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## The "Duty to Deal" under Section 46: Panacea or Pandora's Box?

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## THE "DUTY TO DEAL" UNDER SECTION 46: PANACEA OR PANDORA'S BOX?

GEORGE A HAY\* AND KATHRYN McMAHON\*\*

### I. INTRODUCTION

The privatisation and restructuring of public monopolies and the deregulation of other essential services in Australia and other countries have focused attention on the need for rules which can foster competition and efficiency in the resulting markets. Australia, of course, already has the *Trade Practices Act 1974* (Cth) (the "Act"), and the question that has been raised is whether the Act is adequate to deal with the kind of competitive problems that are likely to arise in such markets. Of particular concern is the situation in which a firm controls the supply of an input that is critical in the production of another "downstream" product, but refuses to supply that input to certain potential suppliers of the downstream product or does so only on terms that render it impossible for those downstream firms to be effective competitors.<sup>1</sup>

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1 For example, a firm controlling the pipeline essential for the long distance transmission of natural gas (and also serving the downstream market for local distribution) might refuse to supply gas at wholesale prices to firms that seek to compete in local distribution or to provide access to the pipeline so that those firms can seek

Under s 46 of the Act, a "duty to deal" can be imposed on a corporation with substantial market power,<sup>2</sup> and there have been several cases in recent years seeking precisely such a remedy.<sup>3</sup> Hence, it could be argued that s 46 ought to be adequate to deal with whatever problems of access might arise as a result of privatisation and deregulation.

This article attempts to demonstrate that the ability of s 46 to deal effectively with problems of access has been oversold. Indeed, we will claim that, except under special circumstances, any effort to impose a "duty to deal" on a monopolist will at best be ineffective and at worst be counterproductive. If significant pockets of monopoly power are likely to persist in some of the markets affected by recent legislative restructurings, other measures may be necessary if consumers are to enjoy the full benefits of competition. Such measures may or may not be forthcoming.<sup>4</sup> But at the very least, Australian courts should not use s 46 in a way that reduces efficiency and operates to the long run detriment of consumers.

## II. THE SIMPLE ECONOMICS OF VERTICAL MARKETS

This section of the paper seeks to establish some basic points about the exercise of monopoly power in vertically related markets. This is done with the use of a number of simple arithmetic examples. Throughout the demonstration, we will be talking about two products. The upstream product, *u*, is an essential ingredient in the production of the downstream product, *d*. For ease of exposition, we will assume that one unit of *u* is required for every unit of *d* that is produced. The analysis would not be affected if, instead of a one-to-one relationship, the proportions were different (eg, one half *u* for every unit of *d*, or two units of *u* for every unit of *d*). The critical assumption is that a downstream producer has no

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alternate supplies of gas. A firm controlling local telephone service (and also providing long distance service) might refuse access to the local exchange by those firms seeking to compete in the long distance market.

- 2 The refusal to supply must be for one or more of the following proscribed purposes: eliminating or substantially damaging a competitor (s 46(1)(a)); preventing entry into a market (s 46(1)(b)); deterring or preventing a person from engaging in competitive conduct (s 46(1)(c)).
- 3 Cf *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177; *MacLean v Shell Chemical (Australia) Pty Ltd* (1984) 6 ATPR ¶40-462; *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd* (1987) ATPR ¶40-809; see generally W Pengilley, "Denial of Supply and Misuse of Market Power in Australia: What follows from the High Court decision in *Queensland Wire*?" Special Report, ATPR, 16 March 1989; K McMahon, "Refusals to Supply by Corporations with Substantial Market Power" (1994) 22 *ABLR* 7.
- 4 The 1993 Report on *National Competition Policy* by the Independent Committee of Inquiry recommended an alternate administrative scheme whereby access would be declared by Ministerial directive: Report by the Independent Committee of Inquiry, *National Competition Policy*, AGPS (1993) (the "Hilmer Report"). The recommendations of the Hilmer Report are discussed later in the paper.

effective substitutes for u. That is, u is an "essential ingredient" in the production of d.

We will also assume that there is only a single producer of u, which we will refer to as U. The fact that U is the only source of u is not, however, enough to give U monopoly power.<sup>5</sup> It is also necessary that there be no good substitutes for the downstream product d which can be produced without using u as an input. If consumers of d have good substitutes, then any attempt by U to raise prices for u will be unprofitable since, when producers of d try to pass on the higher costs to their own customers, those customers will substitute other products and buy less d. But, when less d is sold in the downstream market, less u is purchased by the producers of d. Hence, U loses sales just as surely as if it faced direct competition in the sale of u.<sup>6</sup> We will assume that there are no good substitutes for d and, as a consequence, U has genuine monopoly power.<sup>7</sup>

Now we need to build in some prices and costs. We have chosen numbers which make the calculations simple, but the analytical results do not depend in any

5 We define monopoly power as the power of a firm profitably to raise price above the competitive level: cf *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177 at 188; *Re Queensland Co-operative Milling Association Ltd v Defiance Holdings Ltd* (1976) 1 ATPR ¶40-012. In actual trade practices cases, we would want to add "by a non-trivial amount" and "for a sustained period", but these qualifiers will not be necessary for our demonstration. The qualifier "profitably" is critical, however. Any firm can raise prices above the competitive level. For firms whose customers have good substitutes, the amount sold will decrease by so much that the decision will not be profitable. Only a firm which does not face good substitutes will find it profitable to raise prices above competitive level. Such a firm has genuine monopoly power or market power: cf s 50(3) of the Act. The distinction between monopoly power and substantial market power under s 46 is not important for this analysis. For discussion of these concepts, see G Hay, "Market Power in Antitrust" (1993) 60 *Antitrust Law Journal* 177; G Hay, "Market Power in Australasian Antitrust: An American Perspective" (1994) 2 *Competition and Consumer Law Journal*.

6 Thus, for example, the supply of aluminum might be in the control of a single firm and aluminum might be an essential ingredient in the production of aluminum pipe, but if plastic pipe is a very good substitute for aluminum pipe in the downstream market, the aluminum monopolist has no real market power. Any effort to raise the price of aluminum will result in fewer sales of aluminum pipe as consumers of the now more expensive aluminum pipe switch to plastic pipe. When this happens, fewer sales of aluminum are made and the price increase is unprofitable. The weaker the degree of substitutability between aluminum pipe and plastic pipe in the downstream market, the greater is the market power of the aluminum monopolist.

7 This proposition has important implications for market definition in merger cases under s 50 and cases involving allegations of misuse of market power under s 46. Unfortunately, it has frequently been ignored by the courts. In *QIW Retailers Ltd v Davids Holdings Pty Ltd; Attorney-General of the Commonwealth v Davids Holdings Pty Ltd* (1993) 15 ATPR ¶41-226 the Court found that the proposed merger between QIW and Davids would breach s 50 of the Act.

QIW and Davids were two general wholesalers supplying groceries to independent retailers, who sell groceries to the public in competition with the national chains. In determining market definition the Court rejected the notion that the retail pricing and product policies of the national chains acted as a constraint on the pricing policy of the independent retailers and, hence, on the prices which Davids and QIW could charge those retailers.

The proposition is acknowledged, at least indirectly, in the 1992 *United States Department of Justice Merger Guidelines* and in the Draft Australian Merger Guidelines published by the Trade Practices Commission: Trade Practices Commission, *Merger Guidelines: A guide to the Commission's administration of the merger provisions (ss 50 and 50A) of the Trade Practices Act*, AGPS (November 1992). For a discussion of the latter, see G Hay and J Walker, "Merger Policy and the TPC's Draft Merger Guidelines" (1993-94) 1 *CCLJ* 33.

important way on the numbers chosen. First, we assume that U operates in the upstream market only and that U's marginal cost of producing u is constant at \$2. Second, we assume that U's profit-maximising monopoly price for u is \$5; hence, U earns \$3 per unit profits on the sale of u. Third, we assume that the cost of transforming u into d is constant at \$1 per unit; hence, for downstream producers of d, the overall marginal cost of d is \$6 (the \$5 price to buy a unit of u and \$1 cost of transforming u into d). Fourth, we assume that there are enough downstream producers to make for effective competition at this level; hence, the price of d will be driven to marginal cost, \$6. Finally, we assume that demand for d at the \$6 price is 100 units per period; hence, under our previous assumption that one unit of u is required for each unit of d, U's profits would be \$300 per period.

We take it to be the current state of the law under s 46 that, if U achieved its monopoly over u lawfully and retains it lawfully, there is no legal restriction on its ability to charge the monopoly price and earn the associated profits despite the harm done to consumers and the allocative inefficiency that results from monopoly pricing.<sup>8</sup> Hence, if U limits itself to the production of u, it has nothing to fear from the Act.

Suppose now that instead of being limited to the upstream market, U is vertically integrated into the production of d and that, at least initially, it is the only producer of d as well. Assuming as above that the marginal cost of u remains at \$2 and the cost of transforming a unit of u into a unit of d remains at \$1 (hence U's overall marginal costs of producing d are \$3 per unit), it is an easy matter to show that U's profit-maximizing price in the downstream market is \$6 and that it will earn monopoly profits of \$300 per period, exactly the same as when it was limited to the upstream market. Again, we assume that the current state of the law under s 46 is

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8 The Full Federal Court in *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* (1991) 13 ATPR ¶41-109 at 52,666 stated in its orders for the decision:

Section 46 does not strike at 'monopolists' or those in a 'monopolistic position'...Therefore, there is no contravention of that provision by a corporation with a substantial degree of power in a market which it uses to obtain a particular price...

Section 46 has never been considered as a tool in controlling excessive pricing: cf Senate Standing Committee on Legal and Constitutional Affairs (Cooney Committee), *Mergers, Monopolies and Acquisitions: adequacy of existing legislative controls*, AGPS (1991) at [5.36]-[5.38], [5.69]; Hilmer Report, note 4 *supra* at 64.

In the United States monopolistic pricing will also not constitute a breach of s 2 of the *Sherman Act*: *Berkey Photo Inc v Eastman Kodak C* 603 F 2d 263 (2nd Cir 1979). In the United States the argument for this policy is that the competitive system is designed to encourage firms to compete hard to win the favour of consumers. If successful firms were punished by not allowing them to keep whatever profits they were able to capture, the incentive to compete hard would suffer. High prices also encourage new entry. The United States courts are also sensitive to the problems of determining precisely what a "fair" price for the monopolist to charge would be: cf *Consolidated Gas Co of Florida v City Gas Co of Florida* 665 F Supp 1493 (1987); *Byars v Bluff City News Co* 609 F 2d 843 (6th Cir 1979). The latter will turn out to be important in our demonstration of the futility of a "duty to deal".

that, so long as U has done nothing out of the ordinary to obtain and retain its monopoly, it is entitled to charge monopoly prices and to earn monopoly profits.

U's problems under the Act are likely to emerge under a combination of the two scenarios described above, in which U continues to be a monopolist with respect to u, and is integrated downstream into the production of d, but is not the sole producer of d. Rather it faces competition in the sale of d from other downstream firms who are dependent on U for their supply of u. We defer a discussion of the antitrust issues for now to concentrate on the analytics of the situation. It is an easy matter to show that, so long as the independent producers of d are just as efficient as U at converting u into d, U's profit-maximising price of u will still be \$5; its profit-maximising price of d in the downstream market will still be \$6 (which will also be the price charged by the independent producers of d), and its monopoly profits will be \$300 per period regardless of the proportion of the total downstream market captured by the independent producers of d, since it makes \$3 per unit profit on sales of u to the independents and \$3 per unit profit on sales of d. Hence, so long as U is free to charge the monopoly price (\$5) for u, it has no reason not to sell to the independent downstream producers even though it loses sales in the downstream market.<sup>9</sup>

### III. IMPLICATIONS FOR A "DUTY TO DEAL"

The fact that the downstream price of u and the profits of U are unaffected by how much of the downstream demand is satisfied by the independent downstream producers has several important implications.

#### A. A Duty to Deal at the Profit-maximising Price is of No Benefit to the Consumer

Under the assumptions we have made, U has no particular reason to refuse to sell to the downstream firms. Indeed, even defining a refusal to deal becomes problematic where U, rather than refusing outright to sell to the downstream firms, simply sets a price for u which, combined with U's profit-maximising price for d in the downstream market, makes it impossible for the independent downstream firms to buy from U and still make a profit.<sup>10</sup> If we observe an outright refusal to deal, it

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9 The way the principle underlying this example is sometimes expressed is that there is a single amount of monopoly profits to be earned from the sale of d and that a monopolist at any point in the vertical chain can capture all of those profits. An upstream monopolist can gain no additional monopoly profits by acquiring a second monopoly, ie, the monopoly in the downstream market: cf R Bork, *The Antitrust Paradox: A Policy at War with Itself*, Basic Books (1978) pp 141ff.

10 Thus, for example, if it costs the independents \$2 rather than \$1 to convert u into d, at a price for u of \$5 the independents will not find it profitable to buy from U and still attempt to compete with it in the downstream market. Knowing this, U might simply not offer to sell in the first place or, if it offers u at a price of \$5, the downstream firms might charge U with a "constructive" refusal to deal: cf *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177. Yet, any requirement that U sell to the downstream independents at a price which permits them to compete effectively against U in the downstream

is likely that one of our initial assumptions is not satisfied (such as the assumption that the downstream firms are equally efficient) and that this provides the motive for U's refusal. In that case, the competitive consequences of U's conduct cannot be properly assessed without identifying the way in which the original assumptions are altered and factoring that into the analysis.<sup>11</sup> More importantly, even if U's refusal is completely arbitrary, any effort by the courts to require U to sell to the downstream producers will have no consequences either for consumers (the price will continue to be \$6) or for U's profits (which will continue to be \$300 per period), so long as U is allowed to choose the price at which it will supply (in which case it will choose a price of \$5).

For these reasons, so long as U is entitled to charge the profit-maximising price for u whenever it sells u to downstream independents, a general requirement that U, the upstream monopolist (or owner of an essential facility), deal with downstream competitors is a superfluous and competitively meaningless obligation.

#### **B. Forcing the Monopolist to Sell at a "Competitive" Price May Solve the Short Run Problem but Distorts Incentives in the Long Run**

An important assumption in the demonstration above was that the upstream monopolist, even when integrated into the downstream market to some degree, is permitted to charge the profit-maximising monopoly price for u, whenever it sells u to independent downstream firms. An understanding of the importance of this assumption might tempt a court, determined to resolve this duty-to-deal problem, to exert some degree of control over the price charged by U to the downstream independents, in effect requiring U to sell at a "competitive price" (which in the context of the example is \$2). There are two ways in which this requirement might be imposed. The first would be for the court to say: "You don't have to sell to the independents at all but, if you do, you must sell at a competitive price." Clearly, in this case, the independents will want to buy from U (unless they are so horribly inefficient that, even at \$2, they cannot make a profit in the downstream market) and U will not want to sell at all (since it earns no additional profits on sales made to the independents while still earning \$3 on sales it makes in the downstream

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market is both difficult to enforce (what is that price?) and also inefficient, since it penalises U for its comparative efficiency and subsidises the inefficiency of the independents. The greater the gap in the respective costs of U and the downstream independent firms, the more U has to reduce the price of u to permit them to compete.

11 To motivate a refusal, it would have to be the case that the independent downstream producers are less efficient than U in producing d. If they were more efficient, U would have every reason to want the independents to have as much of the downstream market as possible, so long as there were enough firms for effective competition.

market itself).<sup>12</sup> Hence, setting the price of arms-length sales, without requiring U to sell to any firm that might wish to buy at that price, does not accomplish anything.<sup>13</sup>

Thus frustrated, the court will be tempted to go the next step: "So long as you are integrated into the downstream market you must sell to any firm that chooses to compete against you and you must do so at a competitive price."<sup>14</sup> In this case, U cannot refuse to deal (although it may try to find other ways to avoid having to do so) and must charge a price of \$2. This assumes, of course, that a court is capable of figuring out what the "competitive price" would be in order to determine whether U is satisfying the requirement. This is not a trivial problem and is one of the reasons United States' courts have been reluctant to get into the situation of having to specify a competitive price in a variety of contexts.<sup>15</sup> But, if this practical problem can be overcome, it appears to offer some benefit to consumers. If U is required to sell to the independents at \$2, they can afford to buy from U and sell in the downstream market for substantially less than \$6. Indeed, absent any differences in the efficiency of U and the downstream firms, we would expect the price of d to fall to \$3. Hence, the requirement, as interpreted, seems to be an effective way to undermine the upstream monopoly and the price and profits associated with it.<sup>16</sup>

However, expressing the result this way not only lays bare the anomaly in the rule, but also hints at the long run consequences of the rule. The rule is anomalous because, as we have interpreted s 46, U is not at all restrained from charging

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12 U's refusal may not be blatant. It may simply never put together the sales structure necessary to sell in the external market or will find other excuses not to deal with the independents. The point is simply that one explanation for a refusal to deal is that, because of the implicit regulation on the price of u, U makes substantially more money by keeping all the downstream sales to itself.

13 There is also the problem of identifying the competitive price. Since our conclusion is that no sales will be made, we defer this problem.

14 A somewhat more legalistic way to put the requirement would be to say that you may not refuse to deal with a downstream competitor if the purpose or effect of that refusal is to injure competition in the downstream market, but it is the interpretation of the requirement that is important for the results.

15 Thus, for example, it is not a charge of price fixing under US law, that the firms were charging a "reasonable price." See *US v Addyston Pipe & Steel Co* 85 F 271 (6th Cir 1899), modified and affirmed, 175 US 211 (1899). A regulatory body could take the place of the court but there is a reluctance in Australia to entrust a regulatory body with general price fixing powers. The Hilmer Committee recommended that a limited prices monitoring and surveillance power be entrusted to the proposed National Competition Council (NCC), but specifically excluded price control: Hilmer Report, note 4 *supra* at 289-91. The NCC is proposed to be established jointly by the Commonwealth, State and Territory Governments to assist in coordinating reform and provide independent and expert policy advice on issues arising from the development and implementation of the national competition policy: *ibid* at 313-40.

16 A less severe requirement would be that U must sell to the downstream firms at a price which permits them to compete. But this rule, in addition to the long run consequences discussed below, will be difficult to interpret. In some sense, selling u at \$5 allows the independents to compete if they are as efficient in the production of d as U's downstream subsidiary. If they are not, U is forced to lower the price of u in direct proportion to the degree of their inefficiency, hardly a requirement calculated to produce salutary results. Moreover, if the independents are inefficient, U will want to lower its own price for d to something less than \$6 so as to retain as much of the business as possible. Even though this is the efficient outcome, the downstream firms will complain of a "price squeeze" and there will inevitably be litigation over the degree of "breathing room" U is required to allow the independents.



monopoly prices and making monopoly profits so long as it is not vertically integrated into the downstream market, ie, so long as it merely produces u. However, a firm which chooses to integrate into the downstream market is subject to having its monopoly profits competed away by virtue of having to sell input to its downstream rivals at a competitive price. In the long run, the solution for U is clear - do not vertically integrate into the downstream market and instead simply sell u to all buyers at the monopoly price (\$5). This rule is inefficient, not only because it provides no benefits to the consumer (the price of u does not fall below \$6), but also because there are many circumstances in which the total costs of production will be lower when a firm is vertically integrated.<sup>17</sup> Indeed, every firm is vertically integrated to some degree and it is largely the efficiencies of integration which determine the degree. Yet, U has an incentive to cease production of d and limit itself to the upstream market, even when integration would be more efficient. And, if this happens, the price to the consumer will actually be higher, not lower.<sup>18</sup>

#### IV. THE DECISIONS UNDER s 46 OF THE TRADE PRACTICES ACT 1974 (CTH)

The overall conclusion we reach from the simple examples provided above is that there is a fundamental incompatibility between the general principle that an unintegrated monopolist can charge a monopoly price but an integrated monopolist must sell to its potential downstream competitors at some price other than what it would unilaterally choose. The incompatibility can result in the courts having to take on a price control function they are ill-equipped to handle and in serious distortions in the incentives of firms to participate in vertically related markets. Yet this appears to be exactly the current situation under s 46 of Act. In *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd*,<sup>19</sup> Broken Hill Proprietary Co Ltd (BHP) was charged with a "constructive" refusal to supply because it had offered to supply Y-bar to Queensland Wire Industries (QWI), at an

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17 See generally Williamson, *Markets and Hierarchies*, Free Press (1975); P Areeda and DF Turner, *Antitrust Law*, Little Brown (1978-82) Vol III, at [725]-[726]; Note, "Refusals to Deal by Vertically Integrated Monopolists" (1974) 87 *Harvard Law Review* 1720; *Byars v Bluff City News Co* 609 F 2d 843 (6th Cir 1979).

18 If, for example, an independent downstream firm had marginal costs of converting u into d of \$2, and U charged \$5 per unit of u, the price to consumers would be \$7, not \$6. As a technical matter, it will generally be true that the monopolist's profit-maximising price for u in such a situation will be somewhat less than \$5. For example, the profit-maximising price of u might be \$4.50, resulting in a price for d of \$6.50. In no event would the final price be as low as \$6.

19 Note 4 *supra*.

"excessively high"<sup>20</sup> and "[un]competitive" price<sup>21</sup> with the purpose of deterring or preventing QWI from engaging in competitive conduct in the downstream market of rural fencing.<sup>22</sup> Y-bar was an essential input in the manufacture of star-picket fences and BHP's subsidiary, Australian Wire Industries (AWI), competed with QWI in the manufacture of star-picket fences in the rural fencing market. Pincus J in the Federal Court at first instance stated:

...the offer made by BHP was pitched at a level which BHP knew would make it impossible of acceptance, because [QWI] could not manufacture star picket from Y-Bar purchased at that price and sell it competitively.<sup>23</sup>

Hence, while the courts have maintained that there is no prohibition under s 46 for the charging of a monopoly price, a "constructive" refusal to supply will be established if there is an offer to supply at an "excessively high price" or an "uncompetitive price" defined (in this case) by the effect the price for Y-bar would have on QWI's ability to compete in the downstream market.<sup>24</sup>

The principle in *Queensland Wire* has been applied in other s 46 cases. In *O'Keefe Nominees Pty Ltd v BP Australia*<sup>25</sup> a misuse of market power was established merely because the high prices charged by the respondent eroded the profit margin and competitive ability of the downstream firm. The applicant was a wholesaler and retailer in petroleum products who obtained its bulk supplies from the respondent. The applicant supplied petroleum to independent service stations, which competed directly with service stations operated by the respondent. In *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd*,<sup>26</sup> the respondent (ASX) supplied stock exchange information to retail financial information companies such as the applicant but also to its subsidiary which competed with the other retailers in the downstream market. The imposition of a high fee structure in the supply agreement, which was claimed by the respondent to be a "commercially realistic

20 "[A]n excessively high price relative to other BHP products...Queensland Wire cannot obtain Y-bar at a reasonable price", per Mason CJ and Wilson J.

21 Per Toohey J; it was an "unrealistically high" price, per Deane J; Dawson J agreed generally with the judgment of Deane J; cf Pincus J at first instance: (1987) 16 FCR 50 at 61.

22 Section 46(1)(c) of the Act.

23 (1987) 16 FCR 50 at 61.

24 The opinion contains some language that might be interpreted as restricting the reach of the "duty to deal" obligation, but we think the courts' efforts along those lines will not have much impact. For example, the so-called "nexus" requirement set out by the Court (that BHP "...used that power in a manner made possible only by the absence of competitive conditions": (1989) 167 CLR 177 at 202, per Dawson J; at 192, per Mason CJ and Wilson J; at 197-198, per Deane J; at 216, per Toohey J) is unhelpful in identifying a misuse of market power in these circumstances since the charging of a monopoly price is consistent with the mere "use" of monopoly power made possible by the absence of competitive conditions.

"Purpose" under s 46 has been interpreted as the subjective purpose of the monopolist. See *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* (1991) 13 ATPR ¶41-069 at 52,059; *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1992) 14 ATPR ¶41-167 at 40,303; *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109 at 142. In *Queensland Wire*, it could have been argued that BHP's purpose was merely the collection of monopoly profits, the setting of a "profit-maximising" price or the obtaining of the efficiencies which flowed from vertical integration. But these factors were given very little consideration by the Court.

25 (1990) 12 ATPR ¶41-057.

26 (1991) 13 ATPR ¶41-069.

price” for the data, was found by the Full Federal Court to constitute a misuse of market power because it deterred the applicant from engaging in competitive conduct in the retail market.<sup>27</sup>

In each of these cases, the Court has, in effect, attempted to impose a “duty to deal” at a competitive price, without specifying the price or giving clear guidelines as to the criteria to be used in identifying such a price. The Court seems reluctant to set prices because this raises complex issues of the supervision of the on-going commercial relationship and the feasibility of supply. The Court seems to believe that merely establishing the requirement will suffice to restore competitive conditions.<sup>28</sup> Unfortunately, absent some constraint on the price to be charged, imposing a duty-to-deal is a useless remedy. Yet, attempting to constrain the price at which the monopolist sells (in those circumstances in which it is vertically integrated into the downstream market) creates an asymmetry in the treatment of monopoly pricing under s 46 and induces firms to make inappropriate decisions about the degree to which they will participate in downstream markets.

Courts may perceive that the problem of requiring a monopolist to supply and specifying a supply price is circumvented when there exists a previous course of dealing.<sup>29</sup> However, while this may occasionally be effective on an ad hoc basis, there are two reasons why it is inappropriate as a principle of law. First, a decision to supply a downstream rival at a particular price may be economically rational at a particular point in time but, as economic circumstances change, the upstream firm’s individually rational response may be to increase the supply price or to cease dealing altogether. A requirement to continue the status quo ante indefinitely freezes the upstream firm into a situation which may become grossly inefficient and unfair over time. Second, if the principle is firmly established, firms will tailor their original supply arrangements with an eye toward the difficulty of making changes in those relationships later on. Firms might choose never to supply a

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27 (1991) 13 ATPR ¶41-069 at 52,068. This excessive pricing of the intermediate good causes a “price squeeze” which forces competitors out of the downstream market. *United States v Aluminum Co of America* (the “Alcoa case”) 148 F 2d 416 (1945). In the *Alcoa* case, the Court focused on the earning of a “living profit” by the downstream competitors: *ibid* at 436-7. This focus on the competitor’s profit margin for the final product can be criticised for diminishing the importance of competition analysis and the efficiencies gained from the monopolist’s vertical integration at the second level of operation: cf Areeda and Turner, note 17 *supra* at [728]-[729].

28 In *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, Pincus J was relieved of this matter by the settlement between the parties. The terms of the settlement have not been disclosed: see *Australian Financial Review*, 15 August 1989; cf R Wright, “Injunctive Relief in Cases of Refusal to Supply” (1991) 19 ABLR 65.

29 Cf *MacLean v Shell Chemical (Australia) Pty Ltd* (1984) 6 ATPR ¶40-462; *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd* (1987) 9 ATPR ¶40-809; *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* (1991) 13 ATPR ¶41-069.

downstream rival, to do so only at a price which is higher than it might otherwise choose for the short run but designed to protect the supplier against changed circumstances, or, as suggested above, to limit itself to the upstream market (where it can presumably charge whatever it wants) even though vertical integration is efficient.<sup>30</sup>

## V. THE DUTY TO DEAL REQUIREMENT AND THE "ESSENTIAL FACILITY DOCTRINE"

There are certain limited circumstances in which requiring a monopolist to deal is at least potentially feasible, pro-competitive or both. Indeed, it was precisely under some of these special circumstances that the United States case law on "essential facilities" developed. The special circumstances fall generally into two categories: upstream regulation and non-discrimination.

### A. Upstream Regulation

Assume that the upstream monopolist U is deemed to be a "natural monopoly"<sup>31</sup> and is subject to some form of rate regulation. To simplify, we will assume that regulation takes the simple form of requiring U to set a price of \$2 per unit of u. We will assume further that the downstream market is unregulated.<sup>32</sup> Hence, if U

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30 This is precisely the problem created by one of the more famous American "duty to deal" cases, *Aspen Skiing Co v Aspen Highlands Skiing Corp* 72 US 585 (1985). The defendant, Aspen Skiing Company, owned three of the four mountains in the vicinity of Aspen, Colorado, which was assumed for purposes of the appeal to be a relevant geographic market for skiing. For several years, the defendant and plaintiff, the owner of the other mountain, cooperated to issue an "all mountain" weekly ski pass, which permitted the holder to ski at any of the four mountains on a given day. The passes were particularly popular with out-of-town skiers, who came to Aspen for a week's skiing holiday. The defendant eventually became dissatisfied with the arrangement and not only withdrew from the arrangement but also took some rather heavy handed steps to prevent the plaintiff from effectively recreating the all-mountain pass by combining tickets from its own mountain with daily passes offered for sale by the defendant. The Court observed that it could find no legitimate business reason for defendant's withdrawal from the arrangement and awarded damages to the plaintiff. Under the rather special circumstances of the case, defendant's tactics seemed inappropriate and perhaps damages were appropriate, but the principle established by the case - that once you enter into a joint venture that is critical to your partner's ability to compete effectively, you may not withdraw without proving (to the Court's satisfaction) a legitimate business reason - will give serious pause to a firm being asked to enter into such an arrangement for the first time.

31 Generally speaking, a situation of "natural monopoly" exists when economies of scale are so substantial that it is far more efficient to have a single firm supply all of the output than to have competition among two or more smaller firms. Under such circumstances, not only is monopoly the preferred structure from an efficiency standpoint, but also, any effort to foster competition is almost certainly doomed to failure. As soon as one firm becomes larger than its competitors, scale economies result in its having lower costs than its rivals, permitting lower prices. But the lower prices result in an even greater market share which in turn lowers costs even further, leading to another round of price cutting. The process continues until the firm has acquired 100 per cent of the business.

32 An alternative assumption, which generates essentially the same results, is that downstream regulation is less effective than upstream regulation so that, while a downstream monopolist could not charge the pure monopoly price, it could nevertheless earn some significant margin over the competitive price.

is integrated into the downstream market, and faces no competition there, it will charge the monopoly price of \$6 and make \$300 profit per period. Since it has no competitors downstream, all u production will be transferred to U's downstream subsidiary, and the regulation of the upstream price will be irrelevant.

The situation as just described is, however, unstable. Assuming that the downstream market is not a natural monopoly and that barriers to entry are low, firms have an incentive to enter the downstream market if they can obtain adequate supplies of u at the regulated price of \$2. If entry does occur, we would expect the downstream price eventually to fall to \$3 and all monopoly profits to be eliminated. U, of course, has a strong incentive to resist entry and, left to its own, will refuse to sell to would-be downstream competitors.

In this situation, requiring U to deal does have the potential to help consumers, since a requirement to deal is, because of the regulation at the upstream level, a requirement to deal at a competitive price. Moreover, the antitrust court does not have to get involved in calculating the "competitive price" since there is, presumably, an existing regulatory body to carry out that function.<sup>33</sup>

The example just given is a simplified version of the facts in one of the classic United States cases that provided the foundation of the essential facilities doctrine, *United States v Otter Tail*.<sup>34</sup> In that case Otter Tail was a vertically integrated power company. It generated power, transmitted power over its long distance transmission lines and, for most of the towns in its service area, provided retail service as well. However, in a small number of towns where its retail franchise had expired, the towns attempted to replace Otter Tail with a municipal distribution system, intending to buy power from Otter Tail at wholesale rates or to purchase power from other sources and transmit it using Otter Tail's transmission facilities to "wheel" the power. Otter Tail attempted to prevent its being replaced by refusing to sell power at wholesale and refusing to wheel power. Presumably, Otter Tail's motive was that rate regulation at the retail level was more generous than federal regulation at the generation or transmission level. Hence, it would earn greater profits if it could perform the retail function itself.

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33 In recently privatised and restructured industries, while there may be an implicit regulatory requirement to sell at a "competitive price", there may be no history of supply, no pre-existing regulatory framework, and hence no benchmark for what constitutes a competitive price. Hence, a court may have to take on the regulatory function if it is to decide whether the price charged by the upstream monopolist is reasonable. This was the core of the recent New Zealand litigation involving Telecom and its newly established competitor in long distance service, *Clear Communications: Clear Communications Ltd v Telecom Corp of New Zealand Ltd & Ors* (1993) 4 NZBLC ¶99-321.

34 410 US 366 (1973).

The Supreme Court found Otter Tail's conduct to violate s 2 of the *Sherman Act*<sup>35</sup> since the purpose and effect of its refusal to deal was to maintain a monopoly at the retail level. In this case, however, the Court did not need to dictate the price at which Otter Tail would be required to sell as that would be determined by ongoing federal regulation by an expert administrative body. The fact of ongoing regulation does not solve all the problems since the fundamental incentive for the upstream firm to refuse to deal remains, and the court will have to determine whether in the specific instance there are other "legitimate" reasons why the upstream firm might reasonably have refused.<sup>36</sup> But that, at least, is the kind of scrutiny antitrust courts have some comparative expertise in. Moreover, the fact that Otter Tail's wholesale rates were subject to regulation regardless of its participation in the downstream market meant that the duty to deal imposed by the Court would not distort Otter Tail's incentives to vertically integrate.

## B. Non-discrimination

### (i) *The General Case*

Another circumstance in which a requirement to deal may work involves situations in which the upstream firm is regularly selling *u* to buyers at a particular price, but chooses not to sell to one particular firm or type of firm. For example, suppose that *u* has two different uses; ie, there are two different downstream products into which it is an input. The first downstream product, *da*, is one which faces intense competition from other, substitute, products. Even though *U* is the only source of *u*, its profit-maximising price for *u* must reflect the fact that there are good substitutes for *da*. Hence, that price will be competitive, ie, \$2. The other downstream product, *db*, is one for which there are no good substitutes. Using the numbers from our original example, if *U* were to vertically integrate into the downstream market, and faced no competition from other producers of *db*, its profit-maximising price for *db* would be \$6 and it would earn monopoly profits of \$3 per unit or \$300 per period.

However, as in our earlier example, the situation is unstable. Other firms have an incentive to enter the production of *db* so long as they can obtain their supplies of *u* at the same price *U* is charging to firms that produce *da*, ie, \$2. *U*, of course, has an incentive to resist. It would be willing to sell *u* to producers of *db* for \$5, but if price discrimination is not feasible or not permitted by virtue of s 49 of the Act,<sup>37</sup> *U*'s alternative strategy is simply not to supply *u* to *db* producers at all.<sup>38</sup>

35 Section 2 of the *Sherman Act* 1890 provides that: "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony".

36 An unqualified duty to deal at the regulated price cannot sensibly be imposed. Suppose the downstream firm refused to pay its bills; could the upstream monopolist not lawfully refuse to provide any additional supply? But if failure to pay is a "legitimate" basis for refusal to supply, surely there are other plausible but less obvious arguments the upstream firm might make.

37 Section 49 of the Act prohibits a corporation from discriminating in price between purchasers of goods of like grade and quality: cf *Cool and Sons Pty Ltd v O'Brien Glass Industries Ltd* (1981) 35 ALR 445. The Hilmer

In such a case, a court might productively require U to deal with db producers, with the order essentially being a non-discriminate order; that is, sell u to all buyers at the same price. The court does not need to compute the price since it is whatever U is charging other buyers. If, in fact, U does charge \$2 to all potential buyers of u, the monopoly profits in the db market will be eroded, to the benefit of consumers.<sup>39</sup>

A situation analytically similar to the above example was involved in another of the classic "duty to deal" cases, *Lorain Journal Co v United States*.<sup>40</sup> The Lorain Journal published the only daily newspapers in the city of Lorain, Ohio at a time when local daily newspapers were a very important part of the American culture. Its newspapers reached 99 per cent of the families in the city. The Journal felt that its advertising revenues would be threatened by a new local radio station. The Journal attempted to deal with this threat by refusing to accept local advertising from any local advertiser who advertised on the radio station. The Court found that, while advertising on the radio was perhaps an attractive addition to an advertiser's marketing plan, most advertisers could not afford to completely give up advertising in the Journal. Confronted with the Journal's policy, many local merchants ceased or abandoned their plans to advertise on the radio, thereby threatening the viability of the station and preserving the Journal's advertising monopoly.

The Court found that the Journal's conduct constituted an attempt to monopolise and, in effect, required the Journal to deal with the merchants in question. However, the Court did not need to set the terms at which the Journal would sell advertising other than to say that the Journal could not discriminate against those individual merchants who chose to advertise using the radio as well.<sup>41</sup>

However, even though in a case like *Lorain Journal*, the imposition of a non-discriminatory "duty to deal" seems reasonable, there are serious questions about

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Committee has recommended the repeal of s 49 preferring issues of price discrimination to be dealt with as an abuse of market power under s 46 of the Act: Hilmer Report, note 4 *supra* at 79-80.

38 Sometimes this may not be possible. For example, db producers may be able to obtain supplies from da producers who order more from U than they need.

39 Unfortunately, however, the court cannot guarantee complete success from a requirement on U to deal in this case. U might decide simply to charge a non-discriminatory price of \$5, which is tantamount to abandoning the da market altogether. This will more likely be the case if db sales are large relative to potential da sales. Hence, as in the previous model, there is the potential for the rule to distort the firm's incentives as to what markets it participates in.

40 342 US 143 (1912).

41 In terms of the hypothetical, the two products were: (a) advertising to those who advertised only in the Journal, and (b) advertising to those who advertised both on the radio and in the Journal. To make the actual case resemble the hypothetical more closely, assume that the radio station purchased advertising space in the Journal which it then resold in conjunction with the radio ads to those who wanted to advertise in both media.

how far the principle can be extended. For example, consider situations involving a manufacturer with market power and its wholesale or retail dealers. For any number of reasons, a manufacturer might feel that there is an optimal number of dealers in a given area and will refuse to supply others even where they are just as well qualified. In cases where the manufacturer does not also operate in the downstream market as a dealer, perhaps no duty is contemplated and therefore no problems of interpretation arise. But when the manufacturer elects to vertically integrate forward into distribution or retail, the non-discriminatory "duty to deal" requirement might be interpreted to remove the manufacturer's right to select its dealers and to limit their number.

(ii) *Access to Joint Ventures*

A slightly more complex version of the non-discrimination issue arose in the third of the classic cases, *United States v Terminal Railroad*.<sup>42</sup> The Terminal Railroad Association was a joint venture organised initially by six railroad companies. At the time of the complaint, fourteen companies were joint owners. The Association controlled the terminal facilities without which no railroad could enter the city of St. Louis from either side of the Mississippi River. Because of the topography of the area, building additional facilities would not have been feasible. The rules of the joint venture provided that others could join the joint venture provided there was unanimous consent to their admission and the price they paid for admission. While nonproprietors could use the facilities for the same fee paid by the proprietors, and the defendants asserted that no company had been excluded from use or ownership, the Court nevertheless felt that, given the essential nature of the terminal facilities, the rules of the joint venture giving existing owners discretion over who could join violated the *Sherman Act*. The Court required that the rules be changed so as to provide for the admission of any existing or future railroad to joint ownership upon "such just and reasonable terms as shall place such applying company upon a plane of equality in respect of benefits and burdens with the present proprietary companies" and remanded the case to the lower court for entry of the decree and to exercise continuing oversight over the terms of access.

This appears to be quite similar to *Lorain Journal* in that what the Court was requiring was that the joint venture admit other firms on the same terms as the original members. But while there may be situations where this will not be problematic, in many other situations some very sticky issues will arise. Assume, for example, that the original member railroads built or acquired the critical terminal facility many years ago and, at the time, it was unclear that the project would be a commercial success. When a newcomer emerges at a later date, at least two issues arise when the court requires to treat newcomers "equally". First, how do we adjust the investment of the original members for the passage of time in order to compute an "equivalent" contribution at a later date? Second, and more

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42 224 US 383 (1912).



importantly, how do we adjust the terms for latecomers to reflect the fact that the original members bore the risk that the project would not succeed? Surely, it would not be efficient (or fair) to allow newcomers simply to match the original investment (with adjustment for inflation) since it would create incentives never to be a member of the original group but rather to wait and see if the project succeeds. But precisely how much to reward the original members for the risks they undertook is hardly a question antitrust courts are well equipped to determine.<sup>43</sup>

Our conclusion, then, is that there are conditions under which a "duty to deal" can promote efficiency and competition, but they are very limited. Unfortunately, courts in both the United States and Australia have ignored the special features of the early United States cases in trying to extend the essential facilities doctrine to a more general set of circumstances.<sup>44</sup>

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43 One possible solution is to enforce the "duty to deal" in such cases only at the time that the venture is formed, with the terms for newcomers being left entirely to the discretion of the original partners.

44 The extension of the essential facilities doctrine beyond its appropriate domain has not occurred without some resistance by Australian and New Zealand authorities. In *Queensland Wire* the applicant argued that BHP's control of Y-bar was to be likened to control of an essential facility. The Full Federal Court rejected the argument stating that the doctrine was not readily accommodated to the terms of s 46. The Court referred to the development of the doctrine in the United States courts as a gloss upon the succinct terms of the *Sherman Act*, specifically, as a relaxation of the requirement to prove intent or specific intent in the case of a refusal to deal. It expressed difficulty, at least in cases where a monopoly of electric power, transport, communications or some other "essential service" is not involved, in seeing the limits of the concept of "essential facility". It also recognised the problems in imposing a remedy which required someone to deal with a customer, especially in the absence of a regulatory body to aid in the determination of the price. The Court also questioned how much scope the doctrine allowed for the defence of a legitimate business purpose and vertical integration.

However, it can be argued that many of the reservations expressed by the Federal Court about the essential facility doctrine are now raised by s 46 itself in the light of the High Court decision in *Queensland Wire*. The Federal Court's concerns about the imposition of the duty to deal were clearly not considered a problem by the High Court nor by the Federal Court in *Pont Data*. These cases imposed a duty to deal and in *Pont Data* set prices, and both in the absence of any regulatory body which could determine price. Liability under s 46 after *Queensland Wire* also clearly extends beyond "essential services" such as electric power or communications.

In the inquiry into the collapse of Compass Airlines, the Trade Practices Commission had the opportunity of considering the application of the essential facility doctrine under s 46 to a previously regulated market. Compass had been denied access to terminal gates which were controlled by the existing airlines. The TPC found that Compass' failure to gain access to the terminal facilities "was a factor in its ability to compete effectively in the airline market", yet it did not regard this as constituting an infringement of s 46: Trade Practices Commission, *The Failure of Compass Airlines: Report by the Trade Practices Commission*, AGPS (February 1992). The TPC's finding seemed contrary to its previous submission to the Cooney Committee that the Act should ensure "access to essential facilities during the initial phase of deregulation of such industries": Trade Practices Commission, *Submission by the Trade Practices Commission to the inquiry into mergers, market dominance and unconscionable conduct by the Senate Standing Committee on legal and constitutional affairs*, AGPS (August 1991).

In New Zealand the doctrine has been applied by the New Zealand High Court under s 36 of the *Commerce Act 1986* which is in substantially the same terms as s 46: *Auckland Regional Authority v Mutual Rental*

## VI. THE HILMER REPORT ON NATIONAL COMPETITION POLICY

The 1993 Report by the Independent Committee of Inquiry into National Competition Policy (the "Hilmer Report") examined policies to increase competition in the newly deregulated markets which were traditionally supplied by public monopolies.<sup>45</sup> The Committee was particularly concerned about the anti-competitive effect of natural monopolies which are integrated with potentially competitive activities;<sup>46</sup> in particular the opportunities for "cross-subsidisation" and the denial of access to the natural monopoly element.<sup>47</sup>

As the Committee observes, s 46 is potentially applicable to this situation<sup>48</sup> and has in fact been applied in *Queensland Wire*, *Pont Data* and *O'Keeffe Nominees*. However, partly because of the perceived reluctance of Australian courts to incorporate an "essential facility" doctrine under the Act and the difficulty of incorporating such a doctrine when the courts are reluctant to set prices, the Committee proposed an "essential facility" regime to deal with the problems of access by new competitors to these previously regulated monopolies.<sup>49</sup> It noted that such access was of fundamental importance for the introduction of effective competition into these markets. The Committee proposed that the access right be declared by the relevant Minister exercising a discretion pursuant to certain legislative criteria.<sup>50</sup> Further, the creation of such a right must be recommended by an independent and expert body, the proposed National Competition Council (NCC).<sup>51</sup> The regime is to be economy-wide rather than industry specific.<sup>52</sup> It is

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*Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647. In *Union Shipping New Zealand Ltd v Port Nelson Ltd* [1990] 2 NZLR 662, however, the Court decided not to apply the doctrine because of the uncertainty of its scope.

- 45 Hilmer Report, note 4 *supra* at 219. The key recommendations of the Hilmer Committee were adopted by the Council of Australian Governments (COAG) meeting in Hobart on 25 February 1994. Draft legislation to implement these proposals is expected by August 1994: M Millet, "States Back PM's Reform Plan", *Sydney Morning Herald*, 26 February 1994.
- 46 For example, electricity transmission grids and electricity generation.
- 47 According to the Committee, "cross-subsidisation" occurs when monopoly returns made in the monopoly market may be used to finance otherwise unprofitable prices in the competitive market, potentially driving out or disadvantaging competitors: Hilmer Report, note 4 *supra* at 219.
- 48 The Committee also noted that the delays and uncertainty associated with judicial proceedings under s 46 may still have a deterrent effect on competition: *ibid* at 219, n 7.
- 49 The Griffiths and Cooney Committees had previously considered but rejected legislative proposals under s 46 for access to essential facilities: House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee), *Mergers, Takeovers and Monopolies: Profiting from Competition?*, AGPS (1989) at [4.6.32]; Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee), *Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls*, AGPS (1991).
- 50 The use of an "administrative" scheme whereby access is granted by the Minister exercising discretion under the broad legislative criteria of the "public interest" introduces the additional regulatory burden of review being available for "procedural fairness" and "ultra vires" under *the Administrative Decisions (Judicial Review) Act 1977* (Cth).
- 51 See discussion in note 15 *supra*.
- 52 In contrast to the already existing industry specific access regimes under note 15 *supra*, for example, the *Telecommunications Act 1991* and *Petroleum Pipelines Act 1969* (WA).

to be limited to major infrastructure facilities (electricity transmission grids, telecommunication networks and rail tracks) and not to products and production processes.

As we have argued a “duty to deal” requirement can be effective in a situation of upstream regulation. The Committee identifies this problem:

The main cases where the owner of a vertically integrated monopoly will have an incentive to deny access to an essential facility are where the owner is price regulated in the essential facility market and where providing access might undermine a profit-maximising price discrimination strategy in the dependent market.<sup>53</sup>

The Committee acknowledged that the law in general imposes no duty on one firm to do business with another and protects notions of private property and freedom of contract but recognised that this freedom may require qualification in the case of certain monopolies on public interest grounds. The Committee gave the example of certain transport functions, where natural monopoly characteristics gave rise to the common law notion of “common carriers”, where such carriers have an obligation to carry certain goods.<sup>54</sup> In these circumstances the “public interest” would demand the grant of access “without the need to establish any anti-competitive intent on the part of the owner for the purposes of the general conduct rules”.<sup>55</sup> While, according to the Committee, this public interest requirement would be established in only a few strategic industries which are of “significance to the economy” and are “essential to permit effective competition in a downstream or upstream market”, this criterion has the potential to cast a wide net.

In *Dowling v Dalgety Australia Ltd*,<sup>56</sup> although an “essential facility” was not argued, Lockhart J specifically denied the substance of the doctrine by accepting the respondents’ submission that they could not take advantage of their market power under s 46 by deciding not “to make available to Mr Dowling a valuable asset of theirs to advantage him as a competitor”.<sup>57</sup> The applicant had argued that the respondents’ failure to allow him access to their saleyards prevented him from competing in the market for the provision of livestock auctioneering services. A “public interest” requirement however could demand that the respondents share their asset.

More importantly, what the Committee seems not to appreciate fully is that extending the net of the doctrine means creating some price setting mechanism

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53 Hilmer Report, note 4 *supra* at 241.

54 *Ibid* at 242.

55 *Ibid* at 248.

56 (1992) 14 ATPR ¶41-165.

57 *Ibid* at 40,278.

where the upstream products are not now subject to price regulation. As we have argued, imposing price regulation only where the monopolist is also participating in downstream markets risks distorting firms' incentives to vertically integrate.

## VII. CONCLUSION

We have argued that the imposition of a "duty to deal" on a monopolist (or so called essential facility) is appropriate only under certain very limited circumstances. Failure to limit the scope of the duty may result in the order being ineffectual or working unfairly and inefficiently with respect to the vertically integrated monopolist. The High Court in *Queensland Wire* seemed not to appreciate the problems such a duty would create when applied to an otherwise unregulated vertically integrated monopolist. The Hilmer Committee, while usefully recognising the need for some form of regulation in the context of recently privatised natural monopolies, has proposed an essential facility regime which may extend beyond the limited circumstances where it is appropriate and therefore has the potential to foster the type of inefficiencies we have identified.