Queensland University of Technology
Brisbane Australia

This is the author's version of a work that was submitted/accepted for publication in the following source:

Corones, Stephen G. (2014) Strategic entry deterrence : does it constitute a misuse of market power? *Australian Business Law Review*, *42*(3), pp. 234-244.

This file was downloaded from: http://eprints.qut.edu.au/74455/

© Copyright 2014 Thomson Reuters (Professional) Australia Limited

Notice: *Changes introduced as a result of publishing processes such as copy-editing and formatting may not be reflected in this document. For a definitive version of this work, please refer to the published source:*

Strategic entry deterrence: does it constitute a misuse of market power?

By

Stephen Corones

Queensland University of Technology

Introduction

A challenge for regulators and the courts has been establishing the boundary between behaviour is exclusionary and should be condemned under s 46 of the then *Trade Practices Act 1974* (Cth) (TPA), now s 46 of the *Competition and Consumer Act 2010* (Cth) (CCA), and behaviour that is not exclusionary and might even be pro-competitive. This boundary can be especially difficult to draw in the case of entry deterring strategies. Section 46(1) prohibits corporations with a substantial degree of market power from taking advantage of that market power for one of the statutorily proscribed purposes which include preventing the entry of a person into that or any other market. Section 45(2) separately prohibits corporations from making and giving effect to contracts arrangements and understandings that have the purpose, effect or likely effect of substantially lessening competition in a market.

The latest case in which the ACCC has failed to satisfy the s 46 criteria is the decision of Greenwood J in *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 (*Cement Australia* case). Final orders were published in a separate judgment, in *ACCC v Cement Australia Pty Ltd* [2014] FCA 148 (28 February 2014). The case concerned an entry deterring strategy, namely the pre-emptive buying of input factors in an upstream market to protect an incumbent with substantial market power in a downstream market and to prevent new entry in the downstream market. Greenwood J found that while Cement Australia Pty Ltd, formerly known as Queensland Cement Ltd (QCL), had substantial market power, its conduct in entering into the pre-emptive contracts was not a contravention of s 46, because Cement Australia had not "taken advantage" of its market power. However, since Cement Australia's purpose in entering into the pre-emptive contracts was anti-competitive, they were held to contravene s 45(2) of the TPA.

The purpose of this Note is to consider only the reasons for judgment in the *Cement Australia* case in relation to the "taking advantage" element. The judgment was handed down on 10 September 2013. The final hearing date was 15 July 2011, so it was long-awaited. At 714 pages, it is carefully drafted.

Strategic entry deterrence

Strategic entry deterrence can be defined as any action taken by an incumbent in a market that discourages potential entrants from entering and competing in that market. Such

strategies include predatory pricing to build a predatory reputation, where an incumbent reduces its price to damage existing competitors or to deter or prevent new entry, and then raises its price when its rivals leave the market. They also include the strategic building of excess capacity, where an incumbent chooses to invest in new capacity over and above present and anticipated future requirements in order to deter new entry. Another example is the strategic pre-emption of scarce assets through long-term contracting, the conduct at issue in the *Cement Australia* case. Much has been written on the subject of strategic entry deterrence from a theoretical perspective.[1]

Incumbents can derive competitive advantages over new entrants through innocent strategies such as technological leadership arising from successful research and development and greater experience gained over time. Such conduct is pro-competitive, and benefits consumers through new products, and if there is vigorous competition, lower prices. Incumbents can also gain advantages over new entrants through predatory strategies such as the pre-emption of scarce assets through long-term contracting. These assets may be raw materials or other process inputs. They also include geographic space such as the prime retailing or manufacturing locations and storage and shelf space in supermarkets and other distribution outlets.

For example, this type of strategic entry barrier was recognised by the Tribunal in *Re Southern Cross Beverages Pty Ltd* (1981) 50 FLR 176. It held that a barrier to entry was constituted by the supply of soft drink vending equipment to shopkeepers on the condition that it would be used solely for storing the product of the particular company. The Tribunal found (at 206):

> Approximately fifteen per cent of route trade outlets would fall into the category of outlets where an exclusive tie to the distributor who owns the glass-doored merchandiser would, while the present position pertains, preclude the competing product of another distributor from being displayed for sale and sold in the manner which, on the evidence, is the most effective method of displaying and selling soft drink in the route trade.

Whether such conduct constitutes an antitrust violation was considered *In the matter of Kellog Co* ([1972] TRR 19,898). The action was commenced against the three largest manufacturers of ready-cooked breakfast cereals in the United States alleging that their high profit rates were partly due to their tacit collusion in pre-empting supermarket shelf space. The complaint was dismissed since the evidence did not allow the Federal Trade Commission

---

[1] See Salop, "Strategic Entry Deterrence" (1979) 69 (2) *American Economic Review* 335-338; Geroski, "What do we know about entry?" (1995) 13 (4) *International Journal of Industrial Organisation* 421-440; and Smith and Round, "Section 46: A Strategic Analysis of *Boral* (2002) 30 (3) *Australian Business Law Review* 202.

to conclude that the conduct was anti-competitive.[2]

When an incumbent obtains control of a scarce input in a geographic area by securing rights to virtually the entire supply through exclusive supply arrangements, should this be a matter of concern for competition and consumers? Incumbents are able to deter or prevent new entry in this way, which may lessen competition and harm consumers. Incumbents should not to be punished for their foresight and industry, but equally they should not escape the competition law net if they adopt anti-competitive strategies that harm consumers through higher prices.

The *Cement Australia* case is not the first competition law case in Australia involving asset pre-emption. In *News Ltd v Australian Rugby Football League* (1996) 58 FCR 447, a broadcaster (News Ltd), was seeking to set up a rival rugby league football competition to gain broadcast rights. The incumbent in this case was the Australian Rugby League (ARL) and the New South Wales Rugby League which were the organisers of a rugby league football competition, the National Rugby League Competition. They set about denying News Ltd access to the essential factor inputs required to produce a rival football competition, namely rugby league clubs and players. They did this by requiring their existing member clubs and players to sign Commitment and Loyalty Agreements which prevented the clubs from supplying services to rugby league competitions not approved by the Australian Rugby League and the New South Wales Rugby League for the playing seasons from 1995 to 1999.

The primary judge (Burchett J) held that rugby league operated in a wider market for sports entertainment that included rugby league, rugby union, Australian Rules football, basketball and soccer. Within this wider market the ARL did not have substantial market power and the restrictions in the Commitment and Loyalty Agreements did not constitute a misuse of market power. On appeal, in *News Ltd v Australian Rugby Football League*, (1996) 64 FCR 410), the Full Federal Court held that the restrictions were exclusionary provisions and contravened s 45(2) of the TPA. Because they were illegal the Full Federal Court did not re-visit the market definition of the primary judge or the finding in relation to s 46.

Facts and context of the Cement Australia case

Pt 1 of Greenwood J's reasons for judgment sets out the background facts and the ACCC's contended conduct contraventions. In September 2008, the ACCC commenced proceedings against an incumbent, Cement Australia Pty Ltd, and related entities alleging breaches of ss 45 and 46 of the then TPA, now ss 45 and 46 of the CCA.

Flyash is a by-product of coal-fired electricity generation and when of suitable quality it can be used as a partial substitute for cement in the making of pre-mix concrete. Pre-mix contract

[2] See R. Schmalensee, "Entry Deterrence in the Ready to Eat Breakfast Cereal Industry" (1978) 9 *Bell Journal of Economics* 305-327.

is manufactured using a mix of cement, slag, flyash, sand, gravel and water. Concrete-grade flyash may replace between 20 to 30 percent of cement in the manufacture of concrete. There were four power stations in South east Queensland that were capable of producing flyash – Swanbank, Tarong, Tarong North, adjacent to Tarong, and Millmerran. The allegations related to four contracts entered into by the respondents with four electricity power generation stations in South East Queensland between 2001 and 2006 for the supply of unprocessed fly ash. The ACCC alleged that there were six separate conduct contraventions.

The corporate respondents, Cement Australia Pty Ltd, Cement Australia Holdings Pty Ltd, Cement Australia (Queensland) Pty Ltd, formerly Queensland Cement Ltd (QCL), Pozzolanic Enterprises Pty Ltd and Pozzolanic Industries Pty Ltd were all related bodies corporate.

First contended conduct contravention

Cement Australia already had existing contracts with Swanbank and Tarong. In relation to the Swanbank contract, Pozzolanic had the first option to purchase and remove flyash from Swanbank and the owner agreed not to supply third parties and to refer third parties to Pozzolanic. In relation to the Tarong contract Pozzolanic had the right to acquire unprocessed flyash on a "first rights basis" from the owner.

Following a competitive tender, Pozzolanic entered into a contract in September 2002 which obliged Millmerran Power Partners (MPP) to allow Pozzolanic to take a minimum quantity of 135,000 tonnes of concrete grade flyash in each operating year for seven years (the Original Millmerran Contract). Trasnpacific Industries Pty Ltd (Transpacific) and Flyash Australia (FAA) also tendered for the flyash the subject of the Millmerran Contract.

Second contended conduct contravention

On 26 February 2003, Pozzolanic entered into a contract with Tarong Energy Corporation (TEC) to purchase all concrete grade flyash from the Tarong and the Tarong North power stations for five years from 1 March 2003.

Third contended conduct contravention

In July 2004, Pozzolanic had not purchased any flyash under the Original Millmerran Contract because of the flyash was not within the acceptable quality range limits. Instead of terminating the contract Pozzolanic elected to proceed ("first election to proceed") and the contract was varied to eight years (the Millmerran Amended Contract).

Fourth contended conduct contravention

In 2002, Pozzolanic exercised an option to extend the term of its agreement with the owner of the Swanbank power station to 30 June 2005. This agreement contained provisions which

gave Pozzolanic exclusive access to Swanbank flyash.

Fifth contended conduct contravention

In March 2005, Pozzolanic and Cement Australia approved capital expenditure of $2.52 million to allow Pozzolanic to install a classifier at Millmerran under the terms of the Amended Millmerran Contract. In April 2005, Pozzolanic could have terminated the Amended Millmerran Contract or renegotiated it to reduce payments, but elected instead to continue with the Amended Millmerran Contract ("the second election to proceed"). At the time there was no unsatisfied demand that could not be satisfied by Pozzalanic from Tarong, North Tarong and Swanbank.

Sixth contended conduct contravention

In October 2006, Pozzolanic and Cement Australia installed a classification plant at Tarong North. As a result of the operation of the classifier, unprocessed flyash was transferred to the silo and reject flyash produced by the clasifier was also transferred to the silo. Because the silo might contain unprocessed flyash, reject flyash or a mixture of both it was uncommercial for competitors of Cement Australia and Pozzolanic to take flyash from the silo for the purpose of processing it. Until that time competitors had been able to obtain commercially acceptable flyash from Tarong North's communal silo.

The ACCC claimed that although Cement Australia could have sought to terminate the Millmerran Amended Contract, Cement Australia elected to keep the contract on foot and approve further capital expenditure at Millmerran. The ACCC alleged that by entering and extending the various acquisition and supply contracts when Cement Australia did not have any or sufficient customers for the unprocessed flyash to make it profitable, it had contravened s 46. In the absence of the necessary downstream demand, the ACCC alleged that QCL's purpose was to prevent any other person from acquiring unprocessed flyash from Millmerran and to prevent any person entering into the south East Queensland unprocessed flyash market. [3]

The ACCC's s 46 case was put succinctly at para 655 of its closing submissions and set out at [1894] of Greenwood J's reasons:

> The conduct in this case that is alleged to have involved a taking advantage of substantial market power was conduct related to the entry into and maintaining of the contract for flyash from Millmerran Power Station. The essence of the case is that Pozzolanic was entering into, and maintaining, a contract to acquire an input at a cost that made no commercial sense for anybody that did not have existing substantial market power in the downstream market because QCL, and subsequently Cement Australia, could not recoup the cost (including the opportunity costs) of the contract

[3] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [951].

by selling flyash from Millmerran in the downstream market. Put more simply, for any corporation without substantial market power, the contract could only be anticipated to be loss-making.

Respondents' contentions

Pt 2 of Greenwood J's reasons sets out the respondents' contentions in answer to the ACCC's case. In summary, the respondents contended that they did no possess substantial market power because the alleged source of their market power was the supply contracts with the electricity generators which acquired by means of an open tender process. There was no taking advantage of market power because Pozzolanic engaged in conduct in which a firm lacking market power could engage and Fly as Australia, a company which lacked market power in South East Queensland did engage in the same bidding conduct. The respondents contended that they had a business rationale for entering into the flyash contracts, namely, to maintain diversity and security of supply.

Relevant markets and market power

The principles to be applied in identifying the relevant markets and determining whether Cement Australia had substantial market power are considered in Pt 17 of Greenwood J's reasons. His Honour held that the relevant upstream market was the south East Queensland market for the supply and acquisition of unprocessed flyash. [4]The relevant downstream market was for fine grade, concrete grade flyash in south east Queensland and northern New South Wales.[5]

Greenwood J found that Cement Australia and its related entities had a substantial degree of market power in the downstream market, at the time that it entered into the Millmerran Contract because it effectively had exclusive rights to acquire all of the available flyash from Swanbank and Tarong. [6]

Taking advantage element

Since all of the contended conduct contraventions occurred prior to the 2008 amendments to s 46, the "taking advantage" element of s 46, had been decided in accordance the pre-2008 case law interpreting the 'taking advantage' element of s 46(1). Pt 30 of the decision contains an analysis of that case law. [7]

---

[4] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [1779].

[5] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [1816] and [1834].

[6] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [1892] and [2658].

[7] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [1894] and [1913].

Early in his reasons (at [4]-[5]), Greenwood J referred to the decision of the Full Federal Court in *ACCC v Australian Safeway Stores Pty Ltd* (2003) 129 FCR 339), and the importance of ascertaining why the respondent engaged in the conduct at issue in the sense of what their business rationale was for engaging in the conduct. Greenwood J applied this authority and proceeded to ascertain the reasons why Australian Cement entered into the four contracts at issue. His Honour accepted that Cement Australia had legitimate business reasons for entering and extending contracts including ensuring certainty and diversity of supply and discharging contractual obligations. However, in relation to the Millmerran contract, his Honour found (at [2676]) that a substantial purpose in Pozolanic's entry into the amended Millmerran Contract was that of preventing a competitor, Boral's entry at Millmerran.

Greenwood J referred to a series of High Court cases in which s 46 of the TPA had been considered – *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177; *Melway Publishing Pty Ltd v Robert hicks Pty Ltd* (2001) 205 CLR 1; *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90, and *Rural Press Ltd v ACCC* (2003) 216 CLR 53. From observations in these authorities he identified the so-called "counterfactual" test. Adapting the test to the facts at issue, the test was expressed in the following terms:

> If it can be demonstrated that Pozzolanic as a profit maximising firm operating in a workably competitive market could in a commercial sense profitably engage in the conduct in question having regard to the ordinary business rationale identified, it follows that the corporation has not used its market power in a manner made possible only by the absence of competitive conditions.[8]

His Honour also set out (at [1905)] the "materially facilitated" test propounded by the High Court in *Melway* (2001) 205 CLR 1 at 23 [51]:

> Dawson J's conclusion that BHP's refusal to supply QWI with Y-bar was made possible only by the absence of competitive conditions does not exclude the possibility that, in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission on behalf of the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had, made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.[9]

Greenwood J drew attention to two further aspects about s 46. First, his Honour noted that financial power is not market power even though it may enable a firm to defer revenues and

[8] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [1904].

[9] *Melway Publishing Pty Ltd v Robert hicks Pty Ltd* (2001) 205 CLR 1 at 23 [51].

adapt to changing circumstances. His Honour stated:

> A corporation with a strong balance sheet and substantial cashflows may have access to capital or debt or a mix of both, not available to other market participants. Its cost of capital or debt or its weighted average cost of capital and debt may enable it to enter into arrangements that would see project revenues deferred for a significant time. Such a corporation may be able to withstand fluctuations in the fortunes of a project or the failure of milestones to be reached as planned, of one kind or another. Such a corporation may have access to inter-group or parent financial facilities without the need to call on external facilities. Financial power, of course, is *enabling* of the *capacity* to make *choices* and *adapt* to changing circumstances, and in that sense, financial power confers *adaptive power* which may not be available to other market participants. The financial power to carry a project through a period of deferred revenues for one reason or another may be an example of such a power. However, enabling financial power of this kind is not market power. [10](emphasis in the original)

Secondly, Greenwood J observed:

> …s 46 does not cast a prohibition upon a corporation from engaging in conduct undertaken for the purpose of preserving margins or market share or preventing a competitor from securing access to an essential input in a production process or preventing competitor entry into a market. [11]

Bids for the Original Millmerran and Tarong Contracts

QCL did not have a long-term contract with Tarong. Greenwood J accepted[12] that QCL's business rationale was to cause its wholly owned subsidiary, Pozzolanic, to tender for and to enter into a contract with Millmerran in order to preserve its market share and prevent a market share collapse. His Honour found [13]that this was a substantial purpose guiding to conduct of entry into both contracts. The question then turned on whether a corporation in the position of Pozzolanic, without market power and thus operating in a workably competitive market, would bid for the Millmerran Contract and enter into the contract on the terms and conditions of that contract (at [2279]).

There was evidence that a rival bidder, Transpacific, with no market power had made a bid in substantially similar terms to that of Pozzalanic's bid. This was "powerful evidence" that Cement Australia had not used its market power in making its bid. [14]

---

[10] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2680].

[11] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2681].

[12] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2274].

[13] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2275].

[14] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2279].

Entry into the Amended Millmerran Contract

Greenwood J stated in relation to the Millmerran Contract:

> …notwithstanding that Cement Australia caused Pozzolanic and Pozzolanic Industries to enter into the amended Millmerran Contract in July 2004 for purposes that include a substantial purpose of preventing a competitor from securing access to Millmerran ash and preventing entry into the SEQ concrete grade flyash market, the question is whether in so acting for purposes that included that purpose, Cement Australia took advantage of its market power. The answer to that question involves asking whether a profit maximising corporation confronting the circumstances confronting Pozzolanic and Cement Australia in July 2004 in relation to the outworking of the Millmerran Contract, absent market power and thus operating in a workably competitive market, could have made a decision to preserve the Millmerran Contract; waive the non-compliance with the Acceptable Range Limits; and, amend it in the way Cement Australia did on 28 July 2004 leading to the letter of 30 July 2004.[15]

The Court found (at [2688]) that extending the Millmerran contract in circumstances where Cement Australia had not acquired flyash from Millmerran, and flyash from Swanbank and Tarong exceeded actual and forecast demand, was not the expression of market power.

Greenwood J held:

> Cement Australia's conduct is not conduct that *only* a corporation with market power could have undertaken. The circumstance that Cement Australia had the financial resources to absorb or withstand a deferral in the Millmerran project revenues...is not the expression of market power.[16]

Commentary on these findings

Where a corporation with substantial market power enters into contracts, those contracts can create barriers to entry and where they are used for exclusionary purposes, can foreclose supplies of factor inputs to actual or potential competitors in order to preserve a monopoly position in a market they can be a source of market power. This was recognised by Dawson J in *Queensland Wire* (1989) 167 CLR 177 at 200, where his Honour stated:

> But market power has aspects other than influence upon the market price. It may be manifested by practices directed at excluding competition such as exclusive dealing,

---

[15] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2682].

[16] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2688].

> tying arrangements, predatory pricing or refusal to deal: see *Standard Oil Co. v. United States* ; *United States v. E. I. Du Pont De Nemours* & Co. (35); 54 Am. Jur. 2d, Monopolies, §35. The ability to engage persistently in these practices may be as indicative of market power as the ability to influence prices.

The tribunal, in *Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593 at 44,216, recognised that long-term contracts can be used as an instrument of foreclosure:

> A distinction can be drawn between those long-term contracts that are necessary to sustain substantial, long-lived, sunk investments, as in this matter, and those long-term contracts that create no such social utility but are, rather, an instrument of foreclosure. Examples of the latter were the contracts that created the brewery "ties" in *Tooth and Company Limited; application by Tooheys Limited*. Any of those contracts could certainly be characterised as "long-term": a significant number were for a period of over fifty years, yet no benefit to the public was found by the Tribunal. In that matter, the contracts were the instrument of foreclosure and hence of anti-competitive detriment. However, in the present matter the contract is the instrument of benefit, at least to a significant extent, and its long-term character is intrinsic to the creation of the benefit to the public.

If s 46 does not prevent a corporation with substantial market power from entering into contracts that are an "instrument of foreclosure and hence of anti-competitive detriment" because the corporation in doing so is only taking advantage of its financial power, not its market power, then it is clearly not achieving its policy objective, which Deane J in *Queensland Wire* (1989) 167 CLR 177 at 194 stated to be "…the protection and advancement of a competitive environment and competitive conduct".

The counterfactual test is not the only approach for determining what constitutes a taking advantage of market power. Another approach is to consider the purpose or object that those responsible for the conduct were seeking to achieve. In *Queensland Wire*, Deane J (with whom Dawson J agreed), stated:

> [BHP's] refusal to supply Y-bar to QWI otherwise than at an unrealistic price was for the purpose of preventing QWI from becoming a manufacturer or wholesaler of star pickets. That purpose could only be, and has only been, achieved by such a refusal of supply by virtue of BHP's substantial power in all sections of the Australian steel market as the dominant supplier of steel and steel products. In refusing supply in order to achieve that purpose, BHP has clearly taken advantage of that substantial power in that market.[17]

According to the High Court majority in *Melway* , this was a different test of "taking

[17] *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 197-198.

advantage" under which "the identification of the purpose for which BHP was refusing to supply QWI led directly to the conclusion that BHP was taking advantage of its market power". [18] This test does not rely on any comparative assessment such as that under the counterfactual approach. Having found that a substantial purpose of Pozzalanic's entry into the Amended Millmerran contract was that of preventing competitor entry, and especially Boral's entry at Millmerran, this should have led to a finding of taking advantage of market power as an instrument of foreclosure.

Findings in relation to s 45

The first limb of the substantial lessening of competition test is whether the provision has the "purpose" of substantially lessening competition. Section 45(2) is concerned with the purpose or effect of individual provisions, rather than the purpose or effect of the contract, arrangement or understanding as a whole, although the pro-competitive purpose of the contract, arrangement or understanding taken as a whole may have a bearing on the purpose of an individual provision. The purpose of the provision is to be determined at the time the contract, arrangement or understanding was entered into and, insofar as it was a continuing purpose, the circumstances since the making of the agreement.

Greenwood J stated:

> When s 45 talks about a *provision* of the contract or arrangement having a purpose, it contemplates a proscribed purpose of substantially lessening competition subjectively held by someone or perhaps a number of people within the corporation, and the operative connection between those individuals and the corporation, so as to attribute the views of those persons on the topic of the provision(s) to the corporation, must be such that they were the persons who sought and caused the inclusion of the particular provision(s) in the contract or arrangement. [19]

Greenwood J observed [20] that while s 45 is concerned with the subjective purpose of each party, the parties to an agreement did not need to share a similar purpose. [21]He also observed (at [3010]) that the proscribed purpose must be a "substantial" purpose in the sense of "real", "considerable" or "large"; but there may be other purposes involved. Greenwood J found that the respondents made and gave effect to a contractual arrangement that had the substantial purpose of foreclosing rival entry into the market and preventing rivals obtaining supplies of flyash.

[18] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 at 17 [28].

[19] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3010].

[20] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3011]-[3012]

[21] Applying *Seven Network Ltd v News Ltd* (2009) 182 FCR 160 at 357 [862]-[864] (Dowsett and Lander JJ).

In determining whether a provision has the effect or likely effect of substantially lessening competition, Greenwood J summarised the test:

> *First*, what would the future field of actual and potential rivalry with its substitution possibilities look like with the provision in place (the factual hypothesis), and what would it look like without the provision in place (the counter-factual hypothesis)? *Second*, to what extent is the future field of rivalry diminished or lessened or the competitive process compromised or impacted upon by the provision? *Third*, is the measure of that effect substantial, actually or potentially, in the sense of being "meaningful" or "relevant" to the competitive process? The competitive "process", with its rivalry and field of actual and potential substitution possibilities, protects the interests of consumers by competing away inefficient costs and constraining prices. The effect, and its substantiality or otherwise, is measured as an effect upon the *process* of competition not individual competitors. To the extent that impacts upon particular competitors are analysed, it is done so only for the purpose of assessing the effect of that impact upon broader rivalrous conduct, potential or actual, within the market.[22]

The Court found that a substantial purpose of Pozzolanic, in entering into the Original Millmerran Contract, was to attempt to secure an exclusive arrangement by exercising control over a minimum quantity of raw unprocessed Millmerran flyash which was "…sufficient to foreclose or discourage sustainable new entrant participation at Millmerran".[23] This also had the effect and likely future effect of those provisions would have been to lessen competition substantially in the SEQ unprocessed flyash market and the SEQ concrete grade flyash market, contrary to s 45(2)(a)(ii) of the Act.[24] In giving effect to the provisions it also contravened s 45(2)(b)(ii) of the Act.

The court also found that a substantial purpose of Pozzolanic, in entering into the Amended Millmerran Contract, was to prevent a rival of Pozzolanic from securing access to Millmerran Power Station unprocessed flyash in the SEQ unprocessed flyash market, and preventing a rival of Cement Australia from entering the SEQ concrete grade flyash market, contrary to s 45(2)(a)(ii) of the Act. In giving effect to the provisions it also contravened s 45(2)(b)(ii) of the Act.

The court found that the Tarong contracts included provisions that had a substantial purpose of substantially lessening competition, [25]and the effect or likely effect of substantially lessening competition in contravention of s 45(2), because they operated to discourage ,

---

[22] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3013].

[23] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3076].

[24] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3087].

[25] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3153].

hinder and prevent third party entry into a supply arrangement at Tarong power station. [26]Had a third party acquired access to Tarong flyash processing of that flyash into concrete grade flyash wold very likely have occurred thereby enabling new entrant competition in South East Queensland.[27]

As regards the Swanbank contract, the Court held (at [3226]) that the identified provisions conferring exclusive access to Swanbank flyash in Pozzolanic were provisions that would have the likely effect, and had effect of preventing a rival of Pozzolanic from securing access to Swanbank unprocessed flyash, and preventing a rival of QCL from entering the SEQ market for concrete grade flyash contrary to s 45(2)(a)(ii).

Section 46 and strategic entry deterring conduct

Financial resources can be used to alter the *structure* of markets by creating barriers to entry. Financial resources can also be used to enable a firm that possesses it to engage in *conduct* that creates barriers to entry. Cement Australia used its financial power to engage in conduct (entry into the unprofitable long-term contracts) which created barriers to entry that were a source of market power, and had exclusionary effects so far as rivals were concerned.

In *ACCC v Boral Ltd* (2001) 106 FCR 328 at [340]-[342], Finkelstein J in the Full Court noted the distinction between structural barriers to entry and strategic barriers to entry. His Honour observed:

> It follows the recent trend of economists to broaden barriers beyond those that are structural, to incorporate the strategic behaviour of incumbent firms. In particular, it is now accepted by many economists that the behaviour of incumbent firms to exclude rivals by a variety of restrictive or uncompetitive practices is as much a barrier to entry as any structural condition that may exist in a market.
>
> … Incumbents are often willing to take action that will result in short-term reductions in profit to prevent the establishment of a new entrant. Some economists refer to these deterrent activities as "strategic" barriers to entry, "purposely enacted to redress the possibility of entry" as opposed to "innocent" entry barriers "unintentionally erected as a side effect of innocent profit maximisation".

In the High Court, Kirby J in his dissenting judgment in *Boral Besser Masonry Limited v ACCC* (2003) 215 CLR 374 at 492 [361] also endorsed this approach:

> It is precisely in the context of a market where such structural barriers are not particularly high, that an incumbent corporation which has the capacity to do

[26] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3178].

[27] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [3181]-[3182].

> so, would have a greater incentive to invest in building up a predatory reputation in order to deter competitive conduct or entry. To absolve such conduct from the operation of s 46 simply by saying that (structural) barriers to entry in the market were low, is effectively to render the section inoperative in contexts where it was designed to have operation. This would be an intolerable construction to adopt. The strengthening of the predatory reputation of BBM had a tendency to increase the concentration of the market and to chill the competitive conduct of rivals, including the entry of potential new competitors. Such conduct invariably harms consumers.

Evidence of strategic entry-deterring tactics can be equivocal. In particular, price discounts may signify price competition rather than anti-competitive exclusionary conduct. However, where an incumbent forecloses potential competition by entering into contracts securing supplies of an essential input to a production process this can harm consumers by allowing the incumbent to charge higher prices and is the sort of conduct which s 46 should catch.

Conclusion

Strategic entry deterring conduct such as that at issue in *Cement Australia* can have exclusionary effects. However, under the counterfactual test of the "taking advantage" element of s 46(1), the courts are required to hypothesise about what a firm without market power could or would be likely to do if it were operating in a workably competitive environment, rather than focussing on the actual exclusionary effects of the conduct at issue. If such a firm could or would be likely to engage in the conduct in question then it is not a contravention of s 46(1) because there is no "taking advantage" of market power even though its actual effect may be to exclude new entry, or prevent or deter competitive conduct to the detriment of consumers.

The *Cement Australia* case demonstrates that s 46 prior to the 2008 amendments was very business friendly for firms with substantial market power. Whether the *Cement Australia* case would be decided the same way today taking into account the 2008 amendments is difficult to determine. Section 46(6A) clarifies the meaning of the term "take advantage" in s 46(1). It was enacted pursuant to the *Trade Practices Legislation Amendment Act 2008* (Cth) which commenced on 22 November 2008, and provides that in determining whether a corporation has taken advantage of its market power under s 46(1), the court may consider, without limitation:

(a) whether the conduct was materially facilitated by its substantial degree of market power

(b) whether the corporation engaged in the conduct in reliance upon its substantial degree of market power

(c) whether the corporation would be likely to engage in the conduct if it lacked a substantial degree of market power, or

(d) whether the conduct of the corporation is otherwise related to its substantial degree of

market power.

Prior to the enactment of s 46(6A) the courts relied primarily on the counterfactual test enunciated by Mason CJ and Wilson J in their joint reasons in *Queensland Wire*. [28]This was the test applied by Greenwood J in the Cement Australia case. The counterfactual test is now set out in s 46(6A)(c).

Section 46(6A) sets out three additional methods for satisfying the "taking advantage" element and proving that the requisite causal link exists between the impugned conduct and the respondent's market power. They are intended to make proof of the taking advantage element more flexible. Since 2008 s 46 does not place sole reliance on the counterfactual test. However, most strategic entry deterring conduct (including that at issue in the *Cement Australia* case) relies on the use of financial resources. Financial resources, in the words of Greenwood J, confer "adaptive power" which may not be available to the respondent's competitors. Greenwood J held,[29] that this "enabling financial power is not market power" and accordingly the necessary causal link between the conduct at issue and market power will be absent and the conduct will not be caught by s 46.

Some may argue that it is not a matter of concern that s 46 does not catch strategic entry deterrence involving the use of financial resources, because such conduct is likely to be caught by the safety net provisions of s 45(2)(a) or (b)(ii) as occurred in *Cement Australia.* However, unless the conduct can be linked to a contract, arrangement or understanding, it will fall outside the ambit of Pt IV of the CCA. Smith and Round provide two examples of the unilateral entry deterring strategies that rely on financial power and are not linked to a contract, arrangement or understanding:

> Substantial resources may enable an incumbent to create or maintain a large amount of excess capacity, a conventional source of market power, and this too may heighten barriers to entry. A firm may create "fighting brands" to respond to entry or a rival that has become aggressive, in order to contain the adverse impact on its primary brands or business...All these strategies are made possible by the possession of, or at least access to, substantial financial resources but have their impact on market power via a structural change. [30]

Since *Cement Australia* the decision was handed down the ACCC has commenced proceedings against Pfizer alleging misuse of market power with its patented cholesterol drug Lipitor. The case will consider whether Pfizer took advantage of its market power by offering discounts on the generic version of the patented drug shortly before the patent was due to expire. This is the second s 46 case to be brought by the ACCC. Proceedings were brought in

---

[28] *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 192. See also Deane J at 195, Dawson J at 202 and Toohey J at 206.

[29] *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 at [2680].

[30] Smith and Round, "Do deep pockets have a place in competition analysis?" (2012) ABLR 348 at 353.

2013 against Visa also alleging a misuse of market power to protect revenue obtained through currency conversion systems when overseas visitors used international credit cards at merchants or ATMs in Australia.

It is to be hoped that in future the courts will apply different and alternate tests, apart from the counterfactual test, in determining what constitutes a taking advantage of market power.