australian debate, but the term 'effects-based test' is used in this article to acknowledge the wider range of tests encompassed by this concept. For example, some of the relevant tests are based on the likely effect of conduct rather than its actual effect.

8 In Australia, s 46(1) refers to a firm with 'a substantial degree of market power', as explained in Part II(A) below. In other jurisdictions, similar laws refer to firms with a 'dominant position' or to 'monopolists': see Parts III(C) and IV below. In this article, the term 'dominant firm' is generally 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.

9 See, eg, Stephen King and Graeme Samuel, 'Competition Law Fix Could Seriously Harm Competition', *The Conversation* (online), 5 May 2015 <https://theconversation.com/competition-law-fix-could-seriously-harm-competition-41159>; Marianna Papadakis, 'Harper "Effects Test" Will Hurt Business; Lawyers', *The Australian Financial Review* (online), 31 March 2015 <http://www.afr.com/business/legal/harpers-effects-test-will-hurt-business-lawyers-20150401-1mbnle>.

10 See, eg, Joanna Mather, 'Effects Test to Stifle Bank Competition, Expert Says', *The Australian Financial Review* (online), 2 October 2016 <http://www.afr.com/news/effects-test-to-stifle-bank-competition-expert-says-20161002-grt55r>; Graeme Samuel and Stephen King, 'Competition Law: Effects Test Would Have Shackled Competition', *The Australian Financial Review* (online), 9 September 2015 <http://www.afr.com/opinion/competition-law-effects-test-would-have-shackled-competition-20150908-gjhq5l>; Julie-anne Sprague and Sue Mitchell, 'Woolworths Says "Effects" Test Will "Chill" Competition', *The Australian Financial Review* (online), 31 March 2015 <http://www.afr.com/about-us/woolworths-says-effects-test-will-chill-competition-20150331-1mbw4j>.

11 See, eg, Marianna Papadakis, 'Lawyers Split on Turnbull's "Effects Test", Dislike Labor's Plan' *The Australian Financial Review* (online), 17 March 2016 <http://www.afr.com/business/legal/lawyers-split-on-turnbulls-effects-test-dislike-labors-plan-20160315-gnjsth>; Business Council of Australia, Submission to Treasury, *Options to Strengthen the Misuse of Market Power Law*, February 2016, 19–21; Samuel and King, above n 10; Sprague and Mitchell, above n 10.

12 As defined in Part II(A) below.

13 See Parts III, IV below.

overwhelmingly in improved long-term consumer welfare even if it excludes rivals?

This article makes a comparative analysis of the proposed amendment to section 46(1) of the *CCA* against several effects-based tests for unilateral anticompetitive conduct proposed or adopted in other jurisdictions.[14] From an Australian perspective, such a comparison is especially useful in revealing how others navigate the pitfalls of framing unilateral anticompetitive conduct standards, including the potential for effects-based tests to reduce incentives for dominant firms to engage in beneficial conduct ('disincentive effects'). The 'social problem' that section 46(1) addresses will act as the point of comparison.[15] The social problem is that some firms, acting unilaterally, can engage in conduct that harms the competitive process and, ultimately, consumer welfare.[16] The standards compared are intended to identify the type of unilateral conduct that should be prohibited, having regard to the need to deter conduct which harms the competitive process, without unduly deterring vigorous competition which would otherwise benefit consumers.[17]

This article proceeds as follows. Part II briefly explains the rationale for laws against unilateral anticompetitive conduct and outlines the debate concerning the prohibition of misuse of market power in Australia which preceded the government's proposal. Part III examines arguments for and against effects-based tests based on decision theory and error–cost analysis, which emerged in United States ('US') antitrust commentary from the 1980s and were then highlighted in the debate concerning the notorious monopolisation case of *United States v Microsoft Corporation*[18] around the turn of the century.

Shortly after this debate began in the US, the European Union ('EU') began the process of 'modernising' its competition laws to take greater account of economic effects.[19] Part IV analyses the approach to unilateral conduct in the 'Guidance Paper' published by the Commission of the European Communities ('Commission') in 2009, which demonstrates significantly greater suspicion of dominant firm conduct than standards proposed in the US. Part V outlines an

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14 The purpose of this article is to inform the debate concerning the proposed amendment to section 46(1) of the *CCA* and its likely consequences. It is not within the scope of the article to propose and defend an alternative formulation of the misuse of market power provision in Australia.

15 See Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir trans, Oxford University Press, 3rd ed, 1998) 45 [trans of: *Einführung in die Rechtsvergleichung* (first published 1969)].

16 See Part II(A) below.

17 Ibid. This article is concerned with the 'conduct' aspect of such standards. For present purposes, the general requirement that these standards apply only to firms that possess a substantial degree of market power is assumed. See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart, 2nd ed, 2011) 276–7, regarding the general requirement for a threshold level of market power. It is not within the scope of this article to compare other aspects of the application of these standards, including, for example, the institutional architecture of the respective jurisdictions.

18 253 F 3d 34, 58–9 (DC Cir, 2001) ('*Microsoft*'). See Steven C Salop and R Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and *Microsoft*' (1999) 7 *George Mason Law Review* 617, 617; Mark S Popofsky, 'Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules' (2006) 73 *Antitrust Law Journal* 435, 435.

19 Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart, 2nd ed, 2013) 67–83.

alternative approach under the South African *Competition Act 1998*. While there are a number of jurisdictions which adopt an effects-based test for unilateral conduct,[20] the South African law is particularly interesting because it provides a test which is based expressly on the effects of the conduct, but varies the applicable penalty according to the category of conduct.[21]

Part VI explains the Australian Government's proposal to amend section 46(1) to incorporate the SLC test and critically analyses key arguments raised against this proposal, drawing comparisons with other effects-based tests. This comparison is expanded in Part VII to explain the relative strengths and weaknesses of the tests in their treatment of low pricing and innovative practices in particular. The article concludes that while claims regarding the disincentive effects of the proposed amendment have been overstated, there are more subtle weaknesses in the proposal which may create disincentive effects for dominant firms.

II THE RATIONALE FOR PROHIBITING UNILATERAL ANTICOMPETITIVE CONDUCT AND THE DEBATE IN AUSTRALIA

A Rationale for Unilateral Anticompetitive Conduct Rules

Section 46(1) of the *CCA* is a law that prohibits certain single-firm or unilateral anticompetitive conduct. Almost all modern competition laws incorporate provisions regulating unilateral conduct on the part of dominant firms, or firms which possess a specified degree of market power.[22] These rules are often distinguished from the regulation of mergers between firms, and rules against multilateral anticompetitive conduct, which prohibit practices between rival firms or firms at different levels of the supply chain.

In Australia, a firm is considered to possess a substantial degree of market power if it has the ability to behave persistently in a manner unconstrained by its competitors, suppliers or customers, including the ability to price above the level that would prevail in a competitive market.[23] Dominant firms often achieve or

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20 For example, under the Canadian *Competition Act*, a dominant firm must not engage in anticompetitive conduct which 'has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market': *Competition Act*, RSC 1985, c C-34, s 79(1)(c). However, the Canadian *Competition Act* also incorporates a 'purpose' element: Competition Bureau, Canada, 'Enforcement Guidelines: The Abuse of Dominance Provisions, Sections 78 and 79 of the *Competition Act*' (20 September 2012) 10–11.

21 The South African test also represents a 'pure' effects test in that it depends on proof of actual anticompetitive effects, rather than including purpose or likely effect as alternative bases of liability. See Part V below.

22 See Elhauge and Geradin, above n 17, 273.

23 See *CCA* s 46(3); *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374, 423 [136]–[137] (Gleeson CJ and Callinan J) ('*Boral Besser*'); S G Corones, *Competition Law in Australia* (Thomson Reuters, 5th ed, 2010) 131–7. From an economist's perspective, it is particularly relevant that such firms have the ability to exercise control over price. See Louis Kaplow and Carl Shapiro, 'Antitrust' (NBER Working Paper No 12867, National Bureau of Economic Research, January 2007) <http://www.nber.org/papers/w12867>; Geoff Edwards, 'The Hole in the Section 46 Net:

maintain their market power through superior efficiency, outcompeting their rivals with lower prices, better quality products and services, and innovation, to the benefit of consumers and society as a whole.[24] For this reason, competition laws generally permit a firm to possess substantial market power.[25] But it is also possible for dominant firms to increase or preserve their market power through conduct which suppresses rivalry by other firms while creating no benefits, or no proportionate benefits, for society ('unilateral anticompetitive conduct').[26] Unilateral anticompetitive conduct rules are intended to target these practices.[27] At the same time, policymakers attempt to frame these rules such that they do not unduly hinder beneficial competitive activity.[28]

In a number of jurisdictions, legal tests for unilateral anticompetitive conduct focus on the effect of the dominant firm's conduct on competition in the relevant markets, with particular regard to the impact of the conduct on consumers.[29] Such

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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; *Queensland Wire Industries v The Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, 188 (Mason CJ and Wilson J). That is, the firm can maintain price above the competitive level (or quality below the competitive level) for a sustained period without so many consumers switching that the price increase is unprofitable: Gunnar Niels, Helen Jenkins and James Kavanagh, *Economics for Competition Lawyers* (Oxford University Press, 2011) 116 [3.1].

24 This reflects both the view that monopoly profits are a fair reward for superior skill and ingenuity, and the economic viewpoint that the prospect of monopoly profits motivates firms to innovate, improve quality and lower their costs: Andrew I Gavil, 'Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance' (2004) 72 *Antitrust Law Journal* 3, 33, 42, citing *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP*, 540 US 398, 407–9 (2004); Herbert Hovenkamp, 'Exclusion and the *Sherman Act*' (2005) 72 *University of Chicago Law Review* 147, 163. See also Commonwealth, *Parliamentary Debates*, Senate, 14 August 1974, 923 (Lionel Murphy, Attorney-General), distinguishing anticompetitive conduct from situations where a monopolist is simply 'competing as well as he is able – for example, by taking advantage of economies of scale, developing new products or otherwise making full use of such skills as he has'.

25 International Competition Network, 'Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies' (Paper presented at the 6th Annual Conference of the International Competition Network, Moscow, May 2007) 17.

26 See Committee of Review of the Application of the *Trade Practices Act 1974*, Parliament of Australia, *National Competition Policy* (1993) ('*Hilmer Report*') 62, stating that:

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

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

28 *Hilmer Report*, above n 26, 62; Baumol et al, above n 27, 4.

29 See, eg, Economic Advisory Group on Competition Policy, 'An Economic Approach to Article 82' (Report, July 2005); Steven C Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard' (2006) 73 *Antitrust Law Journal* 311; Christian Ahlborn and A Jorge Padilla, 'From Fairness to Welfare: Implications for the Assessment of Unilateral Conduct under EC Competition Law' (Paper presented at the 12th Annual Competition Law and Policy Workshop, Robert Schuman Centre, Florence, 8–9 June 2007) 38. Cf Gregory J Werden, 'Competition Policy on Exclusionary Conduct: Toward an Effects-Based Analysis?' (2006) 2(1) *European Competition Journal* 53, 61–2, who refers to such tests as 'open-ended' or 'purely effects-based' analysis.

tests are referred to as 'effects-based' tests or standards.[30] In this article, an 'effects-based' test is defined as a test for the characterisation of unilateral anticompetitive conduct, which focuses on the effect, or likely effect, of the impugned conduct on competition in the relevant market. This is not a concept with a single meaning. It has been given different content by authorities in different places and eras, depending on their understanding of the meaning and value of competition, and their theory as to what kind of proof of impact is sufficient to warrant intervention.[31] However, all of these tests have in common a professed concern with the actual or probable effect of the conduct on the competitive process, as opposed to its effect on any individual competitor.[32] These tests may also be distinguished from tests which focus on the dominant firm's purpose or on the effect of the conduct on the dominant firm itself:[33] the current test under section 46(1) focuses on both of these matters, rather than the effect of the impugned conduct on the competitive process.[34]

B The Australian Debate on the Test for Misuse of Market Power

Section 46(1) of the *CCA* currently provides as follows:

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

A firm contravenes section 46(1) if three elements are established, namely that the corporation possesses substantial market power; that it has 'taken advantage' of that power; and that it has done so for one of the three proscribed purposes.[35] This provision (and its identical predecessor in the *Trade Practices Act 1974* (Cth))[36] has been considered by numerous parliamentary

30 See Parts III–VI below.

31 Ibid.

32 Ibid.

33 See Salop, 'Flawed Profit-Sacrifice', above n 29, 331.

34 See Parts II(B), VI below. See also Stephen Corones, 'The Characterisation of Conduct under Section 46 of the *Trade Practices Act*' (2002) 30 *Australian Business Law Review* 409, 411–13; Katharine Kemp, '"Taking Advantage" of Substantial Market Power, and Other Profit-Focused Tests for Unilateral Anticompetitive Conduct' (2016) 41 *Monash University Law Review* 655.

35 See Corones, 'Characterisation of Conduct under Section 46', above n 34; Edwards, 'The Hole in the Section 46 Net', above n 23; Margaret Brock, 'Section 46 of the *Trade Practices Act* – Has the High Court Made a "U-Turn" on "Taking Advantage"?' (2005) 33 *Australian Business Law Review* 327; Justice John Middleton, 'The *Trade Practices Legislation Amendment Act 2008* (Cth) and s 46 of the *Trade Practices Act 1974* (Cth) – Will Anything Really Change?' (Speech delivered at the Twentieth Annual Workshop of the Competition Law and Policy Institute of New Zealand, Auckland, 8 August 2009); Bill Reid, 'Section 46 – A New Approach' (2010) 38 *Australian Business Law Review* 41; Rhonda L Smith and David K Round, 'Do Deep Pockets Have a Place in Competition Analysis?' (2012) 40 *Australian Business Law Review* 348.

36 The provision was originally enacted as *Trade Practices Act 1974* (Cth) s 46(1).

and independent reviews over the last 40 years.[37] Each of these reviews has considered submissions that the provision should incorporate an effects-based test.[38]

Proponents of effects-based tests have claimed that, on its current wording, section 46(1) is under-inclusive. In particular, they have argued that the requirements to prove 'taking advantage' and the subjective purpose of the dominant firm are both misaligned with the objective of the provision, and permit significant instances of unilateral anticompetitive conduct to go unchallenged.[39] However, earlier review committees confronted with proposals for an effects-based test either deferred consideration, or refused to recommend the change on the ground that the existing provision had not been proved defective and a substantial amendment would create unacceptable uncertainty for the business community, potentially deterring competitive conduct.[40]

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

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37 Since the 1970s, there have been 13 parliamentary and independent reviews, and one Green Paper, which have considered the effectiveness of the *Trade Practices Act 1974* (Cth) s 46(1) (later *CCA* (Cth) s 46(1)). See Trade Practices Act Review Committee, Parliament of Australia, *Report to the Minister for Business and Consumer Affairs* (1976) 39 ('*Swanson Report*'); Trade Practices Consultative Committee, Parliament of Australia, *Small Business and the Trade Practices Act* (1979) ('*Blunt Report*'); Parliament of Australia, *The Trade Practices Act: Proposals for Change* (1984) ('*1984 Green Paper*'); House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989) ('*Griffiths Report*'); Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Monopolies & Acquisitions: Adequacy of Existing Legislative Controls* (1991) ('*Cooney Report*'); *Hilmer Report*, above n 26; House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Finding a Balance: Towards Fair Trading in Australia* (1997) ('*Reid Report*'); Joint Select Committee on the Retailing Sector, Parliament of Australia, *Fair Market or Market Failure? A Review of Australia's Retailing Sector* (1999) ('*Baird Report*'); House of Representatives Standing Committee on Economics, Finance and Public Administration, Parliament of Australia, *Competing Interests: Is There Balance? Review of the Australian Competition and Consumer Commission Annual Report 1999–2000* (2001) ('*Hawker Report*'); Senate Legal and Constitutional References Committee, Parliament of Australia, *Inquiry into s 46 and s 50 of the Trade Practices Act 1974* (2002) ('*McKiernan Report*'); Trade Practices Act Review Committee, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act* (2003) ('*Dawson Report*'); Senate Economics References Committee, Parliament of Australia, *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* (2004) ('*Stephens Report*'); Senate Economics References Committee, Parliament of Australia, *The Impacts of Supermarket Price Decisions on the Dairy Industry* (2011) ('*Dairy Report*'); Ian Harper et al, 'Competition Policy Review: Final Report' (Final Report, Competition Policy Review, March 2015) ('*Harper Final Report*').

38 See, eg, *Cooney Report*, above n 37, 82–3; *Hilmer Report*, above n 26, 68; *Dawson Report*, above n 37.

39 See Part VI(B) below.

40 Until 2014, only the *1984 Green Paper* recommended the adoption of an effects-based test: *1984 Green Paper*, above n 37, 8. By contrast, in 2003, the *Dawson Report* went as far as to say that, given the number of times an effects-based test had been considered and rejected, the effects issue should not be considered by future periodic reviews: *Dawson Report*, above n 37, 82. See also 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, 336–7.

> my own view is that the biggest issue is whether it should be a purpose test or a purpose or effects test. To me, that is where the rubber hits the ground, and that is, I think, a legitimate issue to debate.[41]

The Committee recommended that the government initiate an independent review of the effectiveness of the *CCA*.[42] In 2013, the new Coalition Government promised an independent 'root and branch' review of Australian competition law and policy.[43]

In 2014, the Harper Panel conducted the first general review of Australian competition policy in over 20 years and, in March 2015, controversially recommended that section 46(1) be repealed and replaced by a provision which would ask whether the firm's conduct 'has the purpose, or would have or be likely to have the effect, of substantially lessening competition'.[44] The government has since introduced the Misuse of Market Power Bill which would replace section 46(1) with a provision largely in terms recommended by the Harper Panel.[45] Opponents – including the Federal Opposition and the Business Council of Australia – continue to warn that the proposed amendment is likely to chill competition by dominant firms and protect inefficient competitors.[46]

III THE US ORIGINS OF THE MODERN 'EFFECTS' DEBATE AND THE APPLICATION OF DECISION THEORY

A Easterbrook's 'Limits of Antitrust' and the Application of Decision Theory

The origins of the modern debate concerning effects-based tests can be found in US antitrust commentary of the 1980s, when some courts and commentators began to express strong views about the use of such tests to identify anticompetitive conduct. One of the best-known arguments against effects-based

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41 *Dairy Report*, above n 37, 107.

42 Ibid 115.

43 See Joe Hockey, 'Australia: Open for Business' (Speech delivered at the American Australian Association, New York, 15 October 2013) <http://jbh.ministers.treasury.gov.au/speech/001-2013/>.

44 The Harper Panel's reasons for making this recommendation are explained in Part VI below. See *Harper Final Report*, above n 37, 347, see generally 335–47. The Harper Panel also recommended that the new s 46 incorporate legislative guidance on the meaning of this test, and that 'authorisation' should be permitted in respect of conduct which would otherwise be captured by s 46(1), as explained in Part VI(A) below.

45 See Part I above and Part VI(A) below. The proposed amendment to s 46(1) was originally part of the draft Competition and Consumer Amendment (Competition Policy Review) Bill 2016 (Cth) released by the Treasury in September 2016, which incorporated numerous other changes to the *CCA*. However, the Misuse of Market Power Bill was introduced separately in December 2016. See Treasury, Australian Government, *Competition Law Amendments: Exposure Draft Consultation* <https://consult.treasury.gov.au/market-and-competition-policy-division/ed_competition_law_amendments>; Treasury, Australian Government, 'Exposure Draft – Competition and Consumer Amendment (Competition Policy Review) Bill 2016: Exposure Draft Explanatory Materials' (Exposure Draft, 5 September 2016) 35–40.

46 See, eg, Gareth Hutchens, 'Labor Party Opposes "Effect Test" in Harper Review', *The Sydney Morning Herald* (online), 2 October 2014 <http://www.smh.com.au/business/labor-party-opposes-effect-test-in-harper-review-20141001-10oqtv.html>; Business Council of Australia, Submission to Senate Economics Legislation Committee, January 2017, 5. See further Part VI below.

tests was made by Easterbrook in his 1984 article, 'The Limits of Antitrust'.[47] Easterbrook's article focused on the use of an effects-based test, or 'rule of reason' analysis, in antitrust claims concerning *multilateral* arrangements between firms under section 1 of the *Sherman Act*.[48]

Easterbrook noted the Supreme Court's explanation that the inquiry mandated by the rule of reason is 'whether the challenged agreement is one that promotes competition or one that suppresses competition. … [T]he purpose of the analysis is to form a judgment about the competitive significance of the restraint'.[49] According to the classic definition of the 'rule of reason' in the *Chicago Board of Trade* decision of 1918:

> the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.[50]

Easterbrook noted the 'open-ended' nature of this formula and expressed the view that courts, competition authorities and firms were unlikely to arrive at any meaningful conclusions from such a complex weighing exercise.[51] In this and a later article concerning unilateral anticompetitive conduct, Easterbrook applied decision theory under conditions of uncertainty[52] to argue against the application of a rule of reason analysis, and in favour of simpler, deliberately under-inclusive rules.[53]

To explain, decision theory is concerned with optimal choice in the presence of uncertainty.[54] Error-cost analyses based on decision theory have been used in competition law, and other areas of law, as a framework for considering the relative merits of different rules.[55] In making error-cost analyses, statisticians and scientists refer to 'false positive' errors as Type I errors (in the legal context, mistakenly punishing the innocent) and 'false negative' errors as Type II errors

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47 Frank H Easterbrook, 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1.

48 In broad terms, *Sherman Act* § 1 prohibits anticompetitive agreements between firms as opposed to unilateral conduct that amounts to monopolisation or attempted monopolisation under *Sherman Act* § 2: Elhauge and Geradin, above n 17, 12.

49 Easterbrook, 'Limits', above n 47, 11–12, citing *National Society of Professional Engineers v United States*, 435 US 679, 691–2 (1978).

50 *Board of Trade of City of Chicago v United States*, 246 US 231, 238 (1918).

51 Easterbrook, 'Limits', above n 47, 11–14.

52 At least implicitly: Frank H Easterbrook, 'On Identifying Exclusionary Conduct' (1986) 61 *Notre Dame Law Review* 972, 977.

53 Ibid.

54 See Alan Devlin and Michael Jacobs, 'Antitrust Error' (2010) *52 William and Mary Law Review* 75, 83; Jonathan B Baker, 'Taking the Error Out of "Error Cost" Analysis: What's Wrong with Antitrust's Right' (2015) 80 *Antitrust Law Journal* 1, 7.

55 See, eg, Isaac Ehrlich and Richard A Posner, 'An Economic Analysis of Legal Rulemaking' (1974) 3 *Journal of Legal Studies* 257; Frank H Easterbrook, 'Ignorance and Antitrust' in Thomas M Jorde and David J Teece (eds), *Antitrust, Innovation, and Competitiveness* (Oxford University Press, 1992) 119; C Frederick Beckner III and Steven C Salop, 'Decision Theory and Antitrust Rules' (1999) 67 *Antitrust Law Journal* 41.

(mistakenly failing to punish the guilty).[56] The terms 'false positive' and 'false negative' errors are used in this article.

The use of an error-cost framework in respect of legal rules begins with the acknowledgement that, given imperfect information, the application of any legal rule inevitably results in some errors, but that the resulting social cost of different legal rules varies. Different rules may be compared on the basis of their respective error costs, error cost being the product of the likelihood of error and the cost of error associated with each solution.[57] A high probability of a certain type of error – for example, incorrectly finding patent fraud to be anticompetitive – may cause little concern if the error would not cause any significant losses for society.[58] On the other hand, a lower probability of another type of error – for example, incorrectly finding the introduction of an innovative service to be anticompetitive – may cause significantly more concern on the basis that the error would deprive society of highly valuable conduct.[59] Ideally legal rules will be designed such that the total cost of legal error (the product of the likelihood, and the cost, of error) is minimised.[60] At the same time, there will often be a trade-off between different types of errors: a rule which avoids false positives may increase the chance of false negatives. The choice between rules will vary depending on perceptions of the relative costs of these errors.

Easterbrook argued that an antitrust standard based on a case-by-case analysis of effects is likely to give rise to significant false positives, the condemnation of beneficial conduct by firms.[61] In his view, courts are ill-equipped to explain complex economic problems, let alone weigh various economic outcomes against each other.[62] Given the historical suspicion with which courts regard conduct that has no explanation (or no explanation which the court can comprehend), courts are likely to condemn some beneficial conduct under an open-ended analysis of purpose and effects.[63] By contrast, Easterbrook's own proposals for under-inclusive rules would give rise to absolution for some harmful conduct. The latter error, he said, should be preferred, having regard to the respective costs of the errors.[64]

Incorrect judicial condemnation of beneficial firm conduct, Easterbrook argued, causes great losses to society, particularly since these errors are perpetuated by the doctrine of stare decisis and expanded by the efforts of other

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56 See Baker, above n 54, 5.

57 See Fred S McChesney, 'Easterbrook on Errors' (2010) 6 *Journal of Competition Law & Economics* 11, 16.

58 See Herbert J Hovenkamp, 'The Antitrust Standard for Unlawful Exclusionary Conduct' (Research Paper No 08-28, University of Iowa College of Law, June 2008) 31; Herbert Hovenkamp, 'Patent Deception in Standard Setting: The Case for Antitrust Policy' (Research Paper, University of Iowa College of Law, 20 July 2010) 28.

59 Herbert Hovenkamp, 'The Monopolization Offense' (2000) 61 *Ohio State Law Journal* 1035, 1039.

60 Ibid.

61 Easterbrook, 'Limits', above n 47, 4–8; Easterbrook, 'Exclusionary Conduct', above n 52, 977–8.

62 Easterbrook, 'Limits', above n 47, 4–8.

63 Ibid.

64 Easterbrook considered that antitrust rules should be designed to make it relatively difficult for a plaintiff to prove a contravention on the basis that the error costs of false convictions are significantly greater than the error costs of false acquittals: Easterbrook, 'Exclusionary Conduct', above n 52, 977.

firms to 'steer clear of the danger zone'.[65] By contrast, he considered that most anticompetitive conduct, including unilateral anticompetitive conduct,[66] will generally be corrected by market forces in the long run.[67] He therefore argued that the costs of false positives in identifying anticompetitive single-firm conduct are high relative to the costs of false negatives.[68] In Easterbrook's view, effects-based tests also have the disadvantage that increased analysis gives rise to much greater costs in enforcement, litigation and adjudication than simple, under-inclusive rules.[69]

At around this time, the US Supreme Court expressed similar concerns about the cost of false positives in antitrust cases. In *Matsushita Electric Industrial Co Ltd v Zenith Radio Corp* ('*Matsushita*'),[70] the Court referred to Easterbrook's 'Limits of Antitrust' article in its reasons,[71] and, in the context of allegations of collusive predatory pricing, the Court stated that:

> cutting prices in order to increase business is often the very essence of competition. Thus, mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect.[72]

The Supreme Court also showed its concern for the potential disincentive effects of over-broad antitrust scrutiny in *Copperweld Corp v Independence Tube Corp* ('*Copperweld*').[73] The Court warned that:

> Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote.[74]

Those who oppose an effects-based test as a general test for unilateral anticompetitive conduct have often referred to these statements, as well as Easterbrook's analysis, in the subsequent debate.[75]

B Williamson's 'Integration Approach'

Williamson responded to Easterbrook's arguments in an article published in 1987.[76] Williamson accepted the relevance of an error-cost analysis in framing

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65 Easterbrook, 'Limits', above n 47, 2, 17.

66 See Frank H Easterbrook, 'Monopolization: Past, Present, Future' (1992) 61 *Antitrust Law Journal* 99, 108; Frank H Easterbrook, 'Allocating Antitrust Decisionmaking Tasks' (1987) 76 *Georgetown Law Journal* 305, 306–7, 313–4.

67 Easterbrook, 'Allocating Antitrust', above n 66, 306–7; Easterbrook, 'Limits', above n 47, 15.

68 Easterbrook, 'Past, Present, Future', above n 66, 108.

69 Easterbrook, 'Exclusionary Conduct', above n 52, 972.

70 475 US 574 (1986).

71 Ibid 595.

72 Ibid 594. See further Part VII(B) below.

73 467 US 752 (1984).

74 Ibid 775.

75 See, eg, Gregory J Werden, 'Identifying Exclusionary Conduct under Section 2: The "No Economic Sense" Test' (2006) 73 *Antitrust Law Journal* 413, 429–30, citing *Matsushita*, 475 US 574 (1986); *Copperweld*, 467 US 752 (1984); David S Evans and A Jorge Padilla, 'Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach' (2005) 72 *University of Chicago Law Review* 73, 74–5; Business Council of Australia, Submission to Competition Policy Review (June 2014) 70, 112, 119.

76 Oliver E Williamson, 'Delimiting Antitrust' (1987) 76 *Georgetown Law Journal* 271, 280.

antitrust rules, as well as the contention that certain errors give rise to high costs by deterring beneficial firm conduct.[77] However, he disagreed with Easterbrook's assessment of the relative error costs of under- and over-inclusive rules and Easterbrook's solution of greatly reducing the scope of antitrust rules.[78]

In Williamson's view, the better approach would be to *integrate* error-cost and administrability considerations into the judicial decision-making process on a case-by-case basis.[79] In a given case, the court should determine the actual merits of the claim by determining whether strategic or non-strategic explanations more plausibly explain the behaviour in question.[80] In determining whether to condemn the conduct, the court should not be limited by 'hard', permanent rules intended to err on the side of under-inclusiveness, but should proceed with caution, in light of the limits of current theory and the potential for error costs.[81]

According to Williamson, this is an approach 'which invokes temporary constraints but anticipates evolutionary refinements'.[82] This approach to error costs in the context of antitrust rules has sometimes been referred to as the 'integration approach', since it integrates decision-theoretic analysis into the court's decision-making process rather than requiring a reduced scope for antitrust rules more generally.[83]

C The DC Circuit's Effects-Based Test in the *Microsoft* Case

The debate over the appropriateness of effects-based tests was enlivened in the US around the turn of the century, particularly in response to the decision of the DC Circuit in *Microsoft*,[84] a monopolisation case which attracted more attention than perhaps any other in the last century.[85] The Department of Justice accused Microsoft of various practices which were alleged to amount to monopolisation in contravention of section 2 of the *Sherman Act*.[86] The central allegations concerned various exclusionary practices adopted by Microsoft to protect its dominance in the market for computer operating systems.

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77 Ibid 289.
78 Ibid.
79 Ibid 280, 289.
80 Ibid 281, 288.
81 Ibid 289.
82 Ibid.
83 David McGowan, 'Between Logic and Experience: Error Costs and *United States v Microsoft Corp*' (2005) 20 *Berkeley Technology Law Journal* 1185, 1187.
84 253 F 3d 34, 58–9 (DC Cir, 2001) ('*Microsoft*').
85 See Salop and Romaine, above n 18, 617; Popofsky, above n 18, 435, citing *Microsoft*; *LePage's Inc v 3M (Minnesota Mining and Manufacturing Company)*, 324 F 3d 141 (3rd Cir, 2003); *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP*, 540 US 398 (2004).
86 See 15 USC § 2 (2004) ('*Sherman Act*'). Section 2 states:

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

On appeal, the DC Circuit outlined, in obiter dicta, a rule of reason analysis to be applied in section 2 cases.[87] The Court noted the principle, established by *United States v Grinnell Corp*,[88] that the offence of monopolisation has two elements: the possession of 'monopoly power', and 'the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident'.[89] It also noted that the central difficulty lies in determining when this second element is present; that is, in discerning whether the impugned conduct is exclusionary, rather than merely a form of vigorous competition.[90]

The Court determined, from its analysis of case law under section 2 of the *Sherman Act*, that several principles emerged, and outlined a four-step approach for determining whether particular conduct by a monopolist should be found to violate section 2:[91]

- the plaintiff must first establish a prima facie case that the relevant conduct has an 'anticompetitive effect';[92]
- the defendant monopolist may then offer a 'procompetitive justification' for its conduct;[93]
- the plaintiff has an opportunity to rebut the defendant's procompetitive justification; and
- if the plaintiff cannot rebut this justification, the plaintiff must prove that the anticompetitive harm from the conduct outweighs the procompetitive benefit.[94]

The DC Circuit thus enunciated an effects-based approach to monopolisation claims, often noted for its 'burden-shifting' process.[95] Rather than an open-ended investigation of the various effects of the impugned conduct, the court limited the inquiry by specifying the matters for proof, and the party who bore the burden of proof, at each stage of the analysis. This analysis has also attracted comment for

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87 253 F 3d 34, 58–9 (DC Cir, 2001).

88 384 US 563, 570–1 (1966).

89 *United States v Microsoft Corp*, 253 F 3d 34, 50 (DC Cir, 2001), citing *United States v Grinnell Corp*, 384 US 563, 570–1 (1966).

90 *United States v Microsoft Corp*, 253 F 3d 34, 58 (DC Cir, 2001).

91 Ibid 58–9. See Salop, 'Flawed Profit-Sacrifice', above n 29, 334, pointing out the similarities between the DC Circuit's formulation of this balancing approach and the Second Circuit's description of the rule of reason analysis under s 1 of the *Sherman Act*, citing *United States v Visa USA, Inc*, 344 F 3d 229, 238 (2nd Cir, 2003).

92 *United States v Microsoft Corp*, 253 F 3d 34, 58–9 (DC Cir, 2001). For a detailed analysis of the Court's consideration of 'anticompetitive effect', see Katharine Kemp, 'A Unifying Standard for Monopolization: "Objective Anticompetitive Purpose"' (2017) 39 *Houston Journal of International Law* 113, 134–6.

93 That is, 'a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal': *United States v Microsoft Corp*, 253 F 3d 34, 59 (DC Cir, 2001). The defendant must show that the conduct has a purpose other than the purpose of preserving the defendant's monopoly: at 67. See also at 64, 71. Preserving monopoly power, in itself, is a 'competitively neutral' goal: at 72. Something more – such as greater efficiency or enhanced consumer appeal – is required to demonstrate that that goal is being pursued by way of competition on the merits: at 59.

94 Ibid 59.

95 See, eg, Salop, 'Flawed Profit-Sacrifice', above n 29, 334; Gavil, above n 24, 21–2.

the requirement that, at least in some cases, the court should take the final step of 'weighing' or 'balancing' the anticompetitive harm from the conduct against the procompetitive benefit.[96]

D Proposed Tests for Monopolisation in the Commentary in Response to *Microsoft*

1 Salop's 'Consumer Harm' Test

The *Microsoft* case in general, and the reasoning of the DC Circuit in particular, gave rise to extensive commentary on the proper characterisation of unilateral conduct.[97] Some, like Werden, emphasised that the Court's reasoning in this respect was dictum and that it should not be inferred that this effects-based analysis was the test for unlawfulness in monopolisation cases.[98] Drawing on Easterbrook's arguments, Werden contended that, rather than attempt to assess or balance the uncertain effects of unilateral conduct on competition in a market, courts should focus on other indicators of the dominant firm's strategy, which could be more easily assessed.[99] In his view, courts should set a relatively high threshold for liability, requiring the plaintiff to prove that the relevant conduct would 'make no economic sense' or 'would not be rational for the defendant absent a tendency to eliminate competition'.[100] That is, by engaging in the conduct, the dominant firm incurred costs or losses which could only be recouped as a result of the conduct's tendency to eliminate rivalry.[101]

Salop responded that such 'profit sacrifice' standards would fail to capture significant instances of monopolisation.[102] Salop instead proposed an overarching, effects-based test for monopolisation, the 'consumer harm' test.[103] According to this approach, the court should determine whether, on balance, the

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96 See, eg, Andrew I Gavil, William E Kovacic and Jonathan B Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (West Academic, 2nd ed, 2008) 207. See also A Douglas Melamed, 'Exclusionary Conduct under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal' (2005) 20 *Berkeley Technology Law Journal* 1247, 1252–4; Kemp, 'A Unifying Standard for Monopolization', above n 92, 143–5, regarding criticisms of the balancing requirement.

97 See, eg, Salop and Romaine, above n 18; J Bruce McDonald, 'Antitrust Division Update: *Trinko* and *Microsoft*' (Speech delivered at the Houston Bar Association, Antitrust and Trade Regulation Section, 8 April 2004) <https://www.justice.gov/atr/speech/antitrust-division-update-trinko-and-microsoft>; McGowan, above n 183.

98 See Werden, above n 75, 430.

99 Ibid 431–3. Werden argued that his 'no economic sense' test 'is simple to apply when conduct can confer benefits only by eliminating competition, as well as when conduct plainly is profitable absent any tendency to eliminate competition': at 414.

100 Ibid 433. In particular, Werden's 'no economic sense' test asks 'whether the challenged conduct would have been expected to be profitable apart from any gains that the conduct may produce through eliminating competition': at 414.

101 See also Melamed, above n 96, 1255, arguing for the application of a similar 'sacrifice test' in monopolisation cases. According to Melamed's test, the court should ask 'whether the allegedly anticompetitive conduct would be profitable for the defendant and would make good business sense even if it did not exclude rivals and thereby create or preserve market power for the defendant': at 1255.

102 Salop, 'Flawed Profit-Sacrifice', above n 29, 356, 361.

103 Ibid 313–14. In framing the 'consumer harm' test, Salop refined and expanded the earlier 'unnecessarily restrictive conduct' test proposed in Salop and Romaine, above n 18, 617–18, 650–1. See also Kemp, 'A Unifying Standard for Monopolization', above n 92, 116 ff.

relevant conduct caused harm to consumers, in the form of higher prices, lower quality or lower innovation, which was not offset by consumer benefits created by the conduct.[104] Salop explained that this test focused 'directly on the anticompetitive effect of exclusionary conduct on price and consumer welfare'.[105] Unlike 'profit sacrifice' 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.[106] Unilateral conduct is anticompetitive 'if it reduces competition without creating a sufficient improvement in performance to fully offset these potential adverse effect [sic] on prices and thereby prevent consumer harm'.[107]

Salop's 'consumer harm' test required a case-by-case assessment of the net effect of the impugned conduct on consumers.[108] At the same time, Salop acknowledged that it may be necessary to make 'marginal' adjustments to the test to take account of considerations of fairness, disincentive effects and error costs, for example, by varying the applicable standard of proof, or assessing conduct in the light of information reasonably available to the firm at the time it engaged in the conduct.[109] He acknowledged that in some cases, particularly those involving innovations with uncertain outcomes, the court should make adjustments to the test to take account of this uncertainty.[110] The similarities between this approach and Williamson's 'integration approach' are evident.

2 Hovenkamp: 'Proportionality' Definition

Hovenkamp advocated another approach. During the *Microsoft* litigation, Hovenkamp had proposed a definition of monopolisation under section 2 of the *Sherman Act*, sometimes referred to as the 'disproportionality' definition.[111] According to Hovenkamp, 'monopolistic conduct' should be defined as acts that:

(1) are reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals; and

(2) either: (a) do not benefit consumers at all, or (b) are unnecessary for the particular consumer benefits that the acts produce, or produce harms that are out of reasonable proportion to the resulting benefits.[112]

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104 Salop, 'Flawed Profit-Sacrifice', above n 29, 329–31. 'This competitive effects-based antitrust standard essentially would compare the beneficial and harmful competitive aspects of the alleged exclusionary conduct in order to determine the overall impact on consumers': at 330.

105 Salop, 'Flawed Profit-Sacrifice', above n 29, 313–14. See also Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press, 2011) 92.

106 Salop, 'Flawed Profit-Sacrifice', above n 29, 318, 331, 345.

107 Ibid 330.

108 Ibid.

109 Ibid 353–4.

110 Ibid. See further Part VII below.

111 This definition was first put forward in Hovenkamp, 'The Monopolization Offense', above n 59, 1042. Similar wording was used in the 2002 edition of the *Antitrust Law* treatise: Phillip E Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Aspen, 2nd ed, 2002) 72 [651a].

112 Hovenkamp, 'The Monopolization Offense', above n 59, 1042.

Hovenkamp, like Salop, recognised the protean nature of unilateral conduct. Unilateral conduct laws should only condemn business conduct that is likely to create, increase or prolong monopoly power *without giving significant benefits to society*.[113] Many competitive practices can create monopoly power, but create significant social benefits as well.[114] Anticompetitive conduct, on the other hand, prevents or impairs competition by rivals in a way that either does not benefit consumers or does so in an unnecessarily restrictive way.[115]

Importantly, however, Hovenkamp did not advocate the application of an effects-based test on a case-by-case basis. Rather, Hovenkamp argued that courts should frame and apply different tests based on the class of the conduct, taking into account the propensity of that *type* of conduct to create anticompetitive effects, as well as the court's ability to remedy any anticompetitive effect and the likelihood that the court's scrutiny or condemnation of this type of conduct might capture or deter procompetitive conduct.[116]

Hovenkamp considers, for example, that dominant firms should only be made liable for unilateral refusals to deal in very limited circumstances,[117] having regard to the limited capacity of courts to create useful remedies in these situations and the potential for judicial intervention to reduce the incentives for dominant firms to invest in valuable assets or infrastructure.[118] On the other hand, where conduct clearly injures rivals and has no 'business justification' – for example, in the case of patent fraud – Hovenkamp would not require elaborate proof of actual or threatened consumer harm.[119] The influence of decision theory on Hovenkamp's views is clear. In areas where there is significant uncertainty and it is not possible to develop reliable rules or effective remedies, he argues that 'courts and enforcement agencies should err on the side of caution' and decline to intervene:[120] the costs of incompetent intervention are too great.

113 Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005) 157.

114 Ibid.

115 Hovenkamp, 'Antitrust Standard', above n 58, 27; Hovenkamp, 'The Monopolization Offense', above n 59, 1042 n 25.

116 See Herbert Hovenkamp, 'The Harvard and Chicago Schools and the Dominant Firm' in Robert Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust* (Oxford University Press, 2008) 109, 118. Hovenkamp and others argue that this is in fact the approach which US antitrust courts adopt in respect of unilateral conduct. See, eg, Popofsky, above n 18, 437; Hovenkamp, 'Exclusion and the *Sherman Act*', above n 24, 150–1.

117 Herbert Hovenkamp, 'The Obama Administration and Section 2 of the *Sherman Act*' (2010) 90 *Boston University Law Review* 1611, 1632, 1636–9. See also Part VII below.

118 Ibid 1631–2; Hovenkamp, *Antitrust Enterprise*, above n 113, 152; Hovenkamp, 'Harvard and Chicago Schools', above n 116, 118.

119 Hovenkamp, 'Antitrust Standard', above n 115, 31. See also Hovenkamp, 'Patent Deception', above n 58, 28.

120 Hovenkamp, *Antitrust Enterprise*, above n 113, 312.

IV EUROPEAN COMMISSION GUIDANCE PAPER ON EXCLUSIONARY CONDUCT

In recent decades, there has also been vigorous debate concerning unilateral conduct standards in the EU. Unilateral anticompetitive conduct is addressed by article 102 of the TFEU, which prohibits abuse of a dominant position.[121] From the late 1990s, the EU began 'modernising' its competition laws.[122] Central to this process was the acknowledgement that the assessment of competition complaints should depend on an analysis of the actual competitive effects of the impugned conduct, and not on presumptions that certain forms of conduct were anticompetitive and therefore unlawful per se.[123]

The Commission of the European Communities ('Commission') and the EU courts[124] had traditionally taken an expansive approach to competition law enforcement, often condemning conduct based on its form without regard to its likely economic effects.[125] In the modernisation process, various aspects of competition law, including merger analysis and vertical restraint guidelines, were reformed to focus on the economic effects of conduct.[126] A similar process was attempted in respect of unilateral conduct, but, in this area, the EU courts demonstrated reluctance to adopt an effects-based analysis.[127]

The Commission commissioned and received an expert economic report, which recommended an effects-based approach to unilateral conduct under article 102.[128] This report in turn led to the publication of the 'DG Competition Staff Discussion Paper' in December 2005 by the Directorate General for

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121 *Treaty on the Functioning of the European Union*, opened for signature 7 February 1992, [2009] OJ C 115/199 (entered into force 1 November 1993) art 102 ('TFEU') provides that:

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

122 O'Donoghue and Padilla, above n 19, 47–8.

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

124 That is, the General Court (previously the Court of First Instance) and the European Court of Justice.

125 Miguel de la Mano, Renato Nazzini and Hans Zenger, 'Article 102' in Jonathan Faull and Ali Nikpay (eds), *The EU Law of Competition* (Oxford University Press, 3rd ed, 2014) 348 [4.85]–[4.88]; Gormsen, above n 123, 5.

126 Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases and Materials* (Oxford University Press, 4th ed, 2011) 197–201, 650–1.

127 Ibid 273, 275.

128 Economic Advisory Group on Competition Policy, 'An Economic Approach to Article 82' (Report, July 2005) 2, advocating an 'economics-based approach' to abuse of dominance claims, which 'requires a careful examination of how competition works in each particular market in order to evaluate how specific company strategies affect consumer welfare'.

Competition,[129] which adopted an effects-based, consumer welfare standard for exclusionary abuses.[130] The Discussion Paper stimulated lively debate, but, in the absence of any shift in the case law, the Commission could not issue guidelines that incorporated such an approach.[131]

Accordingly, in February 2009, the Commission instead adopted a 'Guidance Paper' setting out its own 'enforcement priorities' for exclusionary abuse of dominance claims ('Guidance Paper').[132] The Guidance Paper does not have the force of law, nor is it representative of the existing legal position in the EU: rather it outlines the manner in which the Commission will determine which claims of exclusionary abuse of dominance warrant investigation and prosecution.[133] The Commission's approach in the Guidance Paper is expressly based on economic analysis and requires a demonstration of the conduct's effects.[134]

In the Guidance Paper, the Commission indicated that its aim is to ensure that dominant undertakings 'do not impair effective competition by foreclosing their competitors in an anti-competitive way, thus having an adverse impact on consumer welfare', including through higher price levels, lower quality or less consumer choice.[135] The Commission defined 'anti-competitive foreclosure' as

> a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices [or otherwise exercise market power] to the detriment of consumers.[136]

As under Salop's 'consumer harm' test, the Commission determines whether such foreclosure has occurred by comparing the actual or likely future situation in the relevant market (with the dominant firm's conduct in place) with an 'appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices'.[137]

The Commission acknowledged that dominant firms may also exclude rivals by competing on the merits of the products or services they provide, and that rivals who deliver less to consumers in terms of price, choice, quality and

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129 The Directorate General for Competition is the division of the European Commission responsible for competition policy.

130 Directorate-General for Competition, European Commission, 'DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses' (Discussion Paper, December 2005). See Jones and Sufrin, above n 126, 274.

131 See de la Mano, Nazzini and Zenger, above n 125, 351–2 [4.98]–[4.99]; Jones and Sufrin, above n 126, 274.

132 European Commission, 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings' (Communication, 24 February 2009).

133 See O'Donoghue and Padilla, above n 19, 75. The Guidance Paper has nonetheless been criticised for creating uncertainty by putting forward different tests to those set out in the case law or expressing legal tests in a way that does not reflect judicial precedent: see, eg, Nazzini, above n 105, 155–68.

134 European Commission, above n 132.

135 Ibid 9 [19].

136 Ibid 9–10 [19].

137 Ibid 11 [21].

innovation may be forced to leave the market.[138] At least in respect of pricing practices, the Commission stated that it would generally[139] only intervene where the pricing conduct hampers, or is capable of hindering, expansion or entry by competitors which are *as efficient* as the dominant firm.[140]

Notwithstanding evidence of anticompetitive foreclosure in a market, the Commission will consider claims by the dominant firm that its conduct is justified. A dominant firm may claim justification in one of two ways, either by demonstrating that its conduct is 'objectively necessary' or by raising an efficiency defence.[141] A justification of objective necessity covers a very narrow range of conduct: the only example cited by the Commission was conduct that is objectively necessary for health or safety reasons.[142]

A dominant firm may alternatively raise an efficiency defence.[143] Efficiencies may include technical improvements in the quality of goods, or reductions in the cost of production or distribution.[144] Thus, even if conduct forecloses competitors, the dominant firm may justify that conduct on 'the ground of efficiencies that are sufficient to guarantee that no net harm to consumers is likely to arise'.[145]

However, in the Guidance Paper the Commission proceeded to outline stringent requirements for efficiency claims by dominant firms. These requirements broadly mirror the requirements for efficiency claims in respect of multilateral anticompetitive agreements under article 101 of the TFEU.[146] Thus, the Commission would expect a dominant firm to demonstrate 'with a sufficient degree of probability, and on the basis of verifiable evidence that the following cumulative conditions are fulfilled':

> (a) the efficiencies have been, or are likely to be, realised as a result of the conduct, …
>
> (b) the conduct is indispensable to the realisation of those efficiencies: there must be no less anti-competitive alternatives to the conduct that are capable of producing the same efficiencies,
>
> (c) the likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets,

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138 Ibid 7 [6].

139 Cf ibid 11 [24]. The Commission indicated that, in some circumstances, 'a less efficient competitor may also exert a constraint which should be taken into account when considering whether particular price-based conduct leads to anti-competitive foreclosure'.

140 Ibid 11 [23], 14 [41], 16 [59], 17 [67], 18 [80]. The 'as efficient competitor', or 'equally efficient competitor', test has often been considered as a method of determining whether unilateral conduct is anticompetitive. In general terms, it asks whether the relevant conduct would exclude a rival who is at least as efficient as the dominant firm, indicating that the dominant firm has not succeeded on the basis of its superior efficiency: see, eg, Nazzini, above n 105, 72–9; Hovenkamp, 'Harvard and Chicago Schools', above n 116, 116.

141 European Commission, above n 132, 12 [28].

142 Although the Commission went on to say that even this is normally the concern of public authorities rather than private firms: ibid 12 [29].

143 Ibid 12 [28].

144 Ibid 12 [30].

145 Ibid.

146 O'Donoghue and Padilla, above n 19, 285.

(d) the conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition.[147]

If the dominant firm meets these conditions, the Commission will determine whether the relevant conduct is likely to result in consumer harm, 'based on a weighing-up of any apparent anti-competitive effects against any advanced and substantiated efficiencies'.[148]

The burden-shifting approach advocated by the Commission in the Guidance Paper is somewhat analogous to that of the DC Circuit in *Microsoft*, requiring first a finding of exclusion which is likely to lead to enhanced or protected market power, after which the burden shifts to the dominant firm to establish an efficiency justification in accordance with the Commission's conditions.[149] If the dominant firm meets this threshold, the burden returns to the claimant to prove that the conduct is likely to result in consumer harm in light of the weighing of competitive effects against the substantiated efficiencies.[150]

The approach in the Guidance Paper differs most from the US tests in the substantial obstacles it creates for a dominant firm seeking to justify its conduct on the basis of efficiency gains. Commentators have argued that the Commission's conditions for the efficiency justification are likely to be difficult to satisfy.[151] Gormsen criticises the requirement at paragraph (d) in particular, arguing that, if the goal of abuse of dominance rules is consumer welfare, a dominant firm should be permitted to eliminate effective competition if the conduct benefits consumers.[152]

V SOUTH AFRICAN ABUSE OF DOMINANCE PROVISIONS

The *Competition Act 1998* (South Africa) ('the South African Act') incorporates a test for unilateral anticompetitive conduct which is interesting for several reasons. First, the South African Act expressly dictates an effects-based test for unilateral conduct: the effects-based nature of the test is not the product of evolving case law or unenforceable guidelines as in the US or the EU. Second, the South African provisions represent an attempt to draw on international 'best practice' and particularly the growing consensus that there should be a 'more economic approach' to analysing unilateral conduct, which makes 'explicit

147 European Commission, above n 132, 12 [30]. That is, where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains: exclusionary conduct which maintains, creates or strengthens a market position approaching that of a monopoly cannot normally be justified on efficiency grounds.

148 Ibid 12 [31].

149 O'Donoghue and Padilla, above n 19, 285–6.

150 Ibid 386.

151 See, eg, Jones and Sufrin, above n 126, 382; O'Donoghue and Padilla, above n 19, 287–90.

152 Gormsen, above n 123, 56. There may be relevant efficiency gains in monopolised markets, including willingness to innovate; competition for the market; and pricing above marginal cost to cover total costs of research and development: at 130.

provision for pro-competitive defences'.[153] Third, the South African prohibition depends *only* on the effect of the impugned conduct, making no reference to the dominant firm's purpose.[154] The South African unilateral conduct provisions therefore provide an example of a 'pure', legislated effects test.

The South African Act prohibits unilateral anticompetitive conduct or 'abuse of a dominant position'.[155] The prohibitions in sections 8(c) and 8(d) provide the closest analogy to Australia's prohibition of misuse of market power in section 46(1) of the *CCA*.[156] Both prohibit certain 'exclusionary acts' by a dominant firm. An 'exclusionary act' is defined as 'an act that impedes or prevents a firm from entering into, or expanding within, a market'.[157] Without further limitation, exclusionary acts could thus include dominant firm conduct which results in lower prices or superior products and services for consumers such that less efficient firms lose custom or are forced to leave the market. However, the Act also requires the complainant to prove that the conduct has an 'anti-competitive effect' and provides that there will be no contravention if that effect is outweighed by 'technological, efficiency or other pro-competitive gains'.[158]

According to the Competition Tribunal, an exclusionary act has an anticompetitive effect if it causes harm to consumer welfare.[159] But it is not essential for the complainant to prove direct harm to consumers. Consumer harm may be inferred where the conduct 'is substantial or significant in terms of its effect in foreclosing the market to rivals'.[160] The Tribunal looks to the effect of the conduct on the dominant firm's rivals or potential rivals to determine whether the requisite effect has been established, but it has emphasised that detriment to a

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153 Simon Roberts, 'Administrability and Business Certainty in Abuse of Dominance Enforcement: An Economist's Review of the South African Record' (Paper presented at the 5th Annual Conference on Competition Law, Economics and Policy, University of Johannesburg, 4 and 5 October 2011) 1.

154 Cf the position in Canada, where the 'anti-competitive act' necessary to establish an abuse of dominance under the *Competition Act* ss 78–9 'is defined by reference to its purpose, and the requisite anti-competitive purpose is an intended negative effect on a competitor that is predatory, exclusionary, or disciplinary': Competition Bureau, 'The Abuse of Dominance Provisions: Sections 78 and 79 of the *Competition Act*' (Enforcement Guidelines, 20 September 2012) 10–11 [3.2], citing *Canada (Commissioner of Competition) v Canada Pipe Co* [2006] FCA 233 [66]. Further, in applying this test, the South African courts have engaged in a depth of case-by-case economic analysis and investigation that is not matched by any other jurisdiction under consideration here: see Giulio Federico, '*SAA II*: Abuse of Dominance in the South African Skies' (2013) 9 *Journal of Competition Law & Economics* 709, 710. See also Simon Roberts, 'Effects-Based Tests for Abuse of Dominance in Practice: The Case of South Africa' (Working Paper No 4/2012, Centre for Competition Economics, University of Johannesburg) 13: 'Indeed, economists indicate that the South African regime probably allows for the fullest presentation and interrogation of economic evidence, written and oral, in the world'.

155 *Competition Act 1998* (South Africa) ch 2 pt B.

156 *Competition Act 1998* (South Africa) ch 2 pt B also includes provisions addressing refusal of access to essential facilities (s 8(b)), price discrimination (s 9), and excessive pricing (s 8(a)). Section 8(a) follows the EU approach in prohibiting certain 'exploitative' (as opposed to exclusionary) conduct. The few excessive pricing cases to date have involved former state, or state-sponsored, monopolies. See Philip Sutherland and Katharine Kemp, LexisNexis South Africa, *Competition Law of South Africa* [7.9.3].

157 *Competition Act 1998* (South Africa) s 1(1).

158 Ibid ss 8(c)–(d).

159 *Competition Commission v South African Airways (Pty) Ltd* [2005] ZACT 50, [132] (South Africa Competition Tribunal).

160 Ibid, see generally [128]–[132].

rival per se does not constitute an anticompetitive effect.[161] A more general effect on the competitive process – that is, on the ability of rivals and potential rivals to compete – is required. In decided cases, the necessary effect has generally been proved by way of evidence of substantial or significant foreclosure, rather than by evidence of direct harm to consumers.[162]

Even if the complainant proves that the dominant firm has engaged in an exclusionary act which has an anticompetitive effect, the firm will avoid liability if it proves that its conduct gave rise to 'technological, efficiency, or other pro-competitive, gains' ('procompetitive gains') that outweigh the anticompetitive effect.[163] As with the EU Guidance Paper, the claimed efficiency gains must be directly related to, and dependent upon, the conduct in question, such that the gains could not otherwise be achieved.[164] If the respondent could achieve the same efficiency gains without engaging in exclusionary conduct, its defence will fail for want of a sufficient connection between the gains and the exclusionary acts.[165]

The South African approach thus also applies a burden-shifting approach to establishing unilateral anticompetitive conduct, with legislation that specifically requires an assessment of anticompetitive effects weighed against substantiated procompetitive gains in each case. However, the Act includes an innovation which has consequences for the likely error costs and disincentive effects. While both sections 8(c) and 8(d) prohibit exclusionary acts with an anticompetitive effect, dominant firms are treated differently depending on the provision under which their conduct falls.

Section 8(d) lists five specific types of conduct, which are deemed to constitute exclusionary acts: in general terms, exclusive dealing or inducement not to deal; refusal to supply scarce goods to a competitor; tying or bundling; predatory pricing; and buying up scarce resources.[166] Section 8(c) concerns a residual category of exclusionary acts beyond those expressly identified.[167] For the specified acts under section 8(d), the defendant bears the onus of proving that the procompetitive gains from the conduct outweigh its anticompetitive effect. Under section 8(c), the onus is on the complainant to show that the harm outweighs the gains.[168]

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161 *Msomi v British American Tobacco South Africa (Pty) Ltd* [2002] ZACT 49, [59] (South Africa Competition Tribunal).

162 Roberts, 'Effects-Based Tests for Abuse of Dominance in Practice', above n 154, 19.

163 *Competition Act 1998* (South Africa) ss 8(c)–(d). The Act does not define this phrase. The wording would appear to encompass gains in allocative, productive and dynamic efficiency, but it seems unlikely that the Tribunal would find that productive efficiency gains are sufficient to outweigh any significant anticompetitive effect, unless those gains are passed on to consumers. See *South African Raisins (Pty) Ltd v SAD Holdings Ltd* [2000] ZACT 49, 11 [3.6] (South Africa Competition Tribunal).

164 *Patensie Sitrus Beherend Beperk v Competition Commission* [2003] 2 CPLR 247, 265 (South Africa Competition Appeal Court).

165 Ibid 266; *Competition Commission v South African Airways (Pty) Ltd* [2005] ZACT 50, [245]–[253] (South Africa Competition Tribunal).

166 Sutherland and Kemp, above n 156, 7-8–7-9 [7.4].

167 Ibid.

168 Ibid.

More importantly, if a dominant firm infringes by engaging in one of the specified acts in section 8(d), it may be liable for a substantial administrative penalty for a first time offence.[169] However, if it contravenes by engaging in an act which only falls within the residual exclusionary acts in section 8(c), it may only be liable for a 'repeat offence'.[170] As explained later in this article, these features may have implications for the potential disincentive effects of the South African Act.[171]

VI THE AUSTRALIAN 'SLC' TEST

A The SLC Test and Criticisms of the SLC Test

Schedule 1 of the Misuse of Market Power Bill repeals section 46(1) of the *CCA* and replaces it with the following provision:

> A corporation that has a substantial degree of power in a market must not engage in conduct that has the purpose, or has or is likely to have the effect, of substantially lessening competition in:
>
> (a) that market; or
>
> (b) any other market in which that corporation, or a body corporate that is related to that corporation:
>
> (i) supplies goods or services, or is likely to supply goods or services; or
>
> (ii) supplies goods or services, or is likely to supply goods or services, indirectly through one or more other persons; or
>
> (c) any other market in which that corporation, or a body corporate that is related to that corporation:
>
> (i) acquires goods or services, or is likely to acquire goods or services; or
>
> (ii) acquires goods or services, or is likely to acquire goods or services, indirectly through one or more other persons.

According to this provision, characterisation of unilateral conduct as anticompetitive, and therefore unlawful, would depend on proof that the conduct 'has the purpose, or has or is likely to have the effect, of substantially lessening competition' in that market or in any other market with which the corporation has one of the listed connections.[172] The government has also indicated its intention to follow the further recommendation of the Harper Panel that the 'authorisation'

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169 *Competition Act 1998* (South Africa) ss 58(1)(a), 59(1)(a)–(b).

170 Ibid. That is, if the conduct is 'substantially a repeat by the same firm of conduct previously found by the Tribunal to be a prohibited practice': Sutherland and Kemp, above n 156, 12-6 [12.3.3].

171 See Part VII(A) and Part VII(B) below.

172 See also Australian Competition and Consumer Commission, 'Framework for Misuse of Market Power Guidelines' (Draft Guidelines, September 2016) <https://consultation.accc.gov.au/compliance-enforcement/consultation-on-draft-framework-for-misuse-of-mark>, published by the ACCC following the publication of the Exposure Bill and providing a summary of the proposed guidelines the ACCC would publish if the amended provision is passed 'about its approach to possible breaches of the misuse of market power prohibition': at 2.

procedure available for other conduct under the Act should be extended to misuses of market power under section 46.[173]

In contrast to the other effects-based tests considered here, the SLC test in the Misuse of Market Power Bill does not expressly permit the dominant firm to raise an efficiency defence or justification for its conduct. The Harper Panel proposed that the amended section 46 should include legislative guidance with regard to the meaning of the SLC test, to 'clarify the law and mitigate concerns about over-capture'.[174] Accordingly, in its original form, the Misuse of Market Power Bill created a new section 46(2) which provided:

> Without limiting the matters to which regard may be had in determining for the purposes of subsection (1) whether conduct has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market, regard must be had to the extent to which:
>
> (a) the conduct has the purpose of, or has or would be likely to have the effect of, increasing competition in that market, including by enhancing efficiency, innovation, product quality or price competiveness in that market; and
>
> (b) the conduct has the purpose of, or has or would be likely to have the effect of, lessening competition in that market, including by preventing, restricting, or deterring the potential for competitive conduct or new entry into that market.

However, on the recommendation of the Senate Economics Legislation Committee, the government has since amended the Bill to remove this legislative guidance in the interests of reducing complexity and potential uncertainty, and to avoid inconsistency with other provisions in the *CCA* which also include the SLC test.[175]

Two key criticisms have been raised in response to the recommendations of the Harper Panel in respect of section 46(1), and the government's decision to adopt those recommendations. Opponents argue that replacing the 'take advantage' test in section 46(1) with the SLC test is likely to:

(a) deter dominant firms from engaging in vigorous procompetitive conduct, which would have benefited consumers, since that conduct might eliminate rivals and thereby fall foul of the SLC test;[176] and

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173 See *Harper Final Report*, above n 37, 62, Recommendation 30; Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth) Sch 9; Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth) 60. Pursuant to the authorisation process, corporations that might otherwise infringe the Act may apply to the ACCC (and in some cases, the Australian Competition Tribunal) for an 'authorisation' in respect of certain potentially infringing conduct: *Competition and Consumer Act 2010* ss 88–90. Such authorisation may be granted by the agency in question on public benefit grounds. See Maureen Brunt, 'Australian and New Zealand Competition Law and Policy' in Barry Hawk (ed), *Fordham Corporate Law Institute: International Antitrust Law and Policy* (Transnational Juris Publications, 1993) 131, explaining Australia's 'dual adjudication' system. To date, authorisation has not been available in respect of conduct which would otherwise infringe *CCA* s 46. However, conduct which does not constitute a contravention of ss 45, 45B, 47, 49 and 50 by reason that an authorisation is in force does not contravene s 46(1): *CCA* s 46(6).

174 *Harper Final Report*, above n 37, 61, 344, see also 513–14.

175 Supplementary Explanatory Memorandum, Competition and Consumer Amendment (Misuse of Market Power) Bill 2016 (Cth) 9. The potential consideration of efficiency gains under the Misuse of Market Power Bill, as amended, is considered in Part VI(B)(3) below.

176 See Part I above.

(b) create uncertainty for dominant firms attempting to comply with the law, resulting in increased risk and compliance costs for dominant firms, both of which are likely to lead to higher prices for consumers.[177]

These claims are examined in the remainder of this Part, which first considers the strengths of the proposed SLC test in limiting error costs and then its weaknesses.

B Strengths of the SLC Test in Limiting Error Costs

1 The SLC Test Is Better Aligned with the Objective of Section 46(1)

The Harper Panel, the ACCC and a number of commentators – including this author – have argued that the 'take advantage' and purpose elements under the existing section 46(1) have made the provision both uncertain in its application and under-inclusive: that is, it is prone to false positive errors.[178] The phrase 'take advantage' has been interpreted to require only that the firm 'uses' its substantial market power to engage in the conduct.[179] This concept is sufficiently open to interpretation that case law has produced various complex, and conflicting, statements about how this element may be proved.[180] In some cases, courts have sometimes interpreted the 'take advantage' element in a way that absolves conduct that protects or increases the corporation's substantial market power, without creating any benefit for consumers, so long as the corporation did not '*use*' its market power to achieve that end, in the sense that a non-dominant firm could engage in similar conduct.[181] Although the provision has been amended in an attempt to cure these defects, there is considerable doubt as to whether the amendment remedies the deficiencies.[182]

The 'purpose' element in the current provision has also proved problematic in that it has been interpreted to require proof of the *subjective* purpose of the dominant firm.[183] According to the ACCC, this subjective purpose is inherently

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177 See, eg, Business Council of Australia, above n 11, 19–21.

178 See Australian Competition and Consumer Commission, Submission to the Competition Policy Review, 25 June 2014, 78–80; Stephen Corones, Submission to the Competition Policy Review, 8 October 2014, 7–10; Small Business Development Corporation, Submission to the Competition Policy Review, November 2014, 7–9; Kemp, 'Profit-Focused Tests', above n 34, 687–90. There is also an argument that the purpose element may make the provision *over*-inclusive in some instances in that the proscribed purposes include the purpose of harming 'a competitor', as opposed to harming rivalry more generally.

179 *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 191 (Mason CJ and Wilson J).

180 See Brock, above n 35; Jeffrey M Cross et al, 'Use of Dominance, Unlawful Conduct, and Causation under Section 36 of the *New Zealand Commerce Act*: A US Perspective' (2012) 18 *New Zealand Business Law Quarterly* 333, 337–40.

181 See also Kemp, 'Profit-Focused Tests', above n 34.

182 See *CCA* s 46(6A); *Harper Final Report*, above n 37, 338.

183 *Harper Final Report*, above n 37, 413. See, eg, Australian Competition and Consumer Commission, Submission No 56 to the Trade Practices Act Review, June 2002, 80–1, 88 ('*ACCC Submission 2002*'). The Australian courts have acknowledged 'the notoriously difficult task of satisfying the criteria of liability' under section 46(1): *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90, 122 [85] (McHugh ACJ, Gummow, Callinan and Heydon JJ).

difficult to prove, and increasingly so as corporations become more sophisticated about covering their tracks and concealing their intentions.[184]

Given that the objective of section 46(1) is the protection of the competitive process in the interests of consumers in particular,[185] it does seem more logical that the provision should focus on the *effect* of the impugned conduct on competition in the relevant market, rather than the subjective intentions of the dominant firm or the ability of non-dominant firms to engage in similar conduct.[186] The appropriateness of the SLC test as an alternative is analysed in the following sections.

2 According to Existing Case Law, Low Prices and Improved Products Per Se Are Unlikely to SLC

Samuel and King have suggested that incorporating the SLC test in section 46(1) 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'.[187] Based on existing case law, however, the amended provision is unlikely to condemn a dominant firm where it does no more than outcompete its rivals with a lower price or improved product, without causing harm to the competitive process.

The SLC test is not new to the *CCA*. As the Harper Panel pointed out, the SLC test is incorporated in several other provisions in Part IV of the *CCA* and it has been analysed in case law under those provisions for decades.[188] It is therefore possible to outline the likely parameters of the test under section 46(1). The SLC test has been interpreted 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.[189] Better products and lower prices are the very essence of increased rivalry,[190] and would generally pass the SLC test with ease, regardless of the fact that they eliminate 'poor' competitors.

As with the other effects-based tests outlined in this article, the SLC test is not concerned with conduct that harms competitors per se, but with conduct that

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184 *ACCC Submission 2002*, above n 184, 79, 82–3. At the time of the Dawson Review in 2002, the ACCC stated that it had not taken action under section 46(1) for about six years and that, on a number of occasions, it did not take such action because it considered that it could not prove the necessary purpose: at 81, 88. At the same time, the purpose element in section 46(1) has been criticised as over-broad since the proscribed purposes extend to the purpose of 'eliminating or substantially damaging a competitor', a purpose which is well within the normal goals of any warm-blooded, competitive firm. See *Harper Final Report*, above n 37, 339.

185 *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 191 (Mason CJ and Wilson J). The High Court has stated that 'the object of s 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end': at 191.

186 See *Harper Final Report*, above n 37, 335–47.

187 Samuel and King, above n 10.

188 See *Harper Final Report*, above n 37, 340–2. See also Australian Competition and Consumer Commission, 'Framework for Misuse', above n 172, 6–7.

189 *Australian Competition and Consumer Commission v Cement Australia Pty Ltd* (2013) 310 ALR 165, 747–8 [3013] (Greenwood J) ('*Cement Australia*').

190 See, eg, *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, 137 (Lockhart J) ('*Dowling*').

harms the competitive *process*. It is well established that rivalry is not lessened simply because one or more competitors are harmed or even removed from the field of play.[191] The elimination of less efficient rivals, who are simply unable to match the competitive price or superior product of a dominant firm, is unlikely to amount to a substantial lessening of competition. What must be lessened is the 'future field of rivalry',[192] or 'rivalrous market behaviour'.[193] Australian courts and authorities have recognised that this is 'a process rather than a situation'.[194]

The case law has also established the counterfactual to be considered under the SLC test. Consistent with the EU Guidance Paper and Salop's 'consumer harm' test, the SLC test requires the court to consider the likely state of competition with and without the impugned conduct. This is not a 'before and after' test,[195] but a comparison of the future state of competition with the impugned conduct and the future state of competition without that conduct[196] to determine whether competition is substantially less in the former scenario.[197]

But when does harm to actual or potential competitors amount to a lessening of rivalry relative to the rivalry that would be present without that conduct? Early Australian decisions concerning the SLC test seemed to suggest that a restraint imposed on competition would be condemned if it increased the relative strength or power of the firm imposing it.[198] It was not, apparently, necessary to examine the extent to which competitive outcomes might continue to be achieved in the market, or whether the restraint itself gave rise to increases in rivalry in price or quality.[199] Rather, it was objectionable that a firm should preserve or enhance its market power by restricting the *choices* of other market participants.[200]

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191 See, eg, *Stationers Supply Pty Ltd v Victorian Authorised Newsagents Association Ltd* (1993) 44 FCR 35, 56 (Ryan J) ('*Stationers Supply*'); *Universal Music Australia Pty Ltd v Australian Competition and Consumer Commission* (2003) 131 FCR 529, 585 (The Court) ('*Universal Music*'); *Re Qantas Airways Ltd* (2005) ATPR ¶42-065, 42 936, 42 944 (Goldberg J, Mr Latta and Prof Round) ('*Qantas Airways*'); *Cement Australia* (2013) 310 ALR 165, 747–8 [3013] (Greenwood J).

192 *Cement Australia* (2013) 310 ALR 165, 747–8 [3013] (Greenwood J).

193 *Re Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169, 188 (Woodward J, Members Shipton and Brunt) ('*QCMA*').

194 Ibid 189. Australian Competition and Consumer Commission, Submission to the Competition Policy Review, 26 November 2014, 50, stated that:

> The SLC test in the context of Part IV is … essentially targeted at distinguishing between conduct which has the purpose or effect of impeding the competitive process rather than conduct by a firm which is 'competition on the merits'. Competition on the merits which results in the elimination of competitors, or even in a monopoly, does not amount to an SLC.

195 *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR ¶41-752, 41 267 (Burchett and Hely JJ) ('*Stirling Harbour*').

196 Which may differ from the pre-existing situation.

197 *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR ¶41-752, 40 731–2 (French J); *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238, 259–60 (Smithers J) ('*Dandy Power*').

198 See, eg, *Re Ford Motor Co of Australia Ltd and Ford Sales Co of Australia Ltd* (1977) ATPR ¶40-043, 17 498 (Keely J, Members Walker and Grant) ('*Ford Motor Co*').

199 See, eg, *Ford Motor Co* (1977) ATPR ¶40-043, where the Tribunal found that there had been a substantial lessening of competition based on the volume of sales diverted to Ford as a result of exclusivity agreements, without analysing the impact of those agreements on prices or other aspects of the offering in the market for passenger cars generally. See also *Re Southern Cross Beverages Pty Ltd*

In later cases, however, the Australian courts have highlighted a different aspect of the impugned restraints, namely that the restraints in question prevented rivals from offering a better price–product–service package than the firms imposing the restraint.[201] In these cases, the incumbent's method of winning in the competition for custom was to impair the ability of rivals to compete for that custom. The incumbent did not succeed by outcompeting its rivals but by interfering with competition, 'freezing out realistic competitive offers',[202] and insulating itself from the effects of competition.[203]

The courts have emphasised that the exclusion of rivalry in these circumstances is likely to lead to higher prices and/or lower quality offerings than those which would be made in the absence of the conduct. In *Rural Press Ltd v Australian Competition and Consumer Commission*,[204] for instance, the High Court found that the new entrant, River News, had become 'a small but potentially significant competitor' of the kind that 'tended to dilute the impact of the existing monopoly'.[205] Following threats by Rural Press, however, River News left the relevant market. The majority found that this 'arrangement'[206] between the parties had the purpose and effect of substantially lessening competition since it 'almost totally negated the beneficial effects' of the previous competitive behaviour by River News, including the previous increase in consumer choice, wider range of news, and lower advertising rates.[207]

In determining whether the conduct has the effect or likely effect of substantially lessening competition, the Australian courts have therefore focused on the impact of the conduct on future competitive rivalry, 'particularly with

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(1981) 50 FLR 176, 206, 208, 217 (Deane J, Members Grant and Johnson); *Dandy Power* (1982) 64 FLR 238, 259–60, 275 (Smithers J).

200 See *Ford Motor Co* (1977) ATPR ¶40-043; *Re Southern Cross Beverages Pty Ltd* (1981) 50 FLR 176, 206, 208, 217 (Deane J, Members Grant and Johnson); *Dandy Power* (1982) 64 FLR 238, 259–60, 275 (Smithers J). See also *O'Brien Glass Industries Ltd v Cool & Sons Pty Ltd* (1983) 77 FLR 441, 449 (Fox J):

> 'It is not to the point to say … O'Brien was providing a wide variety of the subject commodity, or selling at low prices, or providing good services. If enhanced dominance and a resultant lessening of actual competition were to come about by reason of such considerations, it had to be by leaving uninhibited the right of choice, or substitution, in the market.'

According to these cases, if conduct imposed a restraint on market participants and thereby enhanced the dominant firm's market power, the conduct could not be redeemed by evidence that it also resulted in substantial benefits to consumers.

201 *Gallagher v Pioneer Concrete (NSW) Pty Ltd* (1993) 113 ALR 159, 205–6 (Lockhart J) ('*Gallagher*').

202 *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* (No 2)(2008) 170 FCR 16, 102 (Gyles J), see also 68–9, 100.

203 *Gallagher* (1993) 113 ALR 159, 204 (Lockhart J).

204 (2003) 216 CLR 53.

205 Ibid 73 (Gummow, Hayne and Heydon JJ) ('*Rural Press*').

206 Cf Salop and Romaine, above n 18, 629 n 36, 640, regarding the proper treatment of coerced agreements from unilateral predatory threats.

207 *Rural Press* (2003) 216 CLR 53, 73 (Gummow, Hayne and Heydon JJ). Similarly, in *Cement Australia* (2013) 310 ALR 165, 779–80 [3087]–[3088], Greenwood J found that preventing the entry of one rival by buying up a critical input could substantially lessen competition. Importantly, his Honour found that entry by that rival would have caused prompt and vigorous price responses which would not otherwise occur given the virtual monopoly of the respondents. *Cement Australia* (2013) 310 ALR 165, 748 [3014], 775 [3072], 799 [3178]–[3180], 809 [3226]–[3227] (Greenwood J).

consumers in mind'.[208] Nonetheless, the SLC test is not a consumer welfare test, but a test of competitive rivalry.[209] As explained below, the SLC test permits the court to take into account efficiencies created by conduct to the extent that those efficiencies promote competitive rivalry, but where a dominant firm's conduct gives rise to a substantial lessening of competitive rivalry in a given market, it cannot be excused on the ground that, having regard to all the circumstances, the conduct in fact promoted consumer welfare.[210]

3 The SLC Test Permits Consideration of Offsetting Consumer Benefits or Efficiency Gains

In its original form, the proposed provision included legislative guidance to the effect that the court must have regard to 'the extent to which the conduct: increases competition in a market, including by enhancing efficiency, innovation, product quality or price competitiveness'.[211] As noted earlier, the government has since followed the recommendation of the Senate Economics Legislation Committee to amend the Misuse of Market Power Bill to remove this legislative guidance. However, it is arguable that efficiency considerations are inherent in the SLC test in the absence of this legislative guidance.

The matters to which a court may have regard under the SLC test in Part IV of the *CCA* are sometimes contrasted with the broader factors which may be taken into account by the Commission and the Tribunal pursuant to an application for *authorisation* of conduct under Part VII Division 2 of the Act.[212] Pursuant to an authorisation application, the Commission and the Tribunal may take into account a broad range of public interest considerations, including, but not limited to, 'the achievement of the economic goals of efficiency and progress'.[213]

On one view, under the SLC test, the courts are only concerned with whether *allocative* efficiency[214] has been reduced by the conduct in question: that is,

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208 *Universal Music* (2003) 131 FCR 529, 585 (The Court). See also *Dowling* (1992) 34 FCR 109, 137 (Lockhart J); *Stationers Supply* (1993) 44 FCR 35, 57–8 (Ryan J). See also, in the context of *CCA* s 46(1), *Boral Besser* (2003) 215 CLR 374, 459 [261] (McHugh J): 'While conduct must be examined by its effect on the competitive process, it is the flow-on result that is the key – the effect on consumers'.

209 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, 16 October 2015) 12–13.

210 See S G Corones, *Competition Law in Australia* (Thomson Reuters, 6th ed, 2014) 46–7 [1.185], 444 [7.120], 448–51 [7.140]–[7.145].

211 See Part VI(A) above.

212 *Outboard Marine Australia Pty Ltd v Hecar Investments* (No 6) (1982) 66 FLR 120, 128–9 (Fitzgerald J); *Australian Gas Light Co v Australian Competition and Consumer Commission (No 3)* (2003) 137 FCR 317, 492–3 (French J) ('*AGL (No 3)*'). See above n 173, explaining the authorisation process.

213 *Qantas Airways* (2005) ATPR ¶42-065, 42 871, 42 874–5 (Goldberg J, Mr Latta and Prof Round).

214 In a competitive market, allocative efficiency is maximised: the cost of resources used in production is equal to the consumers' willingness to pay (price equals marginal cost) and resources are therefore allocated to their highest value use: Barak Y Orbach, 'The Antitrust Consumer Welfare Paradox' (2011) 7 *Journal of Competition Law & Economics* 133, 141; Nazzini, above n 105, 33.

effects on productive or dynamic efficiency[215] can only be weighed against effects on allocative efficiency pursuant to an authorisation application to the Tribunal.[216] However, any perceived restriction on the court's consideration of the various competitive effects of conduct under the SLC test cannot be justified. Price (or price elasticity) is not the only manifestation of competition. Firms also compete through new technologies, new methods and innovation in general.[217] In Australia, the High Court, the Federal Court and the Tribunal have all acknowledged these aspects of competition.[218] According to the High Court:

> On the basis of many studies and long experience, economists have concluded that the main virtue of competition is that it provides a very powerful means of securing important gains in allocative and especially dynamic efficiency.[219]

Gains in dynamic efficiency are not merely an outcome of competition but a manifestation of competition itself: that is, innovation is a means of competing and increasing competition.[220]

If certain conduct reduces price competition, it should be relevant that the same conduct has led to an increase in innovation, or dynamic efficiency.[221] The Tribunal, for example, has recognised that prices may sometimes increase because the quality of the product increases: consumers are not induced or pressured, but are paying for what they value.[222] Further, a relatively minor lessening of competition in respect of some sales in the market may be more than offset by increases in productive and dynamic efficiency.[223]

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215 While losses in allocative efficiency are assessed in the context of a static analysis of the market – with fixed technology and a given cost situation – dynamic efficiency is concerned with the *rate* at which markets innovate: see Jones and Sufrin, above n 126, 11.

216 The law in respect of mergers, eg, has created 'a clear distinction between an SLC test (in which efficiencies are largely not considered) and the test for authorisation (that explicitly considers efficiencies)': Philip Williams and Graeme Woodbridge, 'The Relation of Efficiencies to the Substantial Lessening of Competition Test for Mergers: Substitutes or Complements?' (2002) 30 *Australian Business Law Review* 435, 436. See also *Qantas Airways* (2005) ATPR ¶42-065, 42 874 (Goldberg J, Mr Latta and Prof Round).

217 See *Hilmer Report*, above n 26, regarding the 'effective functioning of the competitive process, and hence economic efficiency and the welfare of the community as a whole': at 26.

218 See *Gallagher* (1993) 113 ALR 159, 205, 206, where Lockhart J found there was a lessening of competition having regard not only to the restricted ability of rivals to offer lower prices, but also to offer flexible services, reduce costs, introduce effective technology or increase productivity. See also *Seven Network Ltd v News Ltd* (2009) 182 FCR 160, 283–4, 307 (Dowsett and Lander JJ) ('*Seven Network*'), regarding firms competing through new products, new technology, more effective service or improved cost efficiency: 'competition may manifest itself as innovation in the product and/or the way in which it is supplied'.

219 *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379, 414 [87] (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ), quoting *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 1, 14 [63] (Hely J, Members Messenger and Starrs). See also *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136, 267 [800] (Finkelstein J, Mr Latta and Prof Round): 'Some economists contend that innovative efficiency provides the greatest enhancement of social wealth, suggesting it is the single most important factor in the growth of real output in industrial countries.'

220 See *Seven Network* (2009) 182 FCR 160, 283–4, 307 (Dowsett and Lander JJ).

221 See the consideration of this possibility by the Tribunal in *Qantas Airways* (2005) ATPR ¶42-065, 42 870–1 (Goldberg J, Mr Latta and Prof Round).

222 Ibid 42 918 (Goldberg J, Mr Latta and Prof Round).

223 Ibid 42 965 (Goldberg J, Mr Latta and Prof Round); *Australian Competition and Consumer Commission v Metcash Trading Ltd* (2011) 282 ALR 464, 499 [168], 500 [170]–[171] (Emmett J).

However, in contrast to the other tests considered in this article, under the SLC test, increases in efficiency could only be considered to the extent that they promote competitive rivalry *in the same market* in which the lessening of competition occurs. The question is whether competition in a given market has been substantially lessened, not whether the conduct reduces or improves consumer welfare in general. A dominant firm could not argue that, although the impugned conduct is likely to substantially lessen competition in one market, it will also lead to overwhelming improvements in dynamic efficiency, or consumer benefits, in another market. In such circumstances, the Australian SLC test may condemn some conduct that would be absolved under other effects-based tests.

C Weaknesses of the SLC Test in Limiting Error Costs

1 Absence of an Exclusionary Element under the SLC Test

In contrast to the other effects-based tests considered in this article, the Misuse of Market Power Bill does not specify that the relevant conduct must be likely to exclude, deter or impair rivalry on the part of existing or potential competitors. Fisse rightly points to the absence of such an 'exclusionary' element as a weakness in the proposal.[224] The critical threat posed by unilateral anticompetitive conduct is that a firm may preserve or extend its substantial market power through conduct which is not efficient but which suppresses the rivalry of its competitors.[225] In the absence of a reference to this exclusionary element, it is possible that the proposed provision would capture beneficial conduct which does not exclude rivals in a market in which the firm possesses substantial market power.

This might occur, for example, where a firm initially possesses substantial market power as a supplier of an input to manufacturers in a downstream market, but later withdraws from that business to use the entire output of its own product as an input in a separate downstream market.[226] This 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 actually suppress rivalry in any market. Instead, the firm profits by entering a new market where the input is used in a way that potentially improves social welfare and consumer welfare.

The Australian law could incorporate an exclusionary element with relative simplicity, along the same lines as the South African Act, which defines an 'exclusionary act' as an act that impedes or prevents a firm from entering into, or expanding within, a market.[227] This element sets a low threshold for inclusion: proof of the substantiality of the effect on the competitive process is considered

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224 Fisse, above n 209, 11. See also Business Council of Australia, Submission to Treasury and the Australian Competition and Consumer Commission, September 2016, 2.

225 See Part II(A) above.

226 Fisse, above n 209, 12–13.

227 *Competition Act 1998* (South Africa) s 1(1). See Part V above. Similarly, Hovenkamp, 'The Monopolization Offense', above n 59, 1037, proposed a definition of 'monopolistic conduct' under s 2 of the *Sherman Act* which includes a requirement that the conduct is 'reasonably capable of creating, enlarging or prolonging monopoly power by *impairing the opportunities of rivals*' (emphasis added).

separately under the anticompetitive effect (or SLC) element. Nonetheless, incorporating an exclusionary element serves a fundamental purpose. It clarifies that the provision is concerned with conduct which tends to exclude competitors.[228] This threshold enquiry also establishes the focus of the relevant analysis from the beginning. The aim of the analysis is to discern the purpose or effect of conduct which impairs the competitive opportunities of rivals, and not to attempt to characterise the defendant's conduct more generally.[229]

2 Uncertain Threshold for 'Substantiality'

Each of the effects-based tests outlined in this article requires proof of 'substantial' or 'significant' harm to the competitive process.[230] In Australia, the *CCA* does not define the concept of 'substantiality' but only specifies that 'substantially lessening competition' includes 'hindering or preventing competition',[231] indicating that it is not necessary to prove that rivals have actually been excluded from the market. Case law has provided modest direction about the kinds of effects which are *not* a substantial lessening of competition. Thus the inability of consumers to view different brands of a product at a particular outlet is not a substantial lessening of competition.[232] The removal of just one of many competitive firms will not cause a substantial lessening of competition.[233] A short-term effect which is readily corrected by market processes is unlikely to be substantial.[234]

The courts have also offered some *positive* explanation of the meaning of the word 'substantial' in this context. 'Substantial' is said to mean 'considerable';[235] or 'a greater, rather than a lesser, degree of lessening of competition'.[236] Following the judgment of French J in *Stirling Harbour*, it has often been stated that the effect or likely effect must be 'substantial in the sense of meaningful or relevant to the competitive process'.[237] To determine whether such an effect has

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228 See Fisse, above n 209, 10–11.

229 See *Dandy Power* (1982) 64 FLR 238, 277 (Smithers J):

> The overt act proved is the refusal of supplies involved in the termination of the franchise agreement. And that is the only overt act. The question is whether from the character of that act the inference in question should be drawn, namely, that the engaging in that act had the purpose of substantially lessening competition in a market.

230 See Salop, 'Flawed Profit-Sacrifice', above n 29, 347 (liability would not attach if there was no 'significant impact on price or consumer welfare'); *Microsoft*, 253 F 3d 34, 64, 69, 72 (DC Cir, 2001); *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* [2010] ZACT 13 (South Africa Competition Tribunal).

231 *CCA* s 4G.

232 *Dandy Power* (1982) 64 FLR 238, 279 (Smithers J); *Outboard Marine* (1982) 66 FLR 120, 134–5 (Fitzgerald J). Cf *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd* (1987) 75 ALR 581, 598 (Wilcox J).

233 *Outboard Marine* (1982) 66 FLR 120, 125, 134 (Fitzgerald J).

234 *Universal Music* (2003) 131 FCR 529, 585 (The Court).

235 *Dowling* (1992) 34 FCR 109, 135 (Lockhart J).

236 *Universal Music* (2003) 131 FCR 529, 585 (The Court).

237 *Stirling Harbour* (2000) ATPR ¶41-752, 40 732; *Australian Competition and Consumer Commission v Australian Medical Association Western Australia Branch Inc* (2003) 199 ALR 423, 483 (Carr J) ('*AMA*'); *Rural Press* (2003) 216 CLR 53, 71 (Gummow, Hayne and Heydon JJ); *AGL (No 3)* (2003) 137 CLR 317, 417 (French J); *Cement Australia* (2013) 310 ALR 165, 747–8 [3013] (Greenwood J).

occurred, it is necessary to go beyond any numerical assessments and make 'qualitative judgments … about the impact of conduct'.[238]

Unfortunately, these rather vague and subjective terms do not provide significant guidance for those concerned with ex ante compliance. As Deane J commented in another context, the word 'substantial' is 'not only susceptible to ambiguity: it is a word calculated to conceal a lack of precision'.[239] This criticism has been vindicated by case law on the meaning of the SLC test.[240]

Turning to the analyses in the decided cases for guidance, there is some inconsistency in the approaches adopted by Australian courts considering whether conduct has a 'substantial' effect. For example, it seems that it is not necessary to prove that the conduct in question has raised, or is likely to raise, prices[241] in the market generally.[242] Thus, in *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd*,[243] the Court found that Bursill's refusal to supply Salomon-branded ski boots to one retailer was likely to cause a substantial lessening of competition because the retailer in question was a heavy discounter and the refusal to supply Salomon-branded ski boots to such a competitor removed 'significant competition to some retailers'. The Court gave no indication that it had considered whether price competition from *other* brands of ski boots (which had a combined market share of two-thirds) meant that there would be no increase in prices in the market as a whole.[244]

On the other hand, in considering a merger in *Re Qantas Airways Ltd*,[245] the Tribunal cautioned against relying on a short-term 'snapshot' of competition in the relevant market, and stressed the need to consider the potential dynamic interaction with other competitors in that market. Likewise, in *Australian Competition and Consumer Commission v Air New Zealand*,[246] Perram J found

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238 *AMA* (2003) 199 ALR 423, 485 (Carr J).

239 *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 42 FLR 331, 348 (Deane J).

240 See, eg, *Outboard Marine* (1982) 66 FLR 120, 134 (Fitzgerald J) (emphasis added): 'Indeed, in the end, the answer in this case really depends on little more than *one's own instinctive impressions* formed by weighing the various considerations in this particular market which favour one view or another'; *Dandy Power* (1982) 64 FLR 238, 260 (Smithers J) (emphasis added):

> competition in a market is substantially lessened if the extent of competition in the market which has been lost, is seen *by those competent to judge* to be a substantial lessening of competition. Has competitive trading in the market been substantially interfered with? It is then that the public as such will suffer.

241 Or maintain supracompetitive prices.

242 See *Dandy Power* (1982) 64 FLR 238, 260 (Smithers J).

243 (1987) 75 ALR 581, 597–8.

244 Similarly, in *Universal Music* (2003) 131 FCR 529, the court apparently assumed that the elimination of *intra*brand competition would leave the defendants free from constraints from interbrand competition such that competition was substantially lessened: at 590–1. Cf *Stationers Supply* (1993) 44 FCR 35, where Ryan J found that, despite an arrangement for a large number of newsagents to switch their buying allegiance to the Newspower brand, there might in future be active competition between Newspower and other wholesale stationery brands: at 59–60. Similarly, in *Re AW Tyree Transformers Pty Ltd* (1997) ATPR (Com) ¶50-247, the Tribunal found that, even though the conduct might reduce some competition in the market in relation to one range of transformers, this did not give rise to a significant anticompetitive effect on the market as there was a significant degree of competition in the overall market.

245 (2005) ATPR ¶42-065, 42 914–15 (Goldberg J, Mr Latta and Prof Round).

246 (2014) 319 ALR 388.

that an exchange of information between competitors concerning a component of the price charged by those competitors did not necessarily substantially lessen competition, emphasising that 'one needs to keep in mind that one is gauging the competitive effects *in the overall market*'.[247]

These inconsistent approaches, and the general vagueness of judicial statements on the meaning of 'substantial' effect, may give rise to uncertainty for firms attempting to comply with the legislation; as well as the possibility that conduct will be condemned even where it gives rise to no persistent or market-wide effect on competition.[248]

3 Low Threshold for 'Likely Effect' Limb of the SLC Test

Under the 'likely effect' limb, the proposed section 46(1) would condemn conduct if it 'has the likely effect of substantially lessening competition'. According to the interpretation of this phrase under other provisions of Part IV of the *CCA*, proof of 'likely effect' only requires the applicant to demonstrate that the conduct had a 'real chance or possibility' of substantially lessening competition in a market.[249] This assessment is made on an ex ante basis, having regard to the information available at the time the firm engaged in the conduct.[250]

A finding that conduct gave rise to a *real chance or possibility* of substantially lessening competition sets a low, and relatively uncertain, threshold for infringement, particularly when combined with the uncertain standard of 'substantiality'. It is conceivable that the 'likely effect' limb of the SLC test would deter firms from engaging in conduct that is generally procompetitive. That is, an applicant might successfully argue that conduct had a real chance or possibility of lessening competition when the conduct had an inherently unpredictable outcome at the outset, even though the suppression of competition was not the most likely explanation for the conduct.[251] In these circumstances, a 'likely effects' test may reduce dominant firm incentives to engage in some behaviour which is generally beneficial to society.[252]

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247 Ibid 610 [1107], 634 [1243] (Perram J) (emphasis added).

248 See Fisse, above n 209, 12, 16–20. Cf the approach to 'substantiality' proposed by Tom Leuner, 'Time and Dimensions of Substantiality' (2008) 36 *Australian Business Law Review* 327.

249 *Monroe Topple & Associates Pty Ltd v Institute of Chartered Accountants in Australia* (2002) 122 FCR 110, 140 [111] (Tamberlin J) ('*Monroe Topple*').

250 *Universal Music* (2003) 131 FCR 529, 586 [247] (The Court); *Seven Network Ltd v News Ltd* (2009) 182 FCR 160, 342 (Dowsett and Lander JJ).

251 For example, when the dominant firm invests in research and development or increased capacity.

252 See Part VII(C) below.

VII ERROR COSTS AND INCENTIVE EFFECTS

A Error Costs and Incentive Effects from Effects-Based Tests

The effects-based tests considered in this article take quite different approaches to the risks of capturing conduct which is actually procompetitive,[253] and unacceptably reducing the incentives of dominant firms to engage in beneficial competitive conduct.[254] At one extreme, the EU Guidance Paper places considerable faith in the authority's ability to assess competitive effects, and to weigh the procompetitive against the anticompetitive.[255] The Commission also places a heavy burden on the defendant to justify its conduct on efficiency grounds, reflecting a perception that the danger from dominant-firm conduct in the market is greater than the danger of state intervention and relatively little concern with disincentive effects.

In contrast, Salop responds to criticisms of the 'consumer harm' test by arguing that marginal adjustments may be made to the test – for instance to the standard of proof – to take into account potential disincentive effects.[256] Hovenkamp would go further. The risk of deterring socially beneficial conduct is one of the key reasons that Hovenkamp does not in fact recommend the use of an effects-based test, or rule of reason enquiry, in respect of unilateral conduct on a case-by-case basis.[257] Instead Hovenkamp advocates what might be called a 'meta' rule of reason, or effects-based test, as the overarching principle for selecting the conduct-specific tests that maximise long run consumer welfare, which may sometimes require the adoption of an under-inclusive rule to avoid deterring beneficial conduct by dominant firms.[258]

It is important to take into account the context of Hovenkamp's views in this respect. 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'.[259] Accordingly, the extent to which US courts and commentators advocate the categorisation of unilateral conduct and the

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253 Easterbrook, 'Limits', above n 47, 4–8, citing R H Coase, 'Industrial Organization: A Proposal for Research' (1972) 3 *Policy Issues and Research Opportunities in Industrial Organization* 59.

254 See, eg, Josef Drexl, 'Real Knowledge Is to Know the Extent of One's Own Ignorance: On the Consumer Harm Approach in Innovation-Related Competition Cases' (2010) 76 *Antitrust Law Journal* 677, 677; Melamed, above n 96, 1254; Popofsky, above n 18, 436, 443, 465: 'Courts have reasoned that engaging in a case-specific assessment of net effects on consumers in these circumstances is fraught with difficulty, will undermine ex ante incentives to compete, and thus is not in consumers' best interests'.

255 As explained in Part IV above.

256 Salop, 'Flawed Profit-Sacrifice', above n 29, 353–4.

257 Hovenkamp, 'Harvard and Chicago Schools', above n 116, 109, 114, 118, 120–1.

258 Popofsky, above n 18, 456. Popofsky has proposed a similar approach, arguing that, in the developing jurisprudence on monopolisation under the *Sherman Act*, 'the appropriate test for "reasonableness" … can vary depending on the circumstances' and 'that test is the one that makes consumers in the long run best off or, put equivalently, minimizes error and legal process costs'. In some circumstances, the best solution from a consumer standpoint might be to apply certain simplified screening tests, or tests which capture a more limited range of anticompetitive conduct, so as to preserve incentives for dominant firms to engage in behaviour that ultimately benefits consumers. Examples of such simplified tests are considered in the following sections of this article.

259 Hovenkamp, *Antitrust Enterprise*, above n 113, 4.

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.[260] Neither of these factors are present in the Australian context.[261]

Under the South African Act, different rules apply to different types of unilateral conduct, varying the onus of proof and the applicable penalties. Certain categories of exclusionary acts are specified, providing dominant firms with some certainty as to the types of conduct which might infringe; the competitive 'danger zones'.[262] The treatment of such conduct is more severe, both with regard to the burden of proof and applicable penalty, than conduct which only falls within the general, residual category of exclusionary acts. South African commentators have noted that the most marked result of these distinctions is that dominant firms are little deterred from engaging in conduct which falls in the residual category of conduct under section 8(c).[263] On the other hand, the firm may still be exposed to a civil damages claim, not to mention reputational harm.[264]

The Australian SLC test does not create, or permit courts to create, more or less stringent standards of liability depending on the particular conduct which is alleged to be anticompetitive. According to the test in the Misuse of Market Power Bill, any unilateral conduct would infringe section 46(1) if it has the purpose, effect or likely effect of substantially lessening competition in a market. The question whether the conduct meets the SLC test does not provide scope for the courts to take into account the broader implications of condemning the behaviour in question.

On the other hand, unlike the EU Guidance Paper, the SLC test is likely to err in favour of the dominant firm in close cases. On a practical level, the applicant is likely to raise arguments as to how the impugned conduct reduced rivalry in a manner likely to cause detriment to consumers, while the respondent would attempt to prove that the conduct in fact represented increased rivalry,[265] leading to benefits for consumers. However, the burden of proof would remain on the applicant to prove the effect, likely effect or purpose of substantially lessening competition. If this cannot be established, on the balance of probabilities, and having regard to the respondent's procompetitive justifications, the respondent will prevail.

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260 Ibid 48–9, 61–3.

261 However, 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: Easterbrook, 'Past, Present and Future', above n 66, 109.

262 Sutherland and Kemp, above n 156, [7.4].

263 Roberts, 'Administrability and Business Certainty', above n 153, 1, 18:

> The scope for stymying the substantive evaluation of firm conduct may be what business was seeking in arguing for 'certainty'. If this was the real objective, then they have been successful… the record suggests that the [conduct specific] provisions appear to undermine the administrability of abuse enforcement.

264 See, eg, *Competition Commission v Media 24 Pty Ltd* [2016] ZACT 86 (South Africa Competition Tribunal).

265 Or conduct which was essential to increased rivalry.

B Low Prices: Error Costs and Incentive Effects

Critics of the SLC test in Australia have argued that it is likely to inappropriately condemn firms for engaging in vigorous price competition, as well as deterring such competition more generally.[266] This section considers how low pricing is treated by the various effects-based tests.

In Hovenkamp's view, low pricing should only be sanctioned if it meets a relatively stringent test for predation: that is, if the price is clearly below average variable cost or marginal cost[267] and 'the structural conditions for recoupment exist'.[268] He acknowledges that, occasionally, *above*-cost pricing may also produce anticompetitive effects, but contends that identifying these rare cases would tax the measurement capabilities of tribunals 'so severely that it cannot be controlled without discouraging socially beneficial behaviour'.[269] While Hovenkamp admits that this approach is somewhat under-deterrent, he considers that this is justified by administrability considerations,[270] and by the fact that, for pricing claims in particular, the cost of incorrectly condemning conduct is high relative to the cost of incorrectly absolving predatory prices.[271]

In cases of alleged predatory pricing, Salop explains that the 'consumer harm' test would recognise the benefits to consumers, at least in the short-run, of lower prices. But the defendant's strategy would violate the 'consumer harm' standard if higher prices (and therefore consumer welfare losses) during a subsequent recoupment period were such that 'the net present value of consumer welfare decreased'.[272] Under Salop's approach, it would *not* be necessary to show that the pricing was below some measure of costs, since economic theory establishes that, in some circumstances, above-cost pricing may reduce the net present value of consumer welfare.[273]

Under the Guidance Paper, the Commission does not engage in an open-ended consideration of the effects of low pricing. Rather it takes the general approach that low pricing should not be condemned unless it would exclude a

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266 See, eg, Papadakis, above n 9; King and Samuel, above n 9.

267 See Phillip Areeda and Donald F Turner, 'Predatory Pricing and Related Practices under Section 2 of the *Sherman Act*' (1975) 88 *Harvard Law Review* 697, 716–18, regarding the underlying rationale for cost-based tests for predatory pricing. Given the difficulty of calculating marginal cost, average variable cost has been recognised as a reasonable surrogate for marginal cost.

268 Hovenkamp, 'Obama Administration', above n 117, 1644–7. In the context of predatory pricing, 'recoupment' refers to the ability of the dominant firm to recoup its losses from pricing below cost for a period of time by later charging prices above the competitive level once its below-costing pricing has driven its competitors from the market, or deterred price competition by its competitors. Hovenkamp recognises, however, that strict proof of recoupment should not be required if the defendant's prices are clearly below the relevant cost measure: at 1644–7.

269 Hovenkamp, 'Antitrust Standard', above n 115, 27; Hovenkamp, 'Harvard and Chicago Schools', above n 116, 120–1.

270 It is simply too difficult for courts to identify those situations in which above-cost pricing will be anticompetitive. See Hovenkamp, 'Obama Administration', above n 117, 1644; Hovenkamp, *Antitrust Enterprise*, above n 113, 159–67.

271 Hovenkamp, 'Obama Administration', above n 117. See also Hovenkamp, *Antitrust Enterprise*, above n 113, 173–4, regarding under-deterrent cost-based tests for 'bundled' discounts.

272 Salop, 'Flawed Profit-Sacrifice', above n 29, 337–8.

273 Ibid 337–8 n 108. See also de la Mano, Nazzini and Zenger, above n 125, 401–6 for an explanation of instances in which above-cost pricing may amount to predation.

rival who is *as efficient* as the dominant firm.[274] Further, the Commission has provided detailed cost benchmarks below which a firm will be considered to price at a predatory level.[275] However, the Commission also noted that, in exceptional circumstances, a firm's pricing may be found to have an anticompetitive effect even where it prices *above* all of the relevant cost measures.[276] The Commission has been criticised for adding this exception, on the basis that it creates uncertainty and may deter beneficial price competition.[277]

Under the South African Act, section 8(d)(iv) sets out a specific rule for predatory pricing, requiring the complainant to prove that the dominant firm has priced its goods or services below their marginal or average variable costs and that that pricing has had an anticompetitive effect. However, a dominant firm may also infringe section 8(c) by engaging in predatory pricing even where the relevant price is *above* average variable cost, provided that the complainant proves that such pricing had an anticompetitive effect and that that effect outweighed any procompetitive gains. The deterrent effect of this rule may be limited by the fact that a dominant firm is not liable to pay an administrative penalty for an infringement of s 8(c).[278]

The Australian SLC test also permits a relatively open-ended analysis of predatory pricing claims. Australian courts have indicated that low pricing is generally a key indicator of healthy competition: thus low prices alone will not reflect a substantial lessening of competition.[279] They also recognise that a dominant firm's low prices will sometimes drive other firms from the market if those firms are not as efficient as the dominant firm, and that this is the natural outcome of successful competition.[280] Something further will be required if an applicant is to prove that low prices are likely to substantially lessen competition.

It is most likely that an applicant under an amended section 46(1) would attempt to show that the prices in question were below some appropriate cost measure in accordance with current economic theories on predatory pricing.[281] The fact that the dominant firm's price was below an appropriate cost measure for a significant period, for example, may indicate that the price was set with the purpose or likely effect of substantially lessening competition, since the dominant firm would be unlikely to incur such losses unless it expected to recoup

274 Guidance Paper, above n 132, 11 [23], 14 [41], 16 [59], 17 [67], 18 [80].

275 Ibid 11 (price-based exclusionary conduct), 13 (conditional rebates).

276 Ibid 11 [24].

277 See, eg, Oxera, 'The New Guidance on Article 82 – Does It Do What It Says on the Tin?' (Article, Oxera Agenda, January 2009) 2; *Competition Commission v Media 24 Pty Ltd* [2016] ZACT 86 (South Africa Competition Tribunal).

278 Assuming there was no previous finding by a court that this pricing by the firm contravened the provision.

279 *Dowling* (1992) 34 FCR 109, 137 (Lockhart J). See also Part VI above.

280 *Boral Besser* (2003) 215 CLR 374, 409, 411–12 (Gleeson CJ and Callinan J).

281 Although there is no express formula for determining when 'predatory' pricing amounts to an infringement of s 46(1) on its current wording, the courts have considered tests based on current economic theory as 'useful tools' concerning predatory pricing, while cautioning that these tests should not be adopted as a substitute for express statutory language: see *Boral Besser* (2003) 215 CLR 347, 420 [124] (Gleeson CJ and Callinan J).

its costs by charging a supracompetitive price once other firms exited the market.[282]

However, economic theory indicates that dominant firms may exclude vital competitive constraints and protect their market power by lowering their prices even where prices are above cost.[283] It is therefore possible that, in limited circumstances, prices above cost could be found to substantially lessen competition and thereby infringe the amended section 46. It might be considered desirable that the SLC test is sufficiently flexible to capture anticompetitive conduct in these circumstances. However, in making such a finding, it would not be open to an Australian court to take into account the consequences of the finding on pricing behaviour more generally. This has implications for dominant firm incentives: if it is possible for courts to find that above-cost pricing infringes section 46(1), prudent firms may be reluctant to engage in some beneficial low pricing.

C Innovation: Error Costs and Incentive Effects

Claims of unilateral anticompetitive conduct often concern novel products, services or business methods. It is generally acknowledged that dominant firms may engage in 'predatory innovation' which improperly excludes rivals to the detriment of consumers:[284] that is, dominant firms may strategically select some technology, or other novel method of doing business, to take advantage of its adverse impact on rivalry.[285] However, numerous commentators have argued that antitrust rules should err heavily on the side of permissibility in such cases, particularly given the overwhelming economic benefits flowing from innovation in general.[286]

Hovenkamp has recognised that dominant firms may engage in predatory innovation.[287] At the same time, he argues that unilateral innovations should only be condemned in the rare situation where the following conditions are met:

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282 See Hovenkamp, 'Obama Administration', above n 117, 1644–7.

283 See, eg, de la Mano, Nazzini and Zenger, above n 125, 401–6; Aaron S Edlin, 'Stopping Above-Cost Predatory Pricing' (2002) 111 *Yale Law Journal* 941.

284 See Alan Devlin and Michael Jacobs, 'Anticompetitive Innovation and the Quality of Invention' (2012) 27 *Berkeley Technology Law Journal* 1.

285 Hovenkamp, 'The Monopolization Offense', above n 59, 1039. See also Devlin and Jacobs, above n 285, 8–10, regarding methods of 'predatory innovation'.

286 Drexl, above n 254, 679–80; Rachel Trindade, Rhonda L Smith and Alexandra Merrett, 'Building Better Mousetraps: Harper's Re-write of Section 46' (Report, The State of Competition, October 2014) 4. See also Geoffrey A Manne and Joshua D Wright, 'Innovation and the Limits of Antitrust' (2010) 6 *Journal of Competition Law & Economics* 153; Geoffrey A Manne and Joshua D Wright, 'Google and the Limits of Antitrust: The Case against the Case against Google' (2011) 34 *Harvard Journal of Law & Public Policy* 171, 183: 'innovation, by definition, generally involves new business practices or products. Antitrust authorities historically have not treated novel business practices or innovative products kindly, and economists have a longstanding tendency to ascribe anticompetitive explanations to new forms of conduct that are not well understood'.

287 Hovenkamp, 'The Monopolization Offense', above n 59, 1039. See also Devlin and Jacobs, above n 285, 8–10, regarding methods of 'predatory innovation'.

(a) the defendant occupies a very dominant position in the market, sufficient to warrant an inference of serious injury if the firm designs a product that excludes the complementary products of rivals;
(b) there is no significant actual improvement for which the challenged innovation was necessary; and
(c) the defendant did not intend, at the outset, to create a better product but only to redesign it in order to exclude a rival, generally by making the rival's product incompatible with its own.[288]

Accordingly, an innovative act should not be condemned unless it is a 'sham' in the sense that it 'does not benefit consumers at all, but is profitable only because it locks consumers into the dominant firm's technology'.[289]

Hovenkamp argues that where innovative conduct is actually necessary for *any* significant improvement in the product, it should be absolved. Where there is such an improvement, the courts are 'simply not up to the job of balancing the gains from innovation against the losses from reduced competition'.[290] Even though successful innovations may injure competitors and have the effect of creating or expanding monopoly power, he points out that there is general consensus in the economic literature that gains from innovation are likely to be significantly greater than gains from increased competitiveness.[291] Accordingly, '[o]ur market system simply places too high a premium on innovation' to condemn such innovations.[292]

Salop's approach varies most markedly from Hovenkamp's in respect of innovations or product design changes by dominant firms. Salop would condemn a dominant firm's product design change if it maintains or enhances the firm's market power by creating incompatibility with a rival's product if that incompatibility was not necessary for the improvement of the dominant firm's product.[293] However, even if the incompatibility *was* inextricably linked to the dominant firm's quality improvement, Salop would find a violation if the dominant firm 'consequently gains the ability to raise its price by far more than the [value of the] quality improvement'.[294] Salop would thus have courts compare the additional value, or performance benefits, to consumers from the design change with the additional price consumers would be required to pay. A beneficial design change might still infringe if the resulting price is higher than the quality-adjusted price. That is, the change would be condemned if '[t]he

288 Hovenkamp, 'The Monopolization Offense', above n 59, 1039; Hovenkamp, 'Exclusion and the *Sherman Act*', above n 24, 158; Hovenkamp, 'Antitrust Standard', above n 115, 23–4, regarding ex ante analysis of the firm's subjective intent. See also Devlin and Jacobs, above n 285, for an alternative approach to predatory innovation claims.
289 Hovenkamp, 'The Monopolization Offense', above n 59, 1039.
290 Ibid 1046.
291 Ibid. See also Hovenkamp, 'Obama Administration', above n 117, 1663: 'The welfare gains from innovation almost certainly exceed the available gains from squeezing price monopoly out of the economy. An important corollary of this proposition, however, is that the harm caused by an act that restrains innovation can cause far greater harm than a restraint on simple output or pricing'.
292 Hovenkamp, 'The Monopolization Offense', above n 59, 1045.
293 Salop, 'Flawed Profit-Sacrifice', above n 29, 323–6.
294 Ibid 324.

product improvement is valued by consumers, but not by enough when it comes unavoidably bundled with increased barriers to competition that permit such large price increases'.[295]

However, Salop adds a qualification which takes some account of disincentive effects. Salop proposes that, where innovative conduct may have unpredictable results, the conduct should be evaluated from an ex ante perspective, based on information reasonably available at the time the innovator made its investment decision.[296] 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',[297] 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'.[298]

In contrast, the South African Act does not permit the Tribunal to evaluate unilateral conduct from an ex ante perspective, but requires an assessment of the actual competitive effect of the conduct on the balance of probabilities.[299] However, a pure design change or introduction of a new product would not fall within any of the specified exclusionary acts listed in section 8(d) of the Act.[300] In theory, a dominant firm could be found to contravene section 8(c) where its innovation gave rise to a net anticompetitive effect even if that effect could not have been foreseen at the time it engaged in the conduct.[301] However, the deterrent effect of this possibility may be limited given the absence of any administrative penalty for a first time contravention.[302]

Australian courts have acknowledged that innovation is in fact a vital aspect of competition itself.[303] If certain conduct reduces price competition, it should be relevant that the same conduct has led to an increase in innovation, or dynamic efficiency.[304] On the other hand, a product design change or new product may necessarily exclude existing or potential rivals, particularly if the innovation holds vastly superior appeal for consumers. But this does not necessarily equate to a substantial lessening of competition.

Competition may not be significantly lessened even in cases where the market is reduced to a single supplier.[305] The critical consideration is not the 'snapshot' of competition at a given point in time, but the potential for rivalry, including innovation by competitors, over time.[306] In the absence of additional

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295 Ibid 339. Cf Devlin and Jacobs, above n 285, 53, arguing that the appropriate test for predatory innovation should condemn innovative conduct only 'when the offending product offers consumers nothing new and valuable'.

296 Salop, 'Flawed Profit-Sacrifice', above n 29, 339.

297 Ibid 365.

298 Ibid 341.

299 See Part V above.

300 Ibid.

301 Ibid.

302 See Roberts, 'Administrability and Business Certainty', above n 153, 1, 18.

303 See Part VI(B)(3) above.

304 Ibid. See the consideration of this possibility by the Tribunal in *Qantas Airways* (2005) ATPR ¶42-065, 42 870–1 (Goldberg J, Mr Latta and Prof Round).

305 *Stirling Harbour* (2000) ATPR ¶41-752, 40 725, 40 728, 40 733–4 (French J).

306 *Qantas Airways* (2005) ATPR ¶42-065, 42 914–15 (Goldberg J, Mr Latta and Prof Round).

strategic behaviour on the part of the incumbent, new products and standards can and do arrive to the benefit of consumers. Particularly in the 'new economy',[307] competition may take the form of competition to *obtain* transient monopolies, with the prospect of a lucrative monopoly accelerating the rate of innovation.[308] But where a dominant firm's new product or design change excludes rivalry *without* giving rise to any benefit to consumers, the innovation may be found to have substantially lessened competition. Accordingly, strategic behaviour or 'sham' design changes by dominant firms may be captured by the Australian SLC test.

However, the SLC test might also give rise to liability in the rarer situation where the genuine objective of a dominant firm's design change was the creation of consumer benefits, but the design change substantially reduced rivalry in the market while the intended benefits ultimately failed to materialise. The court would not be required to consider the dominant firm's purpose in introducing the design change if it in fact gave rise to a substantial lessening of competition under the 'effect' limb.[309] A dominant firm may also infringe if its conduct had the *likely* effect of substantially lessening competition, which has been held to require only proof that there was a 'real chance or possibility' of such an effect at the outset.[310] In either case, the court would not be permitted to take into account the fact that condemning such conduct may affect the incentives of dominant firms to invest in innovative conduct more generally.

Incentives for dominant firms to invest in potentially beneficial research and development may be dampened if that investment is subject not only to the risk that no marketable product will eventuate, but also to the risk that the end product will create antitrust liability for the firm. While it may be possible to insure against this latter risk by seeking authorisation for design changes or new products where outcomes are uncertain at the outset,[311] firms may be reluctant to subject their research and development plans to a 'cumbersome and bureaucratic' authorisation process.[312]

VIII SUMMARY

The proposal to incorporate an SLC test in section 46(1) of the *CCA* has been criticised on the basis that it is likely to condemn or deter procompetitive conduct by dominant firms. These criticisms have often been overstated. As with the

307 That is, the manufacture of computer software, internet-based businesses and communications services which support these two markets.

308 Richard A Posner, 'Antitrust in the New Economy' (2001) 68 *Antitrust Law Journal* 925, 929–30.

309 Cf Australian Competition and Consumer Commission, 'Framework for Misuse', above n 172, 7–11, which seems to suggest that the ACCC would take into account whether the dominant firm had 'legitimate business reasons' for engaging in the conduct in determining whether that conduct fell afoul of the SLC test *in general*, and not only in respect of the 'purpose' limb of the SLC test, as the wording of the section would require.

310 *Monroe Topple* (2002) 122 FCR 110, 140 [111] (Tamberlin J). See also Part VI(C)(3) above.

311 See the explanation of the authorisation process at above n 173.

312 See Fisse, above n 209, 13.

other effects-based tests considered here, under the SLC test, courts would take into account the negative impact of conduct on actual or potential rivals, but harm to rivals would not be sufficient to establish liability. Low prices based on costs, and improvements in quality or innovation, are manifestations of vigorous competition, which, by themselves, are not generally condemned by effects-based tests, including the SLC test, even if they cause detriment to competitors. Condemnation is only warranted where the negative impact on rivals gives rise to substantial harm to the competitive *process*.

The effects-based tests analysed here also recognise that conduct by a dominant firm which restricts competition may be necessary to increase efficiency or for the creation of other consumer benefits, and that, in some cases, these benefits may be significantly greater than any harm from the restriction on competition. Each of the tests contemplates that the court will weigh these benefits against the relevant harm.

Nonetheless the proposed amendment to section 46(1) has certain weaknesses which may give rise to some false positive errors or disincentive effects. These include the absence of an exclusionary element; the uncertain meaning of 'substantiality'; and the low threshold in the case of 'likely effects'. A further weakness is that the SLC test would expose all types of dominant firm conduct to the same potential liability on the basis of its actual, ex post effects.

Some effects-based tests considered in this article take account of the risk of disincentive effects of such an analysis either by altering the applicable test according to the category of conduct to take into account decision theoretic principles, altering the applicable penalty according to the category of conduct, or requiring the court to have regard to information reasonably available to the dominant firm at the time it engaged in the conduct. By contrast, the SLC test would expose dominant firms to liability for any type of conduct on the basis of its actual effects. If a plaintiff succeeded in proving a rare instance of anticompetitive above-cost pricing, or a design improvement which disproportionately excluded rivalry and increased the dominant firm's market power, the court would not be permitted to take into account the potential disincentive effects of a finding of infringement on low pricing and innovation in general.[313] While dominant firms could seek authorisation for such conduct when delay is not problematic, the Australian SLC test is a blunter instrument than some effects-based tests, which may discourage some beneficial conduct along with the harmful conduct.

I have argued elsewhere that the existing test for misuse of market power in section 46(1) has been demonstrably under-inclusive and uncertain in its application: it is in need of reform.[314] I have also argued that the implicit norm relied on by many courts, commentators and policymakers in assessing unilateral conduct ultimately concerns neither the effect of the conduct nor its impact on

313 The *risk* of liability in this respect may deter dominant firms from engaging in some socially beneficial practices, where there is doubt as to what the actual effects of that conduct might be, or as to how those effects might be interpreted by a court.

314 Kemp, 'Profit-Focused Tests', above n 34.

the dominant firm, but the objective purpose of the firm.[315] This article concludes that, while claims regarding the 'chilling' effect of incorporating an effects-based test in section 46(1) have been overstated, there are subtle weaknesses in the proposed SLC test which may create disincentive effects for dominant firms. Parliament may ultimately prefer these weaknesses to the clear shortcomings of the existing section 46(1).

315 Kemp, 'A Unifying Standard for Monopolization', above n 92.