THE POROUS VEIL - A STUDY ON THE INFLUENCE OF EEC AND US COMPETITION LAW ON AUSTRALIAN TRADE PRACTICES LAW

I. INTRODUCTION

Australia shares with Western Europe and the United States of America a common political and economic heritage. In the economic sphere this includes the belief that competition in the market place is the best means by which the sources of production can best be channelled and utilised - ultimately leading to an increase in consumer welfare. This paper seeks to examine the influence of the competition laws of the European Economic Community (EEC) and the antitrust laws of the United States of America (US) on Australian trade practices laws.

A. The Economic Theory of Competition

Competition law is meant to regulate competition in the market. To appreciate the object of such laws, it will first be necessary to understand the economic theory on which such laws are premised.

Perfect competition is a state achieved where in any particular market there are numerous buyers and sellers, all producing homogeneous products. Consumers have perfect information about market conditions. Resources flow from one area of economic activity to another. There are no barriers to entry which would prevent the emergence of new competition. The producer is a price-taker, with no capacity to affect price by his own unilateral action. It is aggregate output that determines prices. Any change in a producer's individual output will have no or a limited effect on the aggregate output of the market as a whole.

According to the neo-classical economic theory, consumer welfare is maximised in conditions of perfect competition.[1] Consumers express their desires through the price they are prepared to pay for goods or services on the market. Under perfect competition, the suppliers of such goods or services will then allocate economic resources between the different goods and services in the precise quantities demanded by the consumers. This is allocative efficiency i.e. the most effective means by which the economic sources can be allocated. Apart from allocative efficiency, perfect competition also leads to goods and services being produced at the lowest cost possible. This means that as little of society's wealth is expended in the production process as necessary. This is productive efficiency.

Perfect competition also causes prices to hover at just above the marginal cost of production;[2] which is to the benefit of the consumer. The producer will not want to raise prices any higher because this will drive the consumers to other producers; and the producer will not contemplate selling at a lower price because this will be unprofitable.

Allocative efficiency is achieved under perfect competition because the producer, assuming he is acting rationally and has a desire to maximise his profits, will expand his production for as long as it is profitable to do so. As long as he can earn more by producing an extra unit of his product than it costs to make it, he will presumably do so. Only when the marginal cost exceeds the price he will obtain for it will he cease to expand production. Where competition is perfect, a producer will increase output to the point at which marginal cost and marginal revenue coincide.[3] A reduction in his own output cannot affect the market price and so there is no reason to limit it. Output is maintained at an optimal level and consumers obtain the goods they require at the price they are prepared to pay. Resources are allocated precisely to the consumers' wishes.

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[1]See: Lipsey *An Introduction to Positive Economics* 6th ed (Weidenfeld) Ch 19.

[2]Marginal cost is the cost of producing an additional unit of output. There must be a price which is above the marginal cost so as to encourage the producer to invest his capital in the industry in the first place.

[3]Marginal revenue is the net addition to revenue of selling the last unit.

Productive efficiency is achieved in perfect competition because a producer is unable to sell above cost, and he will certainly not sell below it. If a producer were to charge above cost, other competitors would take this as an indication of profitability and move into the market. They would attempt to produce on a more efficient basis so as to earn a greater profit. In the long-run, this will force producers to incur the lowest cost possible in order to be able to earn any profit at all. Eventually, the point will be reached where prices and the average cost of producing goods coincide. This will lead to prices never rising above cost. If, on the other hand, price were to fall below cost, there would be an exit of capital from the industry and, as output would therefore decrease, prices would be restored to competitive levels.

Perfect competition is to be contrasted with monopolies which are condemned by the net-classical economist.[4] A monopolist is responsible for all the output. Since it is aggregate output that determines price through the relationship of supply and demand, the monopolist will thus be able to increase price by reducing the volume of his own production. A monopolist will earn the largest profit if he refrains from expanding his production. Output will be lower than under perfect competition. Consumers will be deprived of goods and services which they would have been prepared to pay for at the market price. There is allocative inefficiency. Society's resources are not distributed in the most efficient way possible. The inefficiency is accentuated by the fact that consumers, deprived of the monopolised product they would have bought, will spend their money on products which they may not want.

Under a monopoly, productive efficiency may also be lower. The monopolist is not constrained by competitive forces to reduce costs to the lowest possible level. Instead the firm becomes 'x-inefficient'.[5] This is a situation in which resources are used to make the right product, but less productively than they might be. Management spends too much time doing other things like playing golf; outdated industrial processes are maintained and a general slackness creeps into the organisation of the firm.

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[4]See: Lipsey *supra* n 1 at Ch 20.

[5]Lieberstein "Allocative Efficiency v X-Efficiency" (1966) *Am Ec Rev* 392.

Furthermore, the monopolist may not feel the need to innovate because he does not experience the constant pressure to go on attracting customers offering better, more advanced products.

A monopolist can also charge what he likes rather than what the market will bear. Wealth is thus transferred from the consumer to the monopolist. Moreover, the prospect of earning large monopoly profits will encourage firms to misallocate resources, and this will induce wasteful expenditure on attempts to acquire a monopoly position which is a loss to society at large.[6]

That is the theory of perfect competition. There is much merit in having the "invisible hand" of competition magically and surreptitiously ordering society's resources in the optimal way. It is on this supposition that the competition laws of the EEC, the US and Australia seek, at varying degrees, to bring about this ideal state of competition.

II. POLICY DIFFERENCES

Australian trade practices laws reflect the influence of US antitrust laws and EEC competition laws. The most significant example of this is the 1986 amendment to section 46 of the Trade Practices Act 1974 (TPA) which closely follow the statutory language of the EEC's prohibition on abuse of a dominant position in Article 86 of the EEC Treaty.[7] The objectives of the EEC and the US laws however differ from one another as does the objectives of Australian laws from EEC and US laws. An examination of EEC competition law and policy as well as US antitrust law and policy as they have evolved over the last three decades is therefore undertaken first as a backdrop to a study of their influence in Australia.

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[6]See: Posner "The Social Costs of Monopoly and Regulation" (1975) 83 *Journal of Politics and Economics* 807.

[7]The EEC Treaty is the Treaty of Rome signed on 25 March 1957 by the founding members of the EEC and adopted by all subsequent members of the EEC.
Article 86 of the EEC Treaty stipulates that:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between member states.

A. Integration

Article 2 of the EEC Treaty provides that:

> The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the community a harmonious development of stability, an accelerated raising of the standard of living and closer relation between the States belonging to it.

Article 3 specifies certain activities of the EEC intended to help the achievement laid down in Article 2. One of them is "the institution of a system ensuring that competition in the common market is not distorted."[8]

This explicit reference to competition in the EEC Treaty sets out the primary goal of EEC competition policy. This is the use of competition laws to bring about the integration of the separate economies of the Member States into a unified common market. To this effect, agreements and practices which have the effect of partitioning markets along national boundaries, such as export bans,[9] and the exercise of intellectual property rights to prevent imports or exports between Member States,[10] have been treated as being in violation of the EEC competition laws.

To bring about the integration of the economies of the Member States the EEC Commission (the Commission), which is charged with administering the competition laws, has not only tolerated but actually encouraged certain forms of horizontal co-operation among small and medium-sized firms. This is to mitigate the risk that formerly isolated and smaller or medium-sized firms may encounter when competing with the larger firms within and without the EEC.

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 trade parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

[8]Article 3(f) EEC Treaty.

[9]Eg *Italy* v *EEC Council* [1966] ECR 563; *Consten & Grundig v Commision* [1966] ECR 429.

[10]Eg *Nungesser* v *Commission* [1982] ECR 2015.

No such integration policy exists in the US or in Australia. This is primarily because there is no and has never been any real restriction on the movement of capital, labour or goods - the sources of production - between the states of the US and Australia. This is unlike the EEC where each Member State is sovereign and each has historically been economic rivals with the other. Added to this are the language and cultural differences, multiple currencies and shifting exchanging rate (although this last element is becoming less significant with more and more of the EEC countries becoming members of the European Monetary System). The shortfall of this policy is that the EEC willingly accepts economic trade-offs in order to advance market integration. This distorts the market. The longer term benefits of free competition are sacrificed to the short term benefits of integration.[11]

B. Social And Political Objectives

Social and political values play a far greater role in EEC competition law and Australian trade practices law than in US antitrust law.

In the EEC, the Commission has stated in several annual reports on competition policy that social and human demands may require modification of results otherwise mandated on purely economic grounds.[12] The Commission is of the view that social or political concerns for individual traders, fairness in the market-place, equality of opportunity for all commercial operators and the legitimate interests of workers, users and consumers and legitimate policy objectives.[13]

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[11]For a critique of the integration policy see Barry E Hawk "European Economic Community and United States Antitrust Law: Contrast and Convergence" (1988) 16 *ABLR* 282.

[12]The EEC Commission has the task of putting into effect EEC policies. It administers EEC laws and can also issue directives and regulations concerning these laws.
Commissioners are appointed by the Government of each Member State. Upon appointment however, they are expected to act in the interest of the EEC and not their respective countries. The Commission is divided into Departments, known as Directorates-General. Each Directorate-General is headed by a Commissioner. Directorate-General IV deals with competition in the EEC. It is presently headed by Sir Leon Brittan.

[13]Eg Commission, Ninth Report on Competition Policy 9-11 (1980).

In Australia, the Trade Practices Commission (TPC) is given no specific guidance in the TPA about matters to be considered when considering the enforcement of the trade practices law. It has been recognised that regard can be paid to anything of value to the community in general, and to any contribution to the aims pursued by Australian society, including protection for the environment, industrial harmony, the promotion of equitable dealings and creating regional employment.[14]

Social and political values used to play important roles in the enforcement of US antitrust law.[15] In the 1960s there were allowances by the Courts for social values. Since the 1970s, however, US antitrust law has shifted from this towards a greater emphasis on economic consideration. In *National Society of Professional Engineers* v *United States*,[16] for example, it was held that an agreement among engineers not to negotiate or discuss fees before a prospective client selected an engineer for a particular project violated section 1 of the Sherman Act.[17] The asserted justification for the agreement was that the discussion of fees would be contrary to public health, safety and welfare; that is, such discussions before selection would lead to deceptively low bids and would tempt engineers to do inferior work. The US Supreme Court rejected the safety justification on the grounds that any inquiry into the reasonableness of a price-fixing term should be confined to consideration of its impact on competitive conditions.

III. ECONOMIC THEORY AND THE REGULATION OF COMPETITION

The differing policy aims of the competition laws of the EEC, the US and Australia are indicative of the different views that have been expressed about the regulation of competition. They

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[14]*Re QCMA and Defiance Holdings Ltd* (1976) ATPR 40-012.
[15]Eg *Brown Shoe* v *United States* 370 US 294.
[16]435 US 679 (1978).
[17]S 1 of the Sherman Act provides that:

> Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states or with foreign nations is hereby declared to be illegal.

range from the complete abandonment of intervention to the adoption of a more active role by governments. At the root of the arguments is the issue of whether competition regulation should be decided on purely economic grounds or on economic, social and political grounds.

The arguments have almost exclusively been in relation to US antitrust law. The effect of these arguments has however been felt here in Australia as well as in the EEC, and will undoubtedly continue to be felt in the future. The US, after all, has had its antitrust law for the last 100 years - the Sherman Act having been passed by Congress in 1890. Much empirical evidence has been collected during those years and many American minds have addressed themselves to the question of regulation. There is much to be learnt from their scholarship. An examination of this scholarship follows.

A. The US Courts' Attitude Towards Regulation

In the late 1950s and early 1960s, social and political consideration played a major role in the enforcement of US antitrust laws. This reflected the confidence of that period; the US was the largest economy and the leader of the free world. There was an ever expanding pie to share. The dominant economic theory at that time was distrustful of large firms and concentrated markets. Strong inferences of anti-competitive behaviour and performance were drawn from high market concentration. Significant barriers to entry were generally presumed to exist. Production and distribution efficiencies were disregarded.

The Supreme Court interpreted the merger laws to mean that there should be a reduction of concentration in business. Competition was defined by the Supreme Court as a process that required numerous participants and de-centralisation. The Supreme Court equated lessening competition with increased concentration. It went about protecting markets of numerous participants. In cases not involving mergers, the Supreme Court protected compatible values. It prohibited a number of restraints on trade, such as contracts requiring petrol stations to buy their petrol from their landlord/supplier,[18] contracts requiring lessees

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[18] *Standard Oil Company of California (Standard Stations) v United States* 337 US 293.

of salt-dispensing machines to buy their salt from their lessor,[19] and theatre owners to show only certain advertising films;[20] all on grounds that suppliers and buyers have the right to agree to buy and sell in the open markets, and that independent traders have the right to sell where, to whom, and at what price they please. This economic theory coincided with the political or social populist attitudes that existed then which favoured de-concentration of markets, diffusion of economic powers, freedom of opportunity for individual traders and freedom of consumer choice. Thus, the broad *per se* prohibitions on many horizontal and vertical arrangements and the strict scrutiny of most agreements and practices, including mergers became prevalent.

Beginning from 1969, however, the ideological balance on the Supreme Court gradually began to change. In 1969, Justice Fortas resigned and was replaced by Harry A Blackmum. In June 1969 Chief Justice Warren resigned and was replaced by Warren E Burger as Chief Justice. In September 1971, Justice Black retired and was replaced by Justice Rehnquist. And in September 1972, Justice Harlan retired and was replaced by Lewis F Powell Jr. All four appointments were made by a Republican Administration headed by President Nixon. Later, another Republican President, President Ford, appointed John Paul Stevens to fill the vacancy created by Justice Doughlas's retirement. These appointments resulted in a new wave of conservatism. There would be less interference in the market place. The Supreme Court's majority demonstrated a new sensitivity to consumers' interests in terms of greater efficiency of business. The Supreme Court declared that antitrust cases must be assessed in terms of market impact. There was an abandonment of the belief that competition meant plenty of competitors. There was an undercurrent in some but not all of the Berger Court cases, that business should presumptively be left free to do what it wished, either on the theory that business freedom tends to maximise efficiency or, perhaps, on a theory that greater private freedom is crucial to a free society.

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[19] *International Salt Co v United States* 332 US 392.

[20] *Federal Trade Commission v Motion Picture Advertising Services* 344 US 392.

B. The Chicago School

The shift in attitude towards big business by the Supreme Court coincided with, and was influenced by, the rise of the competition theories developed at the University of Chicago - the Chicago School of antitrust analysis. The Supreme Court even went so far as to acknowledge the influence of the Chicago School in *Continental TV Inc* v *GTE Sylvania.*[21] In this case, Supreme Court reversed *United State* v *Arnold Schwinn & Co*[22] which had held that vertical non-price restrictions were *per se* anti-competitive. The Supreme Court decided instead that vertical non-price restrictions should be subject to a test of reasonableness, relying expressly on the writing of Chicago School commentators for justification of their decision.

The Supreme Court has also stated in recent years that antitrust laws are intended to protect competition and not individual competitors;[23] and that economic values are to be accorded predominant if not exclusive weight as compared with social and political values.[24] Additionally, following the lead of the Supreme Court, lower courts have also been increasingly tolerant of vertical restraints,[25] co-operative arrangements and joint ventures among competitors[26] and mergers.[27]

The Chicago School thinking is based on the neo-classical economic theory viz, that free market forces will automatically result in the most efficient allocation of scarce resources. The Chicago School believes that allocative efficiency, or wealth

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[21]433 US 36 (1977).

[22]388 US 365 (1967).

[23]Eg *Reiter* v *Sonotone Corp* 442 US 330 (1979); *FRC* v *Indiana Federation of Dentists* 106 S Ct 2009 (1986); *Aspen Skiing Co* v *Aspen Highlands Skiing Corp* 472 US 585 (1985); *Fishman* v *Estate of Wirtz* 807 F 2d 742 (7th Cir 1986).

[24]Eg *National Society of Professional Engineers* v *United States* 435 US 679 (1972).

[25]Eg *Valley Liquors Inc* v *Rentifeld Importers Ltd* 822 F 2d 656 (7th Cir 1987); *Assam Drug Co* v *Miller Brewing Co* 789 F 2d 311 (8th Cir 1986); *Westman Commission Co* v *Hobart International Inc* 796 F 2d 1216 (10th Cir 1986).

[26]Eg *National Bancard Corp* v *VISA USA* 779 F 2d 592 (11th Cir 1986); *Rothery Storage & Van Co* v *Atlas Van Lines Inc* 792 F 2d 210 (DC Cir 1986) cert denied 107 S Ct 880 (1987); *Polk Bros Inc* v *Forest City Enterprises Inc* 776 F 2d 185 (7th Cir 1985).

[27]*United States* v *Siemens Corp* 261 F 2d 499 (2nd Cir 1980); *Stroh Brewing Co* v *Malmgren* 1982-1 Trade Cas (CCH) par 64, 670 (WD Wis 1982); *United States* v *Black & Decker Manufacturing Co* 430 F Supp 729 (D Md 1976).

maximisation, regardless of its distributional effects, should be the only goal of competition law, and that price theory is the only useful tool for determining whether wealth is being maximised. Consequently, the Chicago School, using price theory analysis de-emphasises market structure, "concentration", and "barriers to entry"; and make allocative efficiency the exclusive antitrust policy objective. Political and social values, such as the protection of small traders and the deconcentration of markets, are rejected. The market is assumed to have perfect information about profit-making and cost-saving opportunities; and entry barriers are low. The market is better suited than the courts in correcting market imperfections as well as the effects of anti-competitive and predatory behaviour.

The key ideas of the Chicago School were formulated by Aaron Director in the 1950s[28] and elaborated by commentators such as Bowman, Bork, McGee and Telser.[29] These scholars had made the following observations of the American economy:[30]

(a) A tie-in, i.e. requiring a buyer to buy a second product as the condition of buying the first, is not a rational method of obtaining a second source of monopoly profits. This is because an increase in the price charged for the tied product will, as a first approximation, reduce the price that the purchaser is willing to pay for the tying product. A tie-in makes sense only as a method of price discrimination, based on the fact that the amount of the tied product bought can be used to separate purchasers into more or less elastic demanders of the tying product.

(b) With regards to vertical integrations, it made no sense for a monopoly producer to make take over distribution

[28]Eg Director & Levi "Law and the Future: Trade Regulations" (1956) 51 *Nw U L Rev* 281.
[29]Eg Bork "Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception"(1954) 22 U *Chi L Rev* 157; Bowman "Tying Arrangements and the Leverage Problem" (1957) 67 *Yale LJ* 19' McGee "Predatory Price Cutting: The Standard Oil" (NJ) Case 1 (1958) *JL & Econ* 137; Telser "Why Should Manufacturers Want Fair Trade?" (1960) 3 *JL & Econ* 86.
[30]Richard A Posner "The Chicago School of Antitrust Analysis" (1979) 127 *University of Pennsylvania Law Review* 925 at 926-928.

in order to earn monopoly profits at the distribution as well as the manufacturing level. The product and its distribution are complements, and an increase in the price of distribution will reduce the demand for the product. Assuming that the product and its distribution are sold in fixed proportions, the conclusion is reached that vertical integration must be motivated by a desire for efficiency rather than for monopoly.

(c) Price discrimination does not aggravate a monopoly. Instead, it is often used as a device by which the monopolist in effect seeks to serve additional consumers i.e. those having the more elastic demands, who might be deterred by the single monopoly price that would be charged in the absence of discrimination. Thus, price discrimination brings the monopolist's output closer to that of a competitive market and reduces the mis-allocative effects of monopoly.

(d) Resale price maintenance is not as unmeritorious as it seems. By preventing price competition among dealers, resale price maintenance encourages dealers to offer consumers pre-sale services such as sale advertising, inventory, showroom display and knowledgeable sales personnel, up to the point at which the cost of these services at the margin just equals the price fixed by the manufacturer. Such services enhance the value of the manufacturer's product to consumers and hence the price he can charge the dealers might not be provided if price competition among dealers were permitted.

(e) Selling below cost in order to drive out a competitor is unprofitable even in the long run, except in the unlikely case in which the intended victim lacks equal access to capital to finance a price war. The predator loses money during the period of predation and, if he tries to recoup it later by raising his price, new entrants will be attracted, causing the price to be bid down to a competitive level, and the attempt at recoupment will fail. Most alleged instances of below-cost pricing must, therefore, be attributable to factors other than a desire to eliminate competition.

> The same thing was observed for other methods by which firms were thought to hurt others by hurting themselves - for example, by demanding that purchasers sign longer-term contracts than they desire, in order to deny a market to competing sellers; a rational purchaser would demand compensation for accepting such a disadvantageous term.

From their observations, the scholars concluded that firms cannot in general obtain or enhance monopoly power by unilateral action, unless they were irrationally willing to trade profits for position. Consequently, the focus of the antitrust laws should not be on unilateral action but on cartels and horizontal mergers large enough either to create a monopoly directly or to facilitate cartelisation by drastically reducing the number of significant sellers in the market. Such a conclusion was significant because unilateral action had been the cutting edge of antitrust policy for a great many years.

Based on the above observations and conclusions, the Chicago School began to formulate the argument that the exclusive goal of antitrust laws should be the pursuit of economic efficiency and the tool to use for this objective should be the neo-classical price theory model. The following are some of the elements of the neo-classical price theory model which are of particular importance to the Chicago School:[31]

(a) Economic efficiency consists of two relevant parts; allocative efficiency i.e. the effective allocation of resources and manufactured products by the market, and productive efficiency i.e. the efficient production of goods and services by the relevant producers. Occasionally, practices that increase a firm's productive efficiency may reduce the market's allocative efficiency. For example, construction of a large plant and acquisition of a large market share may increase a firm's productive efficiency by enabling it to achieve economies of scale; however, these actions may simultaneously reduce allocative efficiency by fa-

[31]H Hovenkamp "Antitrust Policy after Chicago" (1985) 84 *Michigan Law Review* 213 at 226-229.

cilitating monopoly pricing. Be that as it may, if consumer welfare does not suffer as a result of this, the practice which creates the productive efficiency should be allowed.[32]

(b) Most markets are competitive, even if they are highly concentrated. Furthermore, product differentiation does not undermine competition. As a result, neither high market concentration nor product differentiation are anti-competitive.

(c) Monopolies, where they exist can be self-correcting. The monopolist's higher profits will attract new entries into the monopolist's market, with the result that the monopolist's position is eroded. The judicial process merely quickens the correction process. Where possible, the state should play the role of a neutral umpire.

(d) Natural barriers to entry are more imagined than real. As a general rule investment will flow into any market where the rate of return is high. The one significant exception consists of barriers to entry that are not natural i.e. barriers that are created by governments. Most markets would be better off if governments left entry and exit unregulated.[33]

(e) Economies of scale are far more pervasive than economists once believed, largely because earlier economists looked only at intra-plant or production of economies, and neglected economies of distribution. Consequently, many more industries than were formerly thought of operate economically at fairly high concentration levels.

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[32]According to Robert Bork, one of the adherents of the Chicago School, "the whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare". : *The Antitrust Paradox* (Basic Books, New York 1978) at 91.

[33]The debunking of the notion that the world is filled with natural entry barriers is one of the significant accomplishments of the Chicago School. The Chicago School perceived that barriers, when they exist, are generally artificial, created by either the government or else by the dominant incumbent firms.

(f) Business firms are profit-maximisers. Their managers generally take decisions they anticipate will make the firm more profitable. Be that as it may, the Chicago School adherents also argue that even if many firms are not profit maximisers, but are motivated by some alternative goal, such as revenue maximisation or sales maximisation, the neo-classical model is not undermined. The integrity of the market efficiency model requires only that a few firms be profit-maximisers. In that case, the profit and market shares of these firms will grow at the expense of other firms in the market.

Premised on the neo-classical market efficiency model the Chicago School's thesis is that governments should not be concerned with the distribution of wealth or entitlement. This is the task of the market. Antitrust enforcement should be designed in such a way as to penalise conduct precisely to the point that it is inefficient, but to tolerate or encourage it when it is efficient. In this state, wealth and the means of production go to where they will do the most net good.

Criticism of the traditional approach towards antitrust regulation was not limited to Chicago School adherents. Economists who did not subscribe to the Chicago School also criticised the courts and the enforcement agencies for failing to recognise distribution and production efficiencies, notably transaction cost efficiencies;[34] and also counselled a more permissive position towards practices such as the exercise of intellectual property rights because of efficiencies.[35]

C. The Traditionalists

This "new learning" fomented by the Chicago School was in turn criticised by traditionalists. The traditionalists argued that the Chicago School's exclusive emphasis on allocative efficiency

[34]Eg Williamson, "Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transactions Cost Approach" (1979) 127 *U Pa L Rev* 953.

[35]Eg Lipsky "Current Antitrust Division Views on Patent Licensing Practices" (1981) 50 *Antitrust LJ* 515.

is inappropriate because economic terms can mask political values and judgments, and the Chicago School's assertion of allocative efficiency as the exclusive antitrust standard rests on political rather than economic grounds.[36] Furthermore, it has been argued by the traditionalist that the Chicago School approach underestimates the dynamic aspects of many business practices, particularly strategic behaviour like price and non-price predation.[37] For example, predation through reputation as a price predator and false signalling of costs may be viable and rational strategies that perhaps should be judged under legal standards different from the cost-based rules accepted or applied by the majority of US courts. As to non-price predation, it is argued that predation and exclusion of competitors may be rationally and profitably accomplished through raising rivals' costs. Raising rivals' costs may be more credible than traditional predatory pricing claims for several reasons that avoid Chicago School objections. The strategy does not necessarily impose higher costs on the predator than on the victims and the strategy does not require a long period of recoupment of the initial investment in the predation strategy.[38] An assemblage of these criticisms of the "new learning" follows.[39]

1. Efficiency

The neo-classical efficiency model is designed to identify the pre-requisites for efficient market performance, and to explain

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[36]Eg Eleanor Fox "The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window" (1986) 61 *NYUL Rev* 554.

[37]Eg Kaplow "Extension of Monopoly Power Through Leverage" (1985) 85 *Colum L Rev* 515; Krattenmaker & Salop "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price" (1986) 96 *Yale LJ* 209; Williamson "Antitrust Enforcement: Where It's Been, Where It's Going" (1987) 27 *St Louis ULJ* 289.

[38]Ordover "What the 'New Learning' Has to Offer" 1987 *Antitrust Magazine* 5 (July).

[39]For detailed critique see: Walter Adams and James W Brock "The New Learning and the Euthanasia of Antitrust" (1986) 74 *California Law Review* 1515; Frank H Easterbrook "Workable Antitrust Policy" (1986) 84 *Michigan Law Review* 1696; Herbert Hovenkamp "Antitrust Policy After Chicago" (1985) 84 *Michigan Law Review* 925; Hovenkamp "Rhetoric and Skepticism in Antitrust Argument" (1986) 84 *Michigan Law Review* 1721; Richard A Posner "The Chicago School of Antitrust Analysis" (1979) 127 *University of Pennyslvania Law Review* 925; Ricahard R Nelson "Comments on a Paper by Posner" (1979) 127 *University of Pennsylvania Law Review* 949.

how deviations from perfect competition affect market efficiency. As a tool for policy making however, it fails for two reasons. Firstly, the model's definition of efficiency differs from any concept of efficiency that can realistically be applied to policy making in the real world; and secondly, efficiency cannot be the only relevant factor in real world policy making.

a. *The Concept of Efficiency*

The term efficiency when used by an economist may mean either productive efficiency or allocative efficiency. Productive efficiency is a ratio between the amount of a firm's input and the amount of its output. Hence, a firm that can produce an item worth one dollar with an input of eighty cents is more efficient in this sense than a firm that requires an input of ninety cents to produce the same item. Allocative efficiency on the other hand is a much more global kind of efficiency than productive efficiency. Allocative efficiency refers to the welfare of society as a whole. Hence, a particular situation will be more allocatively efficient than another if under the former situation people as a group are somehow better off than they would be under the latter situation.

Within the Chicago School paradigm, productive efficiency is not perceived to be a dominant concern of the antitrust laws. Productive efficiency is not so much encouraged as it is tolerated. For example, the Chicago School refuses to make increases in productive efficiency a reason for condemning certain practices; and will approve of practices that do not increase a firm's market power but increase productive efficiency.[40] It is the market, not the antitrust laws, which punishes productive inefficiency by loss of profits, loss of market share, or in extreme cases, forced exit from the market. If a firm engages in a practice that raises its own costs above those of its competitors, that should be of no concern to the antitrust laws, unless the practice also increases the firm's market power or raises the overall price level in the market.

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[40] R Bork *The Antitrust Paradox: A Policy at War with Itself* (1978) at 91.

It is the contention of the Chicago School that the exclusive goals of the antitrust laws should be the maximisation of allocative efficiency.

To determine allocative efficiency, the Pareto approach is used. Under the classic Pareto definition,[41] a situation is efficient or "Pareto optimal" where no change in a particular situation could actually make someone better off without making another worse off. Hence, a situation is "Pareto superior" if a move in a particular situation makes at least one person better off without making another person worse off.

The shortcoming of the Pareto definition of allocative efficiency is that it is too unrealistic. If imposed on efficiency-based policy making, its conditions can virtually never be fulfilled. Nearly all policy changes fail to be allocatively efficient under the Pareto test. For example, the adoption of a rule condemning theft is not a Pareto superior move from a situation where it is tolerated. This is because the thieves would be made worse off by the rule change. Nevertheless, society as a whole would benefit from the rule.

As the result of the practical limitations of the Pareto efficiency criterion, the Chicago School advocates recourse to a "potential" Pareto superiority to gauge the circumstances in which government regulation may be required to overcome failures in the market mechanism. It is this test which the Chicago School adopts in the event of market failure to assess whether government regulation is warranted. A change has "potential" Pareto superiority if the gains experienced by those who gain from the change are larger than the losses experienced by those who lose due to the change. Such a change is "potential" because it could be turned into actual Pareto efficiency if the gainers were to compensate the losers out of their gains. If that occurred, the losers would be no worse off as they would be fully compensated; and the gainers may still be better off as they may have something left over after the payment of compensation. There

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[41] Named after Vilfredo Pareto who first formulated this notion in his work "Manuel D'Economie Politique" (1909).

is no requirement, however, that the gainers actually compensate the losers. It is sufficient that the gainer could compensate the losers and still have some gains left over.

The potential Pareto effciency test, however, has it own shortcomings. The orthodox Pareto efficiency test, which is seldom or never satisfied made changes relatively easy to identify. A change was a Pareto improvement if no one objected to it. On the other hand, if at least one person objected, then the change was presumptively not Pareto superior. The potential Pareto criterion, however, requires the policy maker not only to identify all those who gain and lose from a particular change, but to quantify their individual gains and losses, total them and then net these totals out against each other in order to determine whether the net effect is a social gain or a social loss. Even if welfare could be measured in dollar terms, it is unlikely that policy makers would be up to the task.

Furthermore, the market efficiency model is static in that it fails to take into consideration the many complexities of measurements in the real world. In a market economy, every change imposed on one market affects dozens of other markets as well. The allocative effects of monopolies in multiple markets may tend to cancel each other out. In that case, it is not all clear that the elimination of a monopoly in a single market will be Pareto efficient.

The market efficiency model also fails to take account of preferences that people do not express with their dollar - for example, a distrust of large concentration of economic or political power in private hands, or perhaps even a preference for more expansive opportunities for small business. The Chicago School treats such goals as non-economic i.e. as goals that have nothing to do with the public welfare; and as such should not be included in the cost-benefit calculus. This reasoning is faulty. People do value goals such as the diffusion of privately held economic or political power or the preservation of small business oppotunity. Constant references to these goals in political debates is certainly evidence of this. The concept of allocative efficiency or wealth maximisation must include everything to which people assign a value. If a regime of small businesses is worth anything to anybody, then it deserves to be calculated into the equation off-setting the cost and benefits of a given antitrust policy. The presumption made by the market efficiency model is that consumer behaviour is the best guide to allocative efficiency works only when consumers can be forced to pay for everything they receive. It fails because it does not consider values that are not reflected in consumer choices in the market place.

b. *Efficiency As The Only Goal*

The broadest statement of the Chicago School position and public policy is that all policy making by the State should be concerned exclusively with allocative efficiency. A narrower statement is that antitrust policy should be concerned exclusively with efficiency. In either case, the government should abandon its concern with how wealth is distributed.

The problem with this general policy of maximising efficiency while ignoring distributive concerns is that it meets with one obstacle, that is that the "efficient" allocation of resources in any society substantially a function of the way that society's wealth is distributed initially. For example, if members of a society of one hundred people are all given equal amounts of wealth, and then commence a process of exchange that will yield an efficient outcome, the outcome will be different from what it would be if one person in that society had been given ninety percent of the wealth with the other ninety-nine holding the remaining ten percent equally. This is because the amount of wealth that someone has affects his priorities. The wealthy, for example, may place high values on expensive jewellery while the poor a high value on bread. In these circumstances, the poor may actually bid bread away from the wealthy who would probably show very little interest in it.

The Chicago School argues that a market is efficient or generates efficient solutions where people express preferences as a function of the position they find themselves in. Hence, people with wealth, including wealth caused by a monopoly, express different preferences from people who are poor. But so far as allocative efficiency is concerned, one initial distribution is as good as another. The result is that unless there is a policy for the equitable distribution of wealth to begin with, a policy based on efficiency alone will result in the wealthy having their position entrenched and the poor remaining poor.

2. The Viability of the Neo-classical Efficiency Model

Another shortcoming of the neo-classical efficiency model is that even if efficiency should be the exclusive goal of antitrust enforcement, the model itself is not sophisticated enough to describe or predict the consequences of real world behaviour. There is too much reliance on static concepts of the market in empirical situations where only dynamic concepts will explain behaviour or results; and a failure to appreciate fully the extent and welfare consequences of strategic behaviour.

a. *The Empirical Approach of the Model*

The neo-classical price theory model measures the effects of certain practices on price or output given a premise that the market being examined is unaffected by external events. This is unrealistic as real world markets are always affected by a complex array of external influences. The application of a static model like this to a real world market often causes a court to ignore the obvious. A case in point is *Kartell* v *Blue Shield*.[42]

In *Kartell*, Blue Shield, a large health insurer in the US with a market share approaching monopoly levels, had created a system under which participating doctors agreed to accept Blue Shield's published reimbursement rates as their total payment for a specified medical procedure. For example, if Blue Shield paid $100 for a covered procedure, a doctor participating in the plan could not charge $120 and force the patient to pay the difference. The result was that a patient who went to a participating physician knew that his insurance policy would provide coverage.

In addressing the question whether the Blue Shield's plan amounted to illegal monopolisation, the Circuit Court concluded that Blue Shield was a purchaser of physicians' services on behalf of its clients.[43] This raised the possibility that Blue Shield's ban on balance billing might be an exercise of monopsony power viz. that Blue Shield may have been using its buying power in the market for health care services to force the price below the

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[42] 749 F 2d 922 (1st Cir 1984), cert denied, 105 S Ct 2040 (1985).
[43] *Ibid* at 925-26.

price that would prevail in an unrestrained, competitive market. The result would be that the supply of physicians' services would be reduced below the competitive equilibrium. When a monopsony buyer reduces its outlay to the profit-maximising level, the result will be reduced output of the monopsonised product. This only means however that the absolute supply of the monopsonised product will decrease if all other elements of the market remain unaffected during the period in which the market becomes monopsonised. The evidence revealed, however, that the supply of doctors in the market area had increased steadily during the period covered by the litigation[44] and as such, the reasoning must be wrong. The error derives from the premise that the market was completely static during the relevant period, but for the alleged violation.

Not only is the assumption of a perfectly static market unwarranted, but it is also impossible for a court to identify and measure the degree to which the market changes i.e. the degree to which all factors external to the market causes the supply of doctors to increase or decrease. For example, during the relevant time period, Blue Shield's monopsony may have tended to reduce the supply of doctors or of medical services offered. Be that as it may, hundreds of other factors might have encouraged the supply of doctors to increase during the same period; for example, higher income by medical patients in the relevant market area, a high rate of illness in the relevant market area or a general population increase.

b. *Strategic Behaviour*

Strategic behaviour is conduct designed by one party to reduced the attractiveness of the offers made by its competitors. Not all strategic behaviour is socially harmful, and much is competitive e.g. product improving research and developments which reduces the relative attractiveness of the offers against which the innovating firm must compete. In general, however, strategic behaviour is harmful and raises antitrust concerns because it reduces the attractiveness of the offers of competitors without

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[44] *Ibid* at 927.

producing substantial gains in the productive efficiency of the firm which initiated the strategy. When socially harmful strategic behaviour is successful, the firm engaging in that behaviour earns monopoly profits with competitors and customers paying the bill.

The static market fallacy and the failure of orthodox Chicago School antitrust policy to take strategic behaviour seriously are closely related weaknesses in the market efficiency model. Both errors result from the model's failure to appreciate time and change, and the havoc these factors play with the economist's idea of competitive equilibrium, which exist nowhere in the real world, or at least not for long. Take for instance the neo-classical market model's proposition that firms always concentrate on the long term returns of their investments, and that assets are freely transferable in any given market.

The market efficiency model tends to look at markets over the long run, over which they generally appear to behave competitively. The "long run" refers to a period that is sufficiently long enough for a firm to make decisions on issues such as what size plant to build and where to build it. Over the long run, firms will tend to build plants of optimal size which are efficiently distributed throughout the market. As a result, over the long run, firms will be forced to operate efficiently or to exit from the market. Similarly, over the long run, new firms will enter a monopolised market and bring it into competitive equilibrium.

There are markets in which the long run is indeed very long. For example, a steel mill or chemical plant can easily have a life expectancy of forty years. More often than not, however, in the real world firms are often committed to short run investments in assets the costs of which cannot be fully recovered. The firms do not have the luxury of dwelling exclusively on the long run. They must deal with a previously made decision about plant size and location. Often it is cheaper to operate the existing plant, in spite of possible inefficiencies, than to get rid of the plant and build a bigger or better one, or one that is located in a better place.

As for the proposition that assets are freely transferable, in reality, many fixed costs are not freely transferable from one firm to another. Firms must constantly deal with the problem of "sunk" costs i.e. costs that simply cannot be recovered if a firm exits from the market.[45] Every entry into a new market entails a certain amount of sunk cost, although the extent of sunk costs varies from one market to another. The extent of sunk costs depends on whether the firm exiting the market will be able to sell everything, including its goodwill to a successor or whether it must take its productive capacity out of use entirely. For example, the restaurant owner who goes out of business may be able to transfer everything to a successor, including his built-up investment in name recognition, if the successor assumes the previous firm's name and method of doing business. If the liquor licence is not transferable, however, the old firm's expense in obtaining the license will be sunk i.e. it will have to be borne by the original firm.

In the real world therefore, the extent of sunk costs will influence a firm's decision about when to exit. Many firms will continue to produce as long as it is covering its average variable costs, even if it is losing money because its earnings do not cover its sunk costs. Exit only becomes the best alternative when the business becomes profitable and there is another firm willing to assume the vendor's entire capital commitment.

Although the impact of sunk costs is felt most strongly when the firm exits from a certain market, a rational firm will also consider the extent of these costs when it makes a decision to enter. The cost of exit from the market thence acts as a barrier to entry. For example, in a market in which capital flows freely into profitable areas, the fact that it costs $10 million to enter the market is not nearly as important as the fact that only ten percent of those costs can be recovered if the investment proves unprofitable and exit becomes necessary.

IV. THE EFFECT OF THE "NEW LEARNING" ON THE EEC

The most immediate effect of the revolution in US economic thought is the increasing arguments and assertions faced by the Commission and the European Court of Justice (ECJ) based on

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[45]Sunk costs are distinguished from capital costs. The latter is what a firm must spend in entering a new market but which it will be able to recover when it decides to exit.

Chicago School analyses. Efficiency consideration arguments abound. Further evidence of the "new learning's" influence is the softening in the last few years of the EEC's position towards patent and know-how licensing which has allowed for greater competition and the flow of information between Member States.[46]

In general, however, the Commission and the ECJ have largely resisted the Chicago School approach; and the revolution in US law is not likely to be duplicated in the EEC. This is primarily because the policy and textual difference between EEC and US laws constrain a complete embrace of the Chicago School. The US statutes are more vaguely worded allowing for greater judicial law making. The EEC statutes on the other hand are more specific and defined. This, coupled with the subjugated role of judges in the civil law tradition of continental Europe, does not allow for a more liberal reading of the statutes.

The inclusion of distributive concerns, fairness and other social and political values in EEC competition policy makes it also almost inconceivable that the EEC will ever embrace allocative efficiency as the exclusive policy standard. The market integration goal will continue to trump short-term efficiency arguments.

V. THE "NEW LEARNING" AND AUSTRALIA

Australia in contrast has been most receptive to all the new developments and has sought to be eclectic; choosing the best, in its view, from the EEC and the US and transplanting them here. The following is a study of the influences of EEC law, US law and the "new learning" in Australia. Attention will focus on their influences on sections 46 and 50 of the TPA.[47]

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[46]See: B Hawk, "United States, Common Market and International Antitrust" (1987) Ch II.

[47]S 46(1) of the TPA provides that:

> A corporation that has a substantial degree of power in a market shall not take advantage of the power for the purpose of -
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> (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.

S 50(1) of the TPA provides that:

> A corporation shall not acquire, directly or indirectly, any shares in the capital, or any assets, of a body corporate if -

With sections 46 and 50, the common element which must be satisfied is the identification of the relevant market. After that the courts, the Trade Practices Tribunal (the Tribunal) or the Trade Practices Commission (the TPC) must determine whether, in the case of section 46, a substantial degree of market power exists and there is a taking advantage of that power to distort or eliminate competition in the market. In the case of section 50, the task of the courts, the Tribunal or the TPC is to determine whether the acquisition of shares or assets of a body corporate by an entity would cause that entity to dominate the relevant market.

The difference between sections 46 and 50 is that an offence against section 46(1) is only committed when a corporation takes advantages of the substantial power it possesses in a market for a proscribed purpose. With section 50(1), the domination of a market is at the very heart of its prohibitions.

As it is the common element in both sections 46 and 50, an analysis of the European and American influences on the concept of "market" will be conducted first followed by an examination of their influences on the other pertinent elements of sections 46 and 50.

A. Market

Under the TPA, a "market" means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first mentioned goods or services.[48] This definition in the TPA is in line with the definiton enunciated by the Tribunal in *Re Queensland*

(a) as a result of the acquisitions, the corporation would be, or be likely to be, in a position to dominate a market for goods or services; or

(b) in a case where the corporation is in a position to dominate a market for goods or services -

(i) the body corporate or another body corporate that is related to or associated with that body corporate is, or is likely to be, a competitor of the corporation or a body corporate that is related to or associated with the corporation; and

(ii) the acquisition would, or would be likely to, substantially strengthen the power of the corporation to dominate that market.

[48]S 4E TPA.

Co-op Milling Association Ltd and Defiance Holding Ltd.[49] In this case, the Tribunal said that it considered the concept of a market to be a simple idea, and went on to elaborate on this by holding that:

> A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them ... Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transaction between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. Let us suppose that the price on one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another. As well, on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance and cost and price incentives.
>
> It is the possibilities of such substitution which set the limits upon a firm's ability to 'give less and charge more'. Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were 'to give less and charge more' would there be ... much of a reaction? And if so, from whom? ... From which products and which activities could we expect a relatively high demand or supply response to price change, i.e. a relatively high cross elasticity of demand or cross elasticity of supply.[50]

This test of substitutability for the market of goods or services was elaborated on by the Tribunal in *Re Tooth & Co Ltd; Re Tooheys Ltd.*[51] The tribunal in this case identified several elements of a market. Two of the more important elements are firstly, the cross-elasticity of demand and supply for a product or service; and secondly, the time element. In the words of the Tribunal:

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[49](1976) 25 FLR 169.
[50]*Ibid* at 190.
[51](1979) ATPR 40-113.

> ... competition [in a market] may proceed not just through the substitution of one product for another in use (substitute in demand) but also through the substitution of one source of supply for another in production or distribution (substitution in supply). A market should comprehend the maximum range of business activities and the widest geographic area within which, if given a sufficient economic incentive, buyers can switch to a substantial extent from one source of supply to another and sellers can switch from one production plan to another. In an economist's language, both cross-elasticity of demand and cross-elasticity of supply are relevant.
>
> It is [also] plain that the longer period allowed for likely customers and supplier adjustments to economic incentives, the wider the market is delineated. In our judgment, given the policy objectives of the legislation, it serves no useful purpose to focus attention upon a short-run, transitory situation. We consider we should be basically concerned with substitution possibilities in the longer run. This does not mean we seek to prophesy the shape of the future - to speculate upon how community tastes, or institutions, or technology might change. Rather, we ask of the evidence what is likely to happen to patterns of consumption and production were existing suppliers to raise price or, more generally, offer a poorer deal. For the market is the field of actual or potential rivalry between firms.[52]

This economic approach to market definition is now well established in Australia. The test of substitution extending to both the demand and the supply side of the market, for instance, was confirmed by the High Court in *Queensland Wire Industries Pty Ltd* v *BHP*.[53] In that case, Dawson and Toohey JJ emphasised the importance of both demand and supply side substitutability in their judgment. According to Dawson J:

> A market is in an area in which the exchange of goods or services between buyer and seller is negotiated. It is sometimes referred to as the sphere within which price is determined and that serves to focus attention upon the way in which the market facilitates exchange by employing price as the mechanism to reconcile competing demands for resources ... In setting the limits of a market the emphasis has historically been placed upon what is referred to as the 'demand side', but more recently the 'supply side' has also come to be regarded

[52] *Ibid* at 18, 196-7.
[53] (1988) 167 CLR 177.

> as significant. The basic test involves the ascertainment of the cross-elasticities of both supply and demand, that is to say, the extent to which the supply of or demand for a product responds to a change in the price of another product. Cross-elasticities of supply and demand reveal the degree to which one product may be substituted for another, an important consideration in any definition of a market.[54]

Toohey J noted that:

> The introduction of section 4E followed a recommendation of the Swanson Committee that the definition of 'market' be extended 'to require that, in the determination of a market for particular purposes, regard shall be had to substitute products, being products which have a reasonable interchangeability of use and which have high cross-elasticity of demand, i.e. where a small decrease in the price of a particular product would cause a significant quantum of demand for a similar product to switch to the product in question' ... But this does not mean that supply substitutability is irrelevant to the task of market definition ... Rather, the definition of the relevant market requires a consideration of substitutability both on the demand and on the supply side.[55]

A. The European Influence

In *Queensland Wiré*, three ECJ decision viz., *Europemballage and Continental Can* v *Commission of the European Communities*,[56] *United Brands* v *Commission of the European Communities*,[57] and *Hoffmann-La Roche* v *Commission of the European Communities*[58] were referred to and relied upon by the majority of the Bench[59] to support the view on the fundamental element of a market is substitutability. This is in keeping with what was stipulated in the Explanatory Memorandum which accompanied the Trade Practices Revision Bill 1986 (Cwth). This required

[54] *Ibid* at 199.
[55] *Ibid* at 210.
[56] [1973] CMLR 199.
[57] [1978] 1 CMLR 429.
[58] [1979] 3 CMLR 211.
[59] The three Justices were Mason CJ, Wilson and Toohey JJ. Mason CJ and Wilson J referred to all three decisions in their joint judgment whilst Toohey J only referred to *Continental Can*.

that in interpreting the ambit of section 46, an approach similar to that taken in the three ECJ cases is to be adopted. The formal recognition of these cases by the High Court is significant because of the fact that firstly in Australia there were precedents for the definition of a market; and secondly, although section 15AB of the Acts Interpretation Act 1901 (Cwth) allows the use of Explanatory Memoranda to discover the purpose or object of an Act, there is no requirement that authorities they refer to be adopted. Additionally, these cases are not even drawn from a common law jurisdiction, the sources from which the High Court traditionally draws its authorities.[60] The adoption of these cases brings into Australian jurisprudence the ECJ's interpretation of certain elements of competition which are also found in Australian trade practices law. In light of the significant impact these three ECJ cases will have on Australian law, it is prudent that they be examined in greater detail.

In *Continental Can*, Continental Can held 85 per cent of the shares in the West German company, Schmalbach, and through this subsidiary the Commission asserted Continental Can was enjoying a dominant position in West Germany in respect of a market for light metal containers for canned meats; a market for light metal containers for canned seafood; and a market for metal closures other than crown corks. Continental Can challenged this decision of the Commission in the ECJ arguing that the Commission had defined the concept of market too narrowly. There was only one market, that for light metal containers. The

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[60]S 2(1) of the United Kingdom's European Communities Act 1972 ("the ECA") provides that all rights and liabilities which are in accordance with the EEC treaty are to be given legal effect in the UK and are to be recognised and available in the UK. Furthermore, s 3(1) of the ECA provides that for the purposes of all legal proceedings, any question as to the meaning or effect of the EEC Treaty shall be treated as questions of law and determined in accordance with the principles laid down by relevant decision of the ECJ.

In two House of Lord's cases viz, *Rio Tinto Zinc Corpn* v *Westinghouse Electric Corpn* [1978] AC 547 and *Garden Cottage Foods Ltd* v *Milk Marketing Board* [1984] AC 130, their Lordships held that EEC Law is now directly applicable in the UK and enforceable accordingly. It has been inter-woven into the fabric which is the English common law.

Relying on the above state of UK law, it could thus be argued that since EEC Law is part of UK law, and the UK is the traditional source of Australia's law, the High Court in *Queensland Wire* was still complying with convention.

Commission, it was contended, failed to take into account supply substitutability i.e. the ability of other firms to shift their facilities from producing one product e.g. cylindrical cans to producing and selling another product such as the cans for meats and seafood. The ECJ allowed Continental Can's appeal holding that:

> the [Commission did not] state in detail the peculiarities which distinguish [the three] markets from one another and therefore necessitate their separate treatment. Nor is it stated by what peculiarities these three markets are distinguished from the general market for light metal containers, especially the market for canned fruit and vegetables, condensed milk, olive oil, fruit juices and toilet preparations. However, it can be assumed that the products in question have a special market only if they can be individualised not only by the mere fact that they are used for packaging certain products but also by special production characteristics which give them a special suitability for this purpose.[61]

In *Continental Can*, the focus was on supply substitutability. In *United Brands* the ECJ concentrated on demand substitutability. The Commission was of the view that there was a separate banana market in the EEC, and found evidence to the effect that this market was dominated by United Brands. The arguments before the court turned on whether there was indeed a separate banana market or whether there was only a fruit market, with bananas as one of the fruit available. This point was crucial to United Brands because if there was a wider market, it could not be said to be dominating it as there were other, and sometimes larger, general fruit suppliers. The issue before the ECJ was whether United Brand was in a dominant position in the banana market. The ECJ after hearing the arguments held that:

> For the banana to be regarded as forming a market which is sufficiently differentiated from other fruit markets it must be possible for it to be singled out by such special features distinguishing it from other fruits that it is only to a limited extent interchangeable with them and is only exposed to this in a way that is hardly perceptible.[62]

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[61] [1973] CMLR 199 at para 33.
[62] [1978] 1 CMLR 429 at para 22.

The ECJ noted that there was a considerable weakening of banana prices in the summer months because of the increasing availability of seasonal fruits such as table grapes and peaches, but nevertheless held that the banana market was a separate market in its own right and rejected the notion that it should be considered as part of the fruit market as a whole. In reaching this conclusion, the ECJ noted that the banana has certain characteristics such as appearance, taste, softness, seedlessness, easy handling and a constant level of production which enabled it to play an important part in the diet of a significant section of the population consisting of the very young, the old and the sick. The constant needs of such consumers and the limited possibilities of substitution by oranges and apples justified the recongition of a separate market.

In *Hoffmann-La Roche*, the Commission claimed that Roche had a dominant position in respect of each of seven groups of vitamins viz., vitamins A, B2, B3, B6, C, E and H. It was conceded by Roche that each of the vitamin groups had specific metabolising functions, and as such they were not interchangeable with one another and constituted a separate product market. Two of the groups of vitamins however viz. C and E, were supplied for technological applications as anti-oxidants and fermentation agents, in which they were in competition with other products. Roche argued that the sales of all those other products ought to have been included within the relevant markets and that by failing to do so, the Commission had exaggerated Roche's share for vitamins C and E. The ECJ had to decide whether to exclude these other products from the relevant product markets, thereby understating total sales and, maybe, leaving certain suppliers out of account, or to introduce a range of other products which were not substitutable for vitamins in their principal bio-nutritive applications, only in their technological application.

The ECJ rejected Roche's argument about the definition of the relevant product market for vitamins C and E and held that:

> The concept of the relevant market in fact implies that there can be effective competition between the products which form part of it and this presupposes that there is a sufficient degree of interchangeability

between all the products forming part of the same market in so far as a specific use of such products is concerned.[63]

2. The Chicago School's Definition of Market

The Chicago School differs very little from the traditionalist on the definition of a market so far as the test of substitutability goes. Substitutability, however, is not the only element to consider when considering the limits of a market. Another consideration is the geography of the market. The purpose of identifying the geography of a market is to establish a geographic boundary that roughly separated those firms that engage in the competitive process and those that do not. It will be noted that under section 4E of the TPA, a market is defined as a market within Australia. And in the three ECJ cases mentioned above, the relevant geographic market was the EEC.

It is in this area that the Chicago School has made an impact. It is argued by the Chicago School[64] that the traditional market definition is unsatisfactory because it results in exaggerated market shares. Only goods produced in a particular geography are considered. The actual or potential output of foreign sellers, wherever they are should be included in the relevant market where non-trivial imports are present, regardless of transport costs. This is because the distant seller has a proven record of sales in the market, and consequently could easily increase sales there to meet demand (as indicated by price increases) by diverting sales from other markets. In the US, this argument succeeded in *Gearhart Industries Inc* v *Smith International Inc*[65] which involved the oil service industry. Here it was held that the defendant's market was substantially smaller than argued by the plaintiff because in the opinion of the court, the relevant geographic market was the whole world and not just the US.

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[63][1973] 3 CMLR 211 at para 28.

[64]The argument is made by WM Landes and RA Posner in "Market Power in Antitrust Cases" (1981) 94 *Harvard Law Review* 937.

[65]F Supp 203 (1984).

This approach also has a following in Australia as was revealed in *Fletcher Challenge Ltd.*[66] In this case, Fletcher Challenge was attempting to acquire 50 percent of the share holding in Australia Newsprint Mills Holdings. The TPC disallowed the acquisition on the grounds that it amounted to a breach of section 50. It was the TPC's view that by this acquisition Fletcher Challenge would dominate the market for the production and supply of newsprint in Australia. Fletcher Challenge argued strenuously but was unable to persuade the TPC to consider import competition and the potential for further import competition in the future. The argument did not succeed here, but with the lowering of tariff barriers generally and, in particular, the liberalising of trade between Australia and New Zealand under the Closer Economic Relations Trade Agreement, this argument could be raised more frequently in the future. If so, no doubt the US authorities will be referred to in support of the arguments.

a. *Global Competition*

The application of the Chicago School's approach to the definition of a market would of course clearly reduce the market share of a local seller to a point where the relevant statutory competition test may not apply. Consequently, as an extension of this approach, it has been argued by the Chicago School that there should be limited or no anti-competitive regulation at all. Since the relevant market is not domestic, industry structure is irrelevant, and the maintenance of domestic competition unnecessary. Global competition more than compensates for a non-competitive industry structure in the domestic market.[67] This assertion certainly contains an element of validity. In the US, for example, Henry O Havenmeyer, the father of the Sugar Trust, a sugar cartel, admitted that were it not for the protective tariff accorded to the sugar industry in the past, the various sugar producers would not have risked forming the trust. But since the business was protected as it was by the tariff, they proceeded with the setting up of the trust.[68]

[66](1988) ATPR (Com) 50-077.

[67]Baldrige "How to Ruin an Entire Industry" *NY Times*, Mar 11 1984.

[68]HB Thorelli *The Federal Antitrust Policy: Origination of an American Tradition* (1955) at 72.

The debate on the merits of this approach is still raging in the US. For a medium sized economy like that of Australia however, to adopt the Chicago School approach and thus to open up its markets to global competition could have dire consequences. Its industries are not in the same league as those in Europe or the US, and an abandonment of competition regulation would only lead to Australian industries being servants of these larger and stronger conglomerate. Domestic competition should be protected until such time as when the local firms acquire the skills, vigour and fortitude to enter the highly competitive overseas market.

Furthermore, the Chicago School argument is flawed in a fundamental respect. It mistakenly presumes global competition to be an automatic, self-sustaining and self-regulating mechanism, a natural phenomenon, immune to subversion and control, to which international rivals passively submit. In reality, global markets, like domestic ones, are susceptible to control. International rivals do not submissively subject themselves to the discipline of global competition for long. Instead, they come to recognise that collusion and co-operation, not competition, are most conducive to their mutual profitability, group security and collective stability. They strive to elude the rigours of global competition and to control the international marketplace through a variety of devices such as international cartels, joint ventures and other co-operative arrangements, as well as through mergers and acquisitions. They may attain global control privately through their own efforts or they may manipulate governments to aid them in achieving their anti-competitive ends. Sir Alfred Mond, the organiser of the chemical conglomerate, Imperial Chemical Industries Ltd (ICI), best articulated these tenents of international business relations between supposed rivals:

> The old idea of the heads of great businesses meeting each other with scowls and shaking each other's fists in each other's faces and ... trying to destroy each other's business may be very good on the films ... but it does not accord with any given facts ... The preferred state of affairs ... is an alliance of companies ... working in harmonious co-operation.[69]

[69] G Stocking & M Watkins *Cartels In Action* (1946) at 429.

Across the Atlantic, a vice-president of Du Pont Industries even admitted that it was not good business sense to attempt an expansion in a certain direction if such an act would result in retaliation by its rivals. Du Pont adopted a deliberate policy of restraint and circumspection:

> ... on the broad theory that co-operation is wiser than antoganism and that in the matter of detail the chances in the long run were that the boot was just as likely to be on one leg as on the other.[70]

A representative of Germany's IG Farben once explained that international rivals are fully cognisant that:

> ... a price war is of benefit only to the consumer, and the maintaining of a certain price level would be to the advantage of all competitive companies. [Rivals are aware that in] any field of manufacture where it appears that the situation makes it desirable to enter each others' market [economic self-interest dictates] we get together and see if we cannot negotiate an arrangement of co-operation.[71]

B. Section 46 - Misuse of Market Power

1. Substantial Degree of Market Power

Section 46(3) sets out the factors to be considered in determining when a corporation has a substantial degree of market power. It provides that:

> In determining for the purposes of this section the degree of power that a body corporate or bodies corporate has or have in a market, the Court shall have regard to the extent to which the conduct of the body corporate or of any of those bodies corporate in that market is constrained by the conduct of:-
>
> (a) competitors, or potential competitors, of the body corporate or of any of those bodies corporate in that market; or

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[70] "Economic Concentration: Hearing Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary", 91st Cong 1st Sess 462 (1962).

[71] C Edwards "Subcomm. on War Mobilisation of the Senate Comm. on Military Affairs" 78th Cong 2nd Sess; *Economic and Political Aspects of International Cartels* (1944) at 12.

(b) persons to whom or from whom the body corporate or any of those bodies corporate supplies or acquires goods or services in that market.

This provision requires the Courts to have regard to the extent to which a corporation and any related bodies corporate is free to determine its own conduct in the market without being consistently inhibited from doing so by others. This is the same approach adopted by the ECJ in *United Brands and Hoffmann-La Roche.*

a. ***The EEC Approach***

In *United Brands*, the ECJ defined market power as:

> ... a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers. In general a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative.[72]

In *Hoffmann-La Roche*, the ECJ stated that the test of market power refers to:

> ... a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.
>
> Such a position does not preclude some competition, which it does where there is a monopoly or a quasi-monopoly, but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment. A dominant position must also be distinguished from parallel courses

[72][1978] 1 CMLR 429 at paras 65-66.

> of conduct which are peculiar to oligopolies in that in an oligopoly the courses of conduct interact, which in the case of an undertaking occupying a dominant position the conduct of the undertaking which derives profits from that position is to a great extent determined unilaterally.[73]

The existence of market power in a market may be derived from several factors such as market share, overall size, technological advantages or superiority, access to capital and raw materials, product and geographic diversification, vertical integration, limited number of purchasers, and a highly-developed and specialised sales network. Taken separately these factors are not necessarily determinative. But among them perhaps the most important is the existence of a very large market share. This is because a corporation which does not have a large market share will not normally have discretionary power in matters such as pricing; its conduct in such matters will generally be constrained by competitors or potential competitors. If it raises its price above the competitive level, existing competitors or new competitors will eventually drive prices down and the corporation in question may suffer badly, especially if its former customers do not renew thier patronage after it has lowered its prices back to the competitive level.

The ECJ recognised this in *Hoffmann-La Roche* where it stated that:

> ... although the importance of the market shares may vary from one market to another, the view may legitimately be taken that the very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time, by means of the volume of production and the scale of the supply which it stands for - without those having smaller market share being able to meet rapidly the demand from those who would like to break away from the undertaking which has the largest market share - is by virtue of that share in a position of strength which makes it an unavoidable trading partner and already because of this secures for it, at the very least during relatively long periods, that freedom of action which is the special feature of a dominant position.[74]

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[73] [1979] 3 CMLR 211 at paras 38-39.
[74] *Ibid* at para 41.

b. *The US Approach*

In the US, the issue of market power has been most prominently discussed in relation to section 2 of the Sherman Act i.e. the section which makes monopolies illegal. The US Supreme Court in *US* v *Grinnell Corp*[75] held that monopoly power was the power to control prices or exclude competition and that the existence of such power can ordinarily be inferred from predominant share of a market. It is however not necessary to show that prices have in fact been raised and competition has actually been excluded. As in the EEC, the material consideration is that the power exists to raise prices or to exclude competition as and when a firm desired to do so. Similarly, the starting point is the market share of the entity.

In *US* v *Aluminium Co of America*[76] Judge Learned Hand examined whether the defendant, Alcoa, was in a monopoly position. Judge Learned Hand found that Alcoa's share of total aluminium production, excluding imported and 'secondary' i.e. recyled aluminium ingots, was 64 per cent in the period 1929-38. This, the Judge thought, was not enough to constitute a monopoly. But when imported ingots were included, it was discovered that Alcoa controlled over 90 per cent of the market; and this the Court concluded was a monopoly.

As in the EEC, market share is not the only indicia of market power. The structural characteristics of the market such as barriers to entry and the number and size of the defendant's competitors are also examined. An analysis of profit levels, market share movements, pricing patterns and marketing policies are analysed. In *US* v *United Shoe Machinery Corp*[77] for instance, the Court noted the overwhelming strength of the defendant (75 per cent of the shoe machinery market) was associated with long-term leases of shoe machinery rather than outright sales with over 90 per cent of the shoe factories; and that there were a small number of competitors in the shoe machinery market. Where there is evidence that competitors are an insignificant force in the market, a conclusion that monopoly power exists will generally follow.

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[75] 384 US 573 (1966).
[76] 148 R 2nd 416 (1945).
[77] 110 F Supp 295 (1953), *aff'd* 347 US 521.

The long-term structural movement of the relevant market will also be examined. Evidence that the defendant's market share has shown continuous growth will point to monopoly power while a decline in percentage share will preclude such a finding, particularly where the defendant has no power to control prices.[78] Evidence of barriers to entry by prospective competitors and that no new manufacturers had entered the markets for more than 25 years was held to be evidence of a monopoly in *Aluminium Co of America.*

In *US* v *Du Pont & Co*[79] the Supreme Court found the company's power to set the price of cellophane was limited due to the interchangeability between cellophane and other wrapping materials and Du Pont's inability to prevent competition from such materials. An increase in price of cellophane would cause the customers to respond by buying the competing wrapping materials.

As well as market structure, movement and customer responsiveness, the defendant's conduct is also taken into account. Direct evidence of the use of monopoly power such as the fixing by a monopolist of minimum prices for goods or services within the relevant market[80] or actual exclusion or elimination of competitors[81] wiil be sufficient to establish a violation even though the market share held may not clearly indicate a monopoly in percentage terms or the resource monopolised has substitutes or alternatives. Accordingly, in *Power Replacement Corp* v *Air Preheater Co Inc*[82] the District Court held that where the defendant's power to exclude competition had been proved directly by, *inter alia,* proof that the defendant had obtained specific orders after making discriminatory price cuts in response to the plaintiff's bids, no inference of market share was necessary to prove monopoly power. The Court found that the defendant had intended to limit the plaintiff's market penetration to a certain percentage and had succeeded through price dis-

[78] *US* v *United States Steel Corp* 251 US 417 (1920).
[79] 351 US 377 (1956).
[80] US v Paramount Pictures Inc 334 US 131.
[81] *Gamco Inc* v *Providence Fruit & Produce Blg Inc* 194 F 2nd 484.
[82] 356 F Supp 872.

counts and other commercially unfair acts, including product disparagement. This was sufficient to establish monopoly power and its maintenance.

c. *Queensland Wire Industries*

The influence of the aforementioned EEC and US decisions is apparent in the latest High Court decision on section 46, *Queensland Industries* v *BHP*.[83] Mason CJ and Wilson J, in dealing with the question of how to assess market power, referred to the Explanatory Memorandum accompanying the Trade Practices Revision Bill 1986 (Cwth) which stated at paragraph 46 that section 46(3) was designed to achieve an approach similar to that adopted by the ECJ in determining power for the purposes of Article 86.[84] Their Honours highlighted three indicators of market power which they thought were relevant viz. market share, barriers to entry and vertical integration.

In regards to market share Mason CJ and Wilson J said:

> Courts have often looked to market share to determine degree of market power; see, e.g. *American Tobacco Co* v *United States* 328 US 781 (1946); *United States* v *Grinnell Corp* 384 US 563 (1966) ('The existence of such [monopoly] power ordinarily may be inferred from the predominant share of the market'); *United States* v *Aluminium Co of America* 148 F 2d 416 (1945) per Judge Learned Hand. But as section 46(3) and the passage from *Continental Can* which we just quoted suggest, a large market share does not necessarily mean that there is a substantial degree of market power. To borrow the words from Reed J's opinion for the Court in *United States* v *Columbia Steel Co* 334 US 495 (1948) '[t]he relative effect of percentage command of a market varies with the setting which that factor is placed.'[85]

In relation to ease of entry, Mason CJ and Wilson J observed:

> A large market share may well be evidence of market power (see *Roche*), but the ease with which competitors would be able to enter

[83](1989) 167 CLR 177.
[84]*Ibid* at 189.
[85]*Ibid.*

> the market must also be considered. It is only when for some reason it is not rational or possible for new entrants to participate in the market that a firm can have market power: see *Continental Can*. There must be barriers to entry. As Professor FM Sherer has written, 'Significant entry barriers are the *sine qua non* of monopoly and oligopoly, for. . . sellers have little or no enduring power over price when entry barriers are non-existent': Sherer, *Industrial Market Structure and Economic Performance*, 2nd ed (1980), p 11.[86]

Dawson J underscored the importance of ease of market entry and noted the differing schools of thought in economic circles as to whether high cost of market entry constituted such a barrier.[87] His Honour however was not concerned with precise meaning of entry barriers stating instead that:

> ... it is less important to arrive at a precise meaning than to recognise the assistance given by the identification of conditions, in the nature of barriers to entry, for the purpose of defining the relevant market, measuring the extent of market power and determining whether that power has been exercised.[88]

As for vertical integration, Mason CJ and Wilson J had the following to say:

> Another indicator of market power suggested by the European Court which is relevant to the case at hand is vertical integration: *United Brands*. It is true enough that vertical integration sometimes accompanies a substantial degree of market power, but its presence does not necessarily mean that a substantial degree of power exists. There may be legitimate reasons for a firm vertically integrating - quality control of raw materials for example. Nevertheless, Fuller observes [in *Article 86 EEC: Economic Analysis of the Existence of a Dominant Position*: (1979) 4 European Law Reports 423.], '[v]ertical integration nearly always accompanies monopoly, not because it raises barriers to entry, but because it gives the monopolist greater power to extract more favourable prices from its customers' (p 440). The reason for this is that vertical integration may help a monopolist distinguish between customers whose demand is less and more elastic. Where consumers are able to trade amongst themselves, the

[86] *Ibid* at 189-190.
[87] *Ibid* at 200-201.
[88] *Ibid* at 201-202.

> monopolist cannot discriminate. By integrating vertically it may be possible for a monopolist to prevent this inter-trading. For example, power companies usually own distribution systems. This enables them to discriminate in pricing between residential and commercial users. Therefore, although vertical integration does not by itself mean that a firm has a substantial degree of market power, it may well be the means by which the firm capitalise on that market power.[89]

An important feature of the *Queensland Wire* case is that it shows the convergence of EEC, US and Australia law so far as the assessment of market power is concerned. There is confirmation that the factors which have been considered by the US courts and the ECJ are also relevant in Australia. Market share alone is insufficient. This is clear from the judgments of Mason CJ and Wilson J, as well as that of Dawson J, who regarded it necessary, despite BHP's significant market share and the absence of any real threat from imports, to consider barriers to entry, vertical integration and the capacity to control prices without constant inhibition. *Warman International* v *Envirotech Australia Pty Ltd*,[90] the previous authoritative decision which held that market power was to be decided on market share alone, must hence be regarded as implicitly disapproved of by the High Court.

The question of whether a particular degree of market power is one which falls within the parameters of section 46(1) is one of fact. It is a matter for the judge at first instance to determine whether there exist a degree of market power which is more than trivial or minimal or which is real or of substance; and he is to come to this conclusion after considering all the economic evidence on the market structural level, including but not limited to market share, as well as evidence on market conduct and market performance. It does not require particularly sophisticated analysis. The market must firstly be identified and thereafter, the source of the defendant's market power is to be determined.

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[89] *Ibid* at 190.
[90] (1986) ATPR 40-714.

2. Taking Advantage of that Market Power

Section 46(1) provides that the corporation "shall not take advantage" of its substantial degree of power in a market to control a market. In *Queensland Wire* at first instance, trial judge Pincus J construed the words "take advantage" in a pejorative sense. His Honour relied upon the words of BG Donald and JD Heydon in *Trade Practices Law* (1978) Vol 1 at 224 which stated that:

> Since the words are inserted, they must do some work, and must refer to something more than causing or achieving a result. They must refer to an abuse of position, to something unusual, predatory, forceful or deceitful. A seducer takes advantage of his victim; Hitler took advantage of the disunity and weakness of his enemies; a monopoliser takes advantage of his market power.[91]

On the facts, His Honour thus found that the defendant's refusal to supply its competitor with a product was not a misuse of market power; even though the defendant had a monopoly over the market.

The facts were that the defendant, BHP, had for several years manufactured a steel fence known as the "star picket" which was by far the most popular rural fencing post in Australia. BHP was the sole domestic producer of star pickets, which it manufactured from an intermediate steel product known as the Y-bar. There was no significant import competition. The plaintiff, Queensland Wire Industries Pty Ltd (QWI), competed with BHP principally in Queensland and northern New South Wales in the rural fencing market comprising fencing posts and wire. It manufactured its own wire from wire rods supplied by BHP.

The large pastoral houses purchased their supplies of rural fencing materials from BHP because it was able to deliver a full range of fencing products and there were advantages in having only one supplier. In the 1986 - 1987 year, more than 41 percent of the total tonnage of rural fencing sold by BHP consisted of assemble fencing.

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[91](1987) 75 ALR 331 at 345.

QWI sought supplies of Y-bar from BHP in order to manufacture its own star picket fence posts, thereby enabling it to be in a position to deliver assembled fencing to the large pastoral houses. BHP refused to supply QWI with Y-bar except at a price which would make it unprofitable for QWI to manufacture star picket fence posts and sell them competitively.

On appeal, the High Court unanimously rejected Pincus J's interpretation of section 46(1). Mason CJ and Wilson J said that they had difficulty in seeing why an additional, unexpressed and ill-defined standard should be implanted in the section. To their Honours:

> The phrase 'take advantage' in section 46(1) does not require a hostile intent inquiry - nowhere is such standard specified. And it is significant that section 46(1) already contains an anti-competitive purpose element. It stipulates an infringement may be found only where the market power is taken advantage of for a purpose prescribed in para (a), (b) or (c). It is these purpose provisions which define what uses of market power constitutes misuses.[92]

In relation to the proscribed purposes in section 46(1), Pincus J at first instance had found that BHP's refusal to supply the Y-bar to QWI fell within section 46(1)(b) viz., preventing the entry of QWI into the star picket post market.[93] In the High Court, Mason CJ, Wilson, Deane and Dawson JJ were of the view that it was more apt to describe BHP's actions as being contrary to section 46(1)(c) i.e. deterring or preventing a person from engaging in competitive conduct in a market. As the result of the exorbitant prices charged by BHP, QWI could not offer fence posts at a competitive price to the major distributors. This adversely affected QWI's sale of wire. *A fortiori* by refusing to supply QWI with Y-bars, except at a high price, BHP "extended" its power in the Australian steel market, thereby deterring or preventing QWI from engaging in competitive conduct in the rural fencing market. In reaching this conclusion, the High Court explicitly recognised the market leverage doctrine of assessing an abuse of market power. This doctrine has its origins in the US.

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[92](1988) 167 CLR 177 at 191.

[93]Toohey J held that there had been a contravention of s 46(1)(b).

a. *The US Approach*

The market leverage doctrine stipulates that the entrenchment or strengthening of a firm's power in a particular market must be the result of superior products, business acumen or historical accident. If the market power is acquired or maintained through the wilful acts of a firm, those acts are illegal. The existence of this doctrine in American antitrust law was confirmed by the US Supreme Court in *Aspen Skiing Co* v *Aspen Highlands Skiing Corp*.[94] In the US, any wilful acquisition or maintenance of market power will be contrary to section 2 of the Sherman Act.[95]

Initially, the US Courts adopted a strict approach towards assessing whether the use of a firm's market leverage was a violation of section 2 of the Sherman Act. In *United States* v *Griffith*[96] for example, affiliated exhibitors had used a common agent to negotiate with the distributors of films for all the theatres in the group thereby using their combined buying power to obtain exclusive privileges. It was held by the Supreme Court that the use of the theatre monopoly to beget a monopoly with regard to exhibiting films was a misuse of market power. Per Justice Douglas:

> If a monopoly power can be used to beget monopoly power, the Act becomes a feeble instrument.[97]

In *Motion Picture Patents Co* v *Universal Film Manufacturing Co*[98] the Motion Picture Patents Co owned patents which gave it a monopoly on the sale of motion picture projectors. Related companies produced and distributed motion pictures. The Motion Picture Patents Co licensed the use of its projectors on the condition that they be used to exhibit the films of its affiliates exclusively. This condition was imposed by a notice stamped on each ma-

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[94]105 S Ct 2874 (1985).

[95]S 2 of the Sherman Act provides that:

> Every person who shall monopolise, or attempt to monopolise, or combine or conspire with any other person or persons to monopolise any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanour.

[96]334 US 100 (1948).

[97]*Ibid* at 107-108.

[98]243 US 502 (1917).

chine. The court held that the patent licence restriction extended the Motion Picture Patents Co's monopoly from the projector market to that for films, and accordingly condemned the tying arrangement.

In *United States* v *United Shoe Machinery Corp*[99] it was held that it was unlawful for United Shoe to maintain its monopoly power by leasing rather than selling its machinery. Its leasing practices, while they constituted normal methods of industrial development, went beyond those measures which were necessary to protect United Shoe's legitimate trading interests. The Court held that:

> [They were not] practices which can properly be described as the inevitable consequences of ability, natural forces or law. They represent something more than the use of accessible resources, the process of invention and innovation, and the employment of those techniques of employment, financing, production, and distribution, which competition must foster. They are contracts, arrangements and policies which, instead of encouraging competition based on pure merit, further the dominance of a particular firm. In this sense, they are unnatural barriers; they unnecessarily exclude actual potential competition; they restrict a free market.[1]

This strict approach of the US Courts was criticised by the Chicago School on, *inter alia*, the grounds that they failed to consider the efficiencies which would have arisen as the result of the leverage of a particular monopoly. The "reasonableness" of the leverage must be considered. The thinking of the Chicago School percolated through to the judiciary and in 1975, the first of the cases which adopted the Chicago School approach arose. In *Telex Corp* v *IBM Corp*,[2] the court held that section 2 of the Sherman Act did not prohibit the adoption of legal and ordinary marketing methods already used by others in the market nor prohibit price changes which are "reasonable".[3] In this case, the court found that there was no misuse of market power by IBM because the marketing method used by IBM i.e. heavy discount-

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[99]110 F Supp 295 (1953).
[1]*Ibid* at 346 *per* Judge Wyzanki.
[2]510 F 2d 894 (10th Cir 1975).
[3]*Ibid* at 927.

ing, had caused the prices of their poduct to fall to such a level that it was not receiving an adequate return and was forced to rely on reserves or other activities; the products stood on their own as to financial returns.

In *California Computer Products Inc* v *IBM Corp*,[4] the Court similarly held that IBM's price cuts on items which complemented its computers, principally disk drives, had not been an abuse of market power. This was because the only question the Court had to consider was whether it was reasonable for IBM, which invented and was the dominant supplier of the items, to respond to the lower prices of its competitors with reduced but still substantially profitable prices. The court concluded that the activities were reasonable. IBM was entitled to maintained its dominant postion through "business acumen" which included "shrewdness in profitable price competition".

The aforementioned cases were about using prices as a leverage for expanding a monopoly. In *Berkey Photo Inc* v *Eastman Kodak Co*,[5] Kodak had a pre-eminent place in the market for camera film and competed with Berkey in supplying photo finishing services. Kodak introduced a small camera with a smaller film cartridge called the 110 System. This created another monopoly for Kodak in the small film market. Berkey brought an action under section 2 of the Sherman Act against Kodak arguing that Kodak's monopoly position obliged it to pre-disclose the new 110 System so that all parties would be able to compete for photo processing services. The Court held that the action of Kodak was reasonable because it had undertaken the risk of research into this new field and was thus now allowed to reap its benefits. The Court said:

> It is the possibility of success in the market place, attributable to superior performance, that provides the incentives on which the proper functioning of our competitive economy rests. If a firm that has engaged in the risks and expenses of research and development were required in all circumstances to share with its rivals the benefits of those endeavours, this incentive would very likely be vitiated.

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[4]613 F 2d 727 (9th Cir 1979).
[5]603 F 2d 263 (2nd Cir 1979).

> Withholding from others advance knowledge of one's new products, therefore, ordinarily constitutes valid competitive conduct. Because, as we have already indicated, a monopolist is permitted, and indeed encouraged by section 2 to compete aggressively on the merits, any success that it may achieve through "the process of invention and innovation is clearly tolerated by the antitrust laws.[6]

b. *The European Approach*

In the EEC, the ECJ had adopted a similar approach towards entities which seek to extend their power over a particular market. This was first confirmed by the ECJ in *Europemballage and Continental Can.* Continental Can, an American company already in a strong position in the EEC, had acquired firms in related product lines in the EEC. The question before the ECJ was whether an acquisition which increases a dominant position can for that reason alone, be an abuse of a dominant position prohibited by Articles 86 of the EEC Treaty.

It was argued by Continental Can before the ECJ that Article 86 did not apply because all of the four explicit examples of abuse stated in the EEC Treaty were practices that directly harmed buyers or trading parties. Here there was no evidence of such harm. There was merely a change in market structure which increased Continental Can's market power. Further, it was argued that since Article 86 only prohibited an "abuse ... of a dominant position", there had to be a link between the dominant position and the abuse. The power which underlies the dominant position must be used to inflict the harm which constitutes the harm. Here there was no evidence of such an exploitation of the power.

The ECJ rejected these arguments. The ECJ held that it was not possible to draw a distinction between direct and indirect effects on the market. It was necessary to interpret Article 86 in the light of the spirit of the EEC Treaty generally. Article 3(f) required the institution of a system which ensured that competition in the common market is not distorted and Article 2 called for the promotion of a continuous and balanced expansion in economic activities. Article 86 had to be interpreted with these aims in mind. In the view of the ECJ, activities such as that of Continental Can could lead to:

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[6] *Ibid* at 281 *per* Judge Kaufman.

> ... such dominance as to virtually remove any serious possibility of competition ... [and could thus] jeopardise the proper functioning of the Common Market ...[7]

Abuses, the ECJ concluded, may occur if a firm already in a dominant position were to:

> ... strengthen that position to the point where the degree of domination achieved substantially hampers competition, so that only enterprises which in their market conduct are dependent on the dominant enterprise would remain on the market.[8]

C. Section 50 - Mergers

Section 50 prohibits mergers and acquisitions which are likely to lead a particular entity towards dominating a market. The dominance is proscribed because it may have an adverse effect on competition. The general intent and operation of the section is best described in *Trade Practices Commission* v *Ansett Transport Industries (Operations) Pty Ltd.*[9] In this case the Court held that:

> Section 50 is concerned with the power to control or dominate a market. The unexpressed major premise contained in the section is that it is undesirable for a body corporate to be in a position to control or dominate the market or in other words to have the power to control or dominate a market since the existence of that power tends to lessen competition in that market since the existence of that power tends to lessen competition in that market.[10]

1. Dominance

The issue of what amounts to dominance in a market for the purposes of section 50 came before the courts in *Ansett Transport Industries.* In this case, the court held that an entity was in a position to dominate a market if it were in a position to exert a commanding influence on the market. The Court held that:

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[7] 173 ECR 215 at 243-245.
[8] *Ibid* at 245.
[9] (1978) 32 FLR 305.
[10] *Ibid* at 318 *per* Northrop J.

> ... the word 'dominate' as used in section 50 cannot be given any specific meaning by reason of common usage in the literature of economics. The word 'dominate' is to be construed as something less than 'control'. The word is to be construed in its ordinary sense of having a commanding influence on.[11]

This definition was embellished in *Trade Practices Commission* v *Arnotts Ltd.* At first instance[12] it was held that:

> An enterprise will be in a position to dominate a market when there is a probability that the other enterprise or enterprises in the market will act in a way calculated not to affect adversely the dominant concern's short-term interests. Dominance, unlike control, is not primarily concerned with the formal relationship between entities but rather with their conduct towards each other within a particular market environment. If the size or strength of a particular entity is such that, in practice, other entities are unable or unwilling to compete with it in a particular market, that entity is dominant in that market. The dominant position related to a position of economic strength enjoyed by an undertaking which enabled it to prevent effective competition being maintained in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.[13]

This definition of dominance was approved of by the Full Federal Court in *Arnotts Ltd* when the decision at first instance was appealed.[14]

In *Ansett Transport Industries*, the Judge at first instance, Northrop J, relied heavily on the judgment of the ECJ in *United Brands*. His Honour began by making reference to the evidence of Professor Hogan who had testified as to the economic factors to be taken into account in determining dominance. His Honour surmised that the factors were:

> (1) The market share of the firm over a period of years.
> (2) The capacity of the firm to determine prices for its products without being consistently inhibited in its determination by other firms.

[11] *Ibid* at 325 *per* Northrop J.
[12] (1990) ATPR 41-002.
[13] *Ibid* at 51, 048 *per* Beaumont J.
[14] (1990) ATPR 41-061 at 51,788.

(3) The relevant prices charged by the firm by comparison with other firms.
(4) The profitability of the firm compared with that of other firms.
(5) The ability of new firms to enter the market and to sustain their entry.
(6) The financial stability of the firm in relation to other firms in the market.
(7) The related size of the firm by comparison with others in the market to be measured by -
    (a) market share;
    (b) gross revenues;
    (c) shareholders' funds employed.[15]

His Honour then stated that another factor was product differentiation i.e. the quality of the products or services provided. All the factors, in His Honour's view, had to be considered to determine dominance. No one factor alone could be conclusive.[16]

His Honour went on to state that the aforementioned factors were almost the same factors considered by the ECJ in deciding whether there was a "dominance" by the defendant company in *United Brands*. His Honour quoted at great length from the ECJ's judgment in *United Brands*. Most significantly, His Honour approved of the ECJ's test of dominance which was that:

> The dominant position referred to ... relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers. In general a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative: *United Brands* [1978] 1 CMLR 429 at 486.[17]

Without considering what, if anything else, American or English case law had to say on the matter, Northrop J proceeded to apply the method adopted by the ECJ for establishing dominance in a market. In His Honour's own words:

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[15]*Supra* n 9 at 326.
[16]*Ibid.*
[17]*Ibid.*

> I propose to determine the question of dominance by a method similar to that adopted by the Court in the *United Brands Co* case.[18]

In the second fully argued case on the scope of the dominance test, *TPC* v *Australia Meat Holdings Pty Ltd*,[19] Wilcox J adopted the meaning of the word "dominate" and applied the same factors as had Northrop J in *Ansett Transport Industries*. The European approach gained acceptance and was slowly entrenched. In elaborating on Northrop J's definition, Wilcox J did not differ from the *United Brands* test saying:

> It seems to me that ... dominance, unlike control, is not primarily concerned with the formal relationship between entities but rather with their conduct towards each other within a particular market environment. If the size or strength of a particular entity is such that, in practice, other entities are unable or unwilling actively to compete with it in a particular market, that entity is dominant in that market.[20]

In the latest authoritative case on section 50 viz., *Arnotts Limited & Ors* v *Trade Practices Commission*,[21] the Full Federal Court endorsed Northrop J's approach in *Ansett Transport Industries* and went even so far as to make reference to ECJ decisions themselves,[22] relying on the ratio of the ECJ in those cases to come to a decision as to whether there was a dominance of the biscuit market by Arnotts. In the words of the Court:

> Some of the European cases provide assistance in the resolution of questions of market power and dominance. Although they arise from a different statute they apply similar economic concepts [acceptable in Australia].[23]

2. The American Influence

The European influence is prominent in merger case law. The American influence is more pervasive in the area of merger

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[18] *Ibid* at 328.
[19] (1988) ATPR 40-876.
[20] *Ibid* at 49, 496.
[21] (1990) ATPR 41-061.
[22] *Ibid* at 51,788 - 51,789. The cases referred to were "Europemballange Corporation and Continental Can; United Brands" and "Hoffmann-La Roch".
[23] *Ibid* at 51,788.

policy and the enforcement of the merger laws. D. Oliver, a former Chairman of the US Federal Trade Commission (the FTC), noted that the FTC's approach to mergers is similar to that of the TPC. He went on to say that:

> To the extent that the Australian statute might be considered more 'lenient' than [that of the US], the difference might be explained by the relatively smaller size of most Australian markets and the unavoidably greater levels of concentration that result. But within the parameters established by statute, the methods of economic analysis that should be used, and the structural, behavioural, and performance factors that should be considered, are very much the same. Identifying the 'field of rivalry', considering competitive factors beyond market share, and paying special attention to the role of imports - in all these areas the United States and Australia are fraternal, if not identical twins.[24]

The observations of Oliver above were confirmed by WR McComas, a former Chairman of the TPC, who stated that:

> The TPC, in so far as it deals with takeovers, is attuned to the free market philosophy so identified with the Chicago School of Economics, and the policy currently obtaining in Australia is little different from that which is applied in the United States.[25]

Before assessing the American influence with regards to Australian merger laws, mention should first be made of the fact that in Australia, unlike the US, authorisation for a merger may be obtained from the TPC. This is provided for under sections 88(9) and 90(9) of the TPA.[26] These essentially provide that

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[24]M James (ed) *Regulating for Competition* (Centre for Independant Studies, Policy Forum 8 1989) at 61.

[25]Paper delivered at the New South Wales Branch of the Economic Society of Australia, Sydney on 13 March 1987 entitled "Economics and the Law - The Trade Practices Act 1974 or an Exercise in Micro-economic Legal Theory".

[26]S 88(9) of the TPA provides *inter alia* that:

> Subject to this Part, the Commission may, upon application by a person -
>
> (a) grant an authorisation to the person to acquire shares in the capital, or to acquire assets, of a body corporate; ...
>
> and, while such an authorisation remains in force -
>
> (c) in the case of an authorisation under paragraph (a) - section 50 does not prevent the person from acquiring shares in the capital, or from acquiring assets, of the body corporate in accordance with the authorisation ...

authorisation may be granted where the acquirer proves to the satisfaction of the TPC, or on review the Trade Practices Tribunal, that the merger or acquisition would be likely to result in such benefit to the public that it ought to proceed. A merger would be considered by the TPC to be for the benefit of the public if, *inter alia* "there was a beneficial rationalisation of industry which results in greater efficiency and better allocation of resources and the attainment of international competitiveness."[27] This approach taken by the TPC clearly shows the influence of the Chicago School thinking in Australia.

a. *The Chicago School's Approach to Mergers*

It will be recalled that in the Chicago School philosophy, the only legitimate goal of antitrust is the maximisation of consumer welfare. The social and political purposes of antitrust law which is concerned with maintaining a large number of firms in each market so as to prevent one firm controlling decision making in any particular market should be rejected as being impossible for the courts to enforce objectively. The task of antitrust is to improve allocative efficiency without impairing productive efficiency in such a way that there in neither gain nor loss in consumer welfare. The only mergers that should be proscribed by law are those that adversely affect consumer welfare. These are large horizontal mergers which create or strengthen market power and may have the effect of restricting output without necessarily creating new efficiencies.

Chicago School adherents also argue that there is no reason why growth of a firm should not be by horizontal mergers rather than internal expansion. Businessmen should know what is in their best interests and it must be assumed that a choice is made between growth by internal expansion and growth by merger because of the relative costs of the two possible routes to larger

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S 90(9) of the TPA provides *inter alia* that;

> The Commission shall not make a determination granting an authorisation under subsection 88(9) in respect of a proposed acquisition of shares in the capital, or of assets, of a body corproate . . . unless it is satisfied in all the circumstance that the proposed acquisition would result, or be likely to result, in a such a benefit to the public that the acquisitions should be allowed to take place.

[27]TPC Merger Guidelines (1986) at 14.

size. If the merger route is the less expensive alternative but is blocked by law, higher costs which results from a forced internal expansion will fall onto the consumer.

In relation to vertical mergers, the Chicago School's view is that they are a means of creating efficiency. Easier access for a firm to its sources of production or its ultimate customers can only lead to a lowering of its costs which would flow down to the consumer. Since vertical mergers enhance consumer welfare, they should be presumptively lawful. Predatory foreclosure through vertical merger is extremely unlikely since it is not possible to increase market share by vertical integration in the absence of cost-saving efficiencies which would permit a price reduction.

With regards to conglomerate mergers, the Chicago School argues that these do not lessen competition and in fact may result in cost-saving efficiencies. These mergers do not give rise to any increase in market share and they do not create the power to restrict output. Hence, they should not be prohibited.

3. The TPC Merger Guidelines

In October 1986, the TPC issued Guidelines for the Merger Provisions of the Trade Practices Act 1974. In the Guidelines the TPC stated that it can be expected to:

> ... inquire into all mergers where the outcome will be that the acquirer will have a share of the relevant market of 45 per cent or more and will be the largest competitor in the market, or will be the largest competitor and have a market share exceeding that of its nearest competitor by 15 per cent.[28]

This statement is qualified later in the Guidelines to be only a "general rule" and "it does not mean that a market share of less than 45 per cent will go unchallenged".[29] The Guidelines emphasise that dominance is a "measure of market power" and that its identification is "not confined to an analysis of market structure

[28] *Ibid* at 3.
[29] *Ibid* at 11.

and the market share enjoyed by a particular firm within that structure. It is also vey much concerned with behavioural features".[30] In line with the Chicago School thinking therefore, the TPC takes the view that it is necessary to consider the actual conduct of firms before reaching a conclusion on dominance. It is stated in the Guidelines that:

> ... in the final analysis a major determinant will be the extent to which the firm concerned is able to conduct its affairs in the market indepently of its competitors, its suppliers and its customers.[31]

In June 1989, the House of Representatives Standing Committee on Legal and Constitutional Affairs tabled its report on mergers, takeovers and monopolies recommending retention of section 50 in its present form and rejecting proposals for compulsory pre-merger notification to the TPC. Be that as it may, in the TPC's 1989-1990 statement of objectives and priorities, it stipulated that it would scrutinise major mergers carefully and will *inter alia* encourage the use of the authorisation procedure for some of the larger and more sensitive mergers, use informal conference procedures for merger authorisation and continue to encourage merger parties to seek the TPC's views early. There is hence an emphasis on obtaining authorisation prior to a merger. The parties to a merger which is likely to result in the creation or strengthening of a dominant position in a market are faced with two choices. They can ignore the TPC and risk litigation which may result in an order of divestiture, or they can approach the TPC and seek its authorisation. Needlessly to say, most would prefer the latter. Consequently, it may be fruitful at this point to examine the case law surrounding the TPC's approach towards authorisation. It will be revealed that the cases show a strong inclination on the part of the TPC towards the Chicago School's philosophy on antitrust.

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[30] *Ibid* at 8.
[31] *Ibid* at 1.

a. *Authorisation*

In *Henderson's Federal Spring Works Pty Ltd*,[32] the acquisition of the assets of National Springs Pty Ltd would have created a monopoly in Australia for the supply of suspension springs and automative seating components. The TPC accepted that there was excess capacity in the relevant market and that a rationalisation of plants would eliminate duplication and contribute to an overall cost reduction with a consequent enhancement of efficiencies. The TPC allowed the merger when Henderson was able to convince the TPC that the consumers would derive some benefit from the efficiencies. To this effect, Henderson undertook not to make any adjustments to the overall average selling prices of the goods.

In *Ardmona Fruit Products Co-op Ltd, Letona Co-op Co Ltd and SPC Ltd*,[33] the proposed merger would have resulted in the parties having a combined market share of about 90 per cent of the total Australian sales of deciduous canned fruits. The parties were able to convince the TPC that efficiency could be achieved by the merger. They argued that the merger would bring about significant cost savings in the production and marketing of deciduous canned fruit through more efficient utilisation of plant and equipment and staff.

In *Fletcher Challenge Ltd*,[34] the TPC granted authorisation in respect of the acquisition by Fletcher Challenge of 50 per cent of Australian Newsprint Mills even though this would result in Fletcher Challenge dominating the Australian market for the production and supply of newsprint. In the TPC's view, Fletcher Challenge would bring to Australian Newsprint Mills its marketing expertise, funding for research and development and the transfer of paper-making technology and expertise which would result in improved mill production efficiency. These benefits, if realised, would lead to a more efficient Australian-based newsprint production industry.

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[32](1987) ATPR (Com) 50-054.
[33](1988) ATPR (Com) 50-068.
[34](1988) ATPR (Com) 50-077.

In *Pasminco Ltd*,[35] the application related to the merger of Australian Mining & Smelting Ltd, a wholly owned subsidiary of CRA Ltd and North Broken Hill Holdings Ltd. In the TPC's view, the merger would result in Pasminco, as the sole producer, being in a position to dominate the Australian market for the supply of refined zinc and lead. However, the TPC recognised that a number of significant benefits would flow from the mergers. There would be a rationalisation of the Australian zinc and lead industry which would enhance their competitiveness in the international market; and the production synergies that were achiveable where the mines and smelters were owned by the one company would lead to greater efficiency. The TPC allowed the merger to go ahead; but to ensure competitiveness in the marketing of zinc in the domestic market, the TPC required that Pasminco market its zinc in Australia through the two independent marketing arms of CRA and North Broken Hill Holdings.

In *TRW Australia Ltd*,[36] the TPC authorised TRW Australia Ltd to acquire the shares, or alternatively the assets, of James N Kirby Products Pty Ltd. The relevant market was that for manual and power steering gears in Australia of which Kirby provided 47 per cent, TRW provided 29 per cent and imports 24 per cent. Kirby had been granted an exclusive licence from Arthur E Bishop & Associated Pty Ltd to manufacture, use and sell products made from Bishop technology in Australia. This license was regarded as the heart of the Kirby steering business. It could not be assigned without the consent of Bishop, but there was no provision for termination upon change of ownership of Kirby. The acquisition would result in TRW becoming the sole Australian manufacturer of steering gears. TRW argued however that its proposed rationalisation of the Kirby and TRW operations after the merger would lead to cost savings. Further, there would be competition from imports and the possible exercise of countervailing power by vehicle manufactures which would act as potential inhibiting pressures on TRW. Considering these elements, the TPC granted authorisation.[37]

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[35](1988) ATPR (Com) 50-082.

[36](1989) ATPR (Com) 50-087.

[37]The authorisation was subsequently set aside when the Foreign Investment Review Board refused to approve the acquisition but this does not diminish the rationale for the approval in the first place.

VI. OVERVIEW

The Chicago School advocates a permissive approach towards government regulation. This is especially so in regard to mergers. His concentration, the Chicago School argues, does not necessarily lead to high prices and profits; and even if it does, higher profits would not signify power but efficiency. The Chicago School's ethos pervades the US judiciary and hold sway with the enforcement authorities in the US. Its influence ranges wide and far, as has been established above. The question that now has to be asked is whether a permissive approach is indeed in the interest of the consumer.

Studies by some academics in the US have been inclined to argue that many mergers, whether horizontal, vertical or conglomerate, have not resulted in increased economic efficiency and that while managerial energy has been directed at mergers, investment in new plants, new products and new manufacturing techniques has been ignored resulting in firms losing their competitiveness.[38]

Additionally, it would appear that most sizeable mergers are followed by little operational changes which could have enhanced efficiency. To the extent that changes are effected, they appeared least frequently in the production area and most frequently in finance and accounting with marketing changes occupying an intermediate position. A substantial body of statistical analysis also revealed that there was little, if any, systematic increase in post-merger as compared to pre-merger profitability. Much of the impetus for sizeable acquisition hence would seem to stem not from the quest for efficiency but from the desire to exploit stock market disequilibria, to avoid double taxation of dividends or reap other tax advantage, to enhance size and diversification and hence to present a more attractive picture to investors, or perhaps to simply build an empire.[39]

Those who advocate a permissive approach fail to consider distributional and fairness concern. The social costs of market

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[38] W Adams and JW Brock "The New Learning and the Euthanasia of Antitrust" (1986) 74 *California Law Review* 1516.

[39] FM Scherer "The Posnerian Harvest: Separating Wheat from Chaff" (1977) 86 *Yale Law Journal* 974.

power can be considerable. Those who say that judges should not be called upon to redistribute income or to protect competitors ignore the fact that competition policy is about protecting consumers from exploitation and loss of income to producers; protecting competitors from predation and intimidation; and promoting entrepreneurs' right to enter business. Morever, to the extent that legislators have been concerned with efficiency, it has been technical and dynamic, not allocative efficiency that mattered most. Advocates of vigorous antitrust enforcement have long stressed the remedial benefits of competition in pressing managers to reduce costs, seek and install appropriate technology, avoiding excess capacity, and use advertising to inform consumers rather than creating artificial product differentiation.[40]

The Chicago School theorists also fail to consider the micro-micro economics of a firm which could well be antithetical to profit maximisation. The managers may be pursuing their own interests and this affects the firm's behaviour. It could well be that if a firm has market power in its output market, management may be able to keep profits at an acceptable level, allowing costs to rise in ways that protect management amenities or assure management of a quiet life. What might have been the excess profits paid to shareholders becomes instead excess costs; excess salaries and perquisites for management; excess staff to increase prestige; excessive wages for labour to assure "peace" with the unions; excessive advertising to try to differentiate a product that is functionally identical to those of rivals; excessive re-tooling costs to make trivial product changes that protect the differentiated images; and excess capacity inhibiting entry and assuring that commitments can be easily met in times of high demand.[41]

Chicago School theorists argue that there is no causal link between concentration in an industry and profitability, and that efficient firms grow only because they are efficient, so that industry structure reflects efficiency. The weakness in this argument is that it treats profit levels as the only measure of performance,

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[40]RG Harris and LA Sullivan "Horizontal Merger Policy: Promoting Competition and American Competitiveness" (1986) 31 *Antitrust Bulletin* 871 at 897.
[41]*Ibid* at 900.

and assumes that if it can be demonstrated that concentration does not lead to higher profits, then it cannot be argued that concentration leads to poor performance. It fails to realise that firms in concentrated markets function differently from firms in competitive markets - that management of firms in concentrated markets live in a different environment, one with far more amenity, including the luxury of not worrying unduly about costs. Concentration yields market power and market power increases costs as well as prices.[42]

In Australia there is a lack of empirical evidence on the effect of the present enforcement policy of the TPC. Consequently, the Inquiry into Mergers, Takeovers and Monopolies by the House of Representatives on Legal and Constitutional Affairs (The Griffiths Committee),[43] for want of such evidence recommended that the present policy be retained and, in that regard, that the dominance test be retained. The Griffiths Committee however was split on this issue with the majority recommending the retention of the permissive approach and the minority (Robert Tikner MP and Keith Wright MP) suggesting a reversion to the more restrictive approach. This in itself is representative of the two opposing views in relation to antitrust policy presently raging in the US - between the Chicago School adherents who argue for a more "hands off" approach and the traditionalist who are pushing for a more "hands on" approach. Ultimately the issue will depend on whether one believes a perfect market is possible and if so whether that perfect market can be achieved with or without regulation from the state.

VII. CONCLUSION

If the sole function of competition law were the maximisation of consumer welfare by achieving the most efficient allocation of resources and by reducing costs as far as possible, the formulation of legal rules and their application would be relatively

[42] *Ibid* at 922.

[43] Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs *Merger, Takeovers and Monopolies; Production from Competition?* (AGPS Canberra 1989).

simple. In reality, as noted above, many different policy objectives have been pursued in the name of competition law. Many of these policies are not rooted in notions of consumer welfare in the technical sense at all, and some are plainly inimical to the pursuit of allocative and productive efficiency.

Competition policy does not exist in a vacuum. It is an expression of the current values and aims of society and is as susceptible to change as political thinking is generally. Different systems of competition laws therefore reflect different concerns. Significant policy differences exists between Australian, EEC and US competition laws. Each seeks to achieve different things. Australian competition policy is strongly influenced by the EEC and the US approaches, and the evidence suggests that it is attempting to tread a middle path between the free for all market approach which dominates US policy and the social responsibility approach of the EEC. This, however, is only a reactive response. Australia knows what it does not want but does not seem quite sure where it is going. For example, the second reading speech accompanying the passage of the TPA in 1974 referred to the Act's purpose only in terms which did little more than describe a number of key sections. There was no exposition of a basic policy goal. In its 1986 amendments to the Act, the Government was only a little more forthcoming when the Attorney-General described the provisions as being aimed at promoting efficiency through competition to ensure that goods are provided to the consumer at the cheapest price.

The Griffiths Report also fails to address the objectives of the Act. Chapter 3 of the Report discusses some economic issues relating to the Act's objectives but these objectives were themselves not identified. Importantly, the Report does not establish any criterion against which the effectiveness of sections 46 and 50, subject to the committee's inquiry, were to be measured.

This lack of guidance from the Executive and the Legislature leaves the Australian Courts no choice but to refer to the works of jurists in Western Europe and the US in the hope of gleaning from them some common "golden threads" which it is hoped can be applied here. This is done under the assumption that since we share a common economic and cultural heritage, the legal notions should also be the same. This is clearly wrong. Different systems of competition laws reflect different concerns.

This is one thing which must constantly be borne in mind by the courts when reference is made to US and EEC competition law. By all means look abroad for guidance, but Australian courts must be more circumspect and selective. The choice must be dependent upon an understanding of Australia's requirements and the market which Australia seeks to develop here. In the case of the US, the country at the vanguard of competition law jurisprudence, it certainly behoves us to be aware of the US antitrust experience. This is because firstly, most commercial phenomena that cause competition problems have at some point been considered by courts, antitrust authorities and commentators in the US. Secondly, economic analysis has come to play a greater role in US antitrust recently, and this is something which all competition lawyers must come to terms with in the years ahead. One does not have to accept the Chicago School's brand of antitrust economics to see that economic analysis is central to understanding of the concepts with which competition law is concerned.

To the credit of the courts here, they have done a remarkable job; and it must be noted that perhaps in no other area of Australian law is the coincidence of or influence by US and European jurisprudence greater. Be that as it may, if the Executive is to retain its pre-eminence as the policy makers of the three arms of government, a much clearer and detailed competition policy must be put forward leaving the courts free to implement the law as intended rather than acting as conduit tubes for foreign laws whose policy objectives may be substantially different from Australia's.

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