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Case Commentary:

Melway Publishing Pty Ltd v Robert Hicks Pty Ltd

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Headings in this case note:

1. Summary of Facts
 2. Comments
 - (i) Did Melway Publishing have a 'substantial degree of power in a market'?
 - (ii) Did Melway 's conduct 'take advantage' of its market power?
 - (iii) Did Melway Publishing engage in the conduct for a proscribed purpose?
 3. Conclusion
-

1. Summary of Facts

{1} Melway Publishing Pty Ltd ('Melway') is the publisher of the 'Melway' street directory. The Melway directory is the leading Melbourne Metropolitan directory and at the relevant time accounted for between 80 and 90% of retail sales of such directories. Its rivals, UBD and Gregory, both of which are published by Universal Press, share the remaining sales. Universal Press is the major publisher and supplier of street directories for Brisbane, Sydney, Adelaide and Perth. Melway also publishes and supplies the 'Sydneyway' street directory for the Sydney metropolitan area. The Sydneyway represents only a minor percentage (under 10%) of sales of directories in the Sydney metropolitan area.

{2} Central to the case was the distribution system adopted by Melway to market its directories. Melway supplied its directories to selected wholesalers who in turn were responsible for distributing the directories to retailers. While Melway's arrangements with its wholesalers were informal, in the sense that there were no written terms of supply, it was clear that supply of the directories was on the basis that the wholesalers would sell the directories only to retailers within particular market segments. There were 5 segments identified by Melway for this purpose: (a) newsagents and bookshops; (b) service stations; (c) office stationers; (d) authorised car dealers; and (e) automotive parts retailers. UBD does not have a similar market segmentation system.

{3} Until February 1995, Auto Fashions Australia ('Auto Fashions') had been Melway's appointed distributor to retailers of automotive parts. In 1993, there had been a falling out between the 2 proprietors of Auto Fashions and one had left to form a new company, Beyond Auto Pty Ltd ('Beyond Auto'). Melway made a decision to replace Auto Fashions with Beyond Auto and in February 1995 it gave notice to Auto Fashions that it was terminating its distributorship. Just prior to the termination (and acting on legal advice) Auto Fashions placed an order with Melway for between 30,000 and 50,000 directories. Importantly, this

order was placed on the basis that Auto Fashions would be free to supply directories to any retailer, that is, not only automotive parts retailers. Melway refused to meet the order.

{4} Auto Fashions claimed that Melway's refusal to supply the directories constituted a misuse of market power by Melway and so was in breach of s 46 of the *Trade Practices Act*.

{5} At first instance, Merkel J held that Melway's conduct did constitute a breach of s 46 and, in addition to granting a declaration of breach, granted an injunction and damages. This decision is reported at (1999) ATPR 41-668. Melway appealed to the Full Federal Court and this was heard by Heerey, Sundberg and Finkelstein JJ, each of whom delivered separate judgments. Sundberg and Finkelstein JJ agreed that the appeal should be dismissed. Heerey J dissented. The appeal is reported at (1999) ATPR 41-693.

2. Comments

{6} For conduct to constitute a breach of s 46, three elements must be proved:

- i. the corporation engaging in the conduct had a 'substantial degree of power in a market';
- ii. the conduct complained of involved the corporation 'taking advantage of' this market power; and
- iii. the conduct was engaged in for one of 3 proscribed purposes. In this case the relevant purpose was 'deterring or preventing a person from engaging in competitive conduct' (s 46(1)(c)).

Each of these elements will be considered in turn.

(i) Did Melway Publishing have a 'substantial degree of power in a market'?

{7} The principles to determine whether a firm has market power are well established and involve a linked, two-stage analysis - (1) what is the market in which the firm operates? and (2) what is the structure of that market? It is the structure of the market, particularly the firm's market share and the height of any barriers that might make entry into the market difficult, that determines the extent to which the firm is free from competition, that is, whether it has market power.

{8} Although the definition of the relevant market was disputed at first instance, Merkel J's findings were not challenged in the Full Federal Court nor are they the subject of appeal before the High Court and so this issue is dealt with briefly here. A market is the 'field of rivalry' in which competitors and potential competitors operate: *Queensland Co-op Milling Association Ltd & Defiance Holdings Ltd* (1976) ATPR 40-012 (*QCMA*). To identify a firm's competitors and potential competitors, we ask whether there are other firms that are able to offer goods or services that are closely substitutable for those of the firm in question: see *QCMA, Queensland Wire Industries Pty Ltd v BHP* (1989) 167 CLR 177 (*Queensland Wire*); *Singapore Airlines Ltd v Taprobane Tours WA Pty Ltd* (1990) ATPR 41-054. Applying the oft-quoted *QCMA* test in the present context we ask whether, if Melway had put up the price of its directories, 'would there have been much of a reaction and if so from whom'? Those who could be expected to react to such a hypothetical price increase constitute Melway's

competitors and potential competitors. On the demand side, consumers could turn to other directories if the price of Melway's directory went up (and so these firms need to be included in the market) but there were no other products that could be substituted for street directories. Melway originally argued that directories are really part of a broader 'car or car accessory' market but this was properly rejected by Merkel J.

{9} Merkel J held that, on the supply side, there were no firms that could start competing with directory publishers. This was said to follow from the facts that (a) the publishers held copyright over the directory and so a new competitor would, in effect, need to start again in preparing a directory and (b) the difficulty of overcoming the strong consumer loyalty for the established directories. This analysis is less convincing. The test is designed to identify whether entry by potential competitors is likely if incumbent firms earn greater than competitive returns: if barriers to entry are high, entry will be difficult and so the incumbents will not be constrained by the threat of potential competition. Barriers to entry are constituted by costs borne by new entrants that did not (or do not) have to be borne by the incumbents (*Queensland Wire*). It is not clear from Merkel J's analysis that a potential entrant would face costs that would not be borne by the incumbent publishers, although of course there may have been other evidence to this effect.

{10} In the event, the relevant market was found to be the supply of street directories. This market was held to include both wholesaling and retailing functions, which seems sensible in view of the fact that apparently Melway's competitors did not necessarily deal through wholesalers. The geographical limits of the market were held to be Melbourne and the metropolitan area. While such a limited area is supported in terms of demand substitutability - the directories were unique to each capital city - the fact that the publishers operated in different States appears to suggest a national market. Again, Merkel J relied on the existence of the barriers to entry, referred to above, to confine the market to the Melbourne metropolitan area. As noted, the market definition has not been challenged by Melway.

{11} Once the market was defined in this way Melway conceded that it had market power. It had a market share of up to 90% and, as noted, significant barriers to entry were held to exist, making entry difficult.

(ii) Did Melway 's conduct 'take advantage' of its market power?

{12} This element requires that there be a causal connection between the firm's market power and the relevant conduct. As established by the High Court in *Queensland Wire*, the question is whether the firm has 'used' its market power. This is tested by asking whether the firm would have acted in the same manner in the absence of market power - that is, under competitive conditions. As stated by Sundberg J in this case, 'to use the language of Mason CJ and Wilson J in [*Queensland Wire*], if the appellant were operating in a competitive market, would it have refused to supply the respondent, or would it have tried to secure the deal itself?' Hanks and Williams point out ((1990) 17 *Melbourne University Law Journal* 437) that the *Queensland Wire* test has the virtue of turning the court's focus on whether a firm's conduct is explicable by efficiency considerations - if so, the conduct in question would have been engaged even in the absence of market power.

{13} It was the formulation and application of the 'take advantage of' test which divided the judgments in this case. Merkel J at first instance, and Sundberg and Finkelstein JJ on appeal, asked whether Melway would have refused an order of this magnitude in a competitive

market. Finkelstein J framed the issue in these terms: 'Was Melway able to refuse to supply street directories to Auto Fashions because it had no other effective competitor who could supply Auto Fashions with street directories?' The three Justices had little difficulty in answering that question in the negative; it was only the absence of competitors that enabled Melway to refuse supply. Sundberg J pointed to the absence of evidence that Melway had previously refused supply. In his Honour's view, this suggested that Melway only refused supply when it had market power.

{14} Heerey J on the other hand considered that Melway would have refused supply even if it had no market power. His Honour thought that this was evidenced by the fact that Melway used the same distribution system even when it had no market power - as when it first commenced supplying Melway directories and in its distribution of the 'Sydney' (where its market share was no more than 10%). His Honour stated that the absence of evidence that Melway had refused an order such as made by Auto Fashions in the past was irrelevant because those in the trade would have been aware that Melway's terms of supply required compliance with its distribution system.

{15} It is evident that there is a difference in approach in the two lines of reasoning. Heerey J focuses on the particular circumstances of Melway's refusal and asks why Melway refused supply in this case. His Honour concluded that it was to protect its distribution system. The majority, on the other hand, ask whether Melway would be able to refuse supply. This is a more abstract question. This can be seen in the way the test is stated by Finkelstein J in the quotation above: his Honour refers to the *capacity* of Melway to refuse supply rather than its reason in this particular case.

{16} It is suggested that Heerey J's approach is the correct one. The reason for Melway's refusal to supply Auto Fashions is central to the question of whether it has taken advantage of its market power. To treat the refusal to supply in isolation and thus ignore the link between Melway's refusal to supply and the maintenance of its distribution system is artificial. Such an approach also diverts attention away from the proper focus of a s 46 action, namely whether the firm's conduct is properly characterised as an attempt to maintain or increase its market power or whether, on the other hand, it is an attempt to pursue efficiency. The approach of the majority which considers Melway's ability to withhold supply in the abstract, gives insufficient attention to the possible efficiency justification for Melway's conduct in this particular case.

{17} Melway sought to justify its distribution system on the basis that specialist wholesalers were able to offer a better service to retailers and, in not having to compete against each other, were encouraged to promote Melway's product. Melway's conduct in this case amounted to a non-price vertical restraint imposed on its distributors. The conduct could equally have been dealt with under s 47. Unlike *Queensland Wire*, Melway did not operate at both manufacturing and retailing levels. There was no evidence of any lessening of inter-brand competition; that is, the conduct did not appear to have an impact on products other than Melway's. In the absence of evidence of attempted foreclosure of the market by Melway, it is difficult to see how it would be anti-competitive: see Hanks and Williams, 'The Treatment of Vertical Restraints Under the Australian Trade Practices Act' (1987) *Australian Business Law Review* 47. Decisions in other jurisdictions indicate that non-price vertical restraints will only be anti-competitive in limited circumstance, none of which appeared to apply here: see, for example, the general discussion in *Continental TV Inc v GTE Sylvania Inc* 433 US 36 (1977) and *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731.

(iii) Did Melway Publishing engage in the conduct for a proscribed purpose?

{18} The discussion of Melway's purpose in the judgments was brief and, it is suggested, unsatisfactory. All justices agreed that Melway's purpose was to prevent competitive conduct by Auto Fashions and so within the purpose proscribed by s 46(1)(c). Melway argued that its purpose was to preserve its successful distribution system. Both Finkelstein and Heerey JJ treated this as the same as a purpose to prevent competition among distributors. Even Heerey J adopted Merkel J's assessment that the purpose of maintaining its distribution system was 'indistinguishable from the purpose of preventing competition by a new distributor with existing wholesalers. Put colloquially it is the reverse side of the same coin.'

{19} In *Queensland Wire* the High Court suggested that the purpose must be one of harming competition. Mason CJ and Wilson J stated that 'the object of s 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end... the purpose provisions in s 46(1) are cast in such a way as to prohibit conduct designed to threaten ... competition... The question is simply whether a firm with a substantial degree of market power has used that power for a purpose proscribed in the section, thereby undermining competition.' (at 191). See also Wilcox J in *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1991) ATPR 41-128 at 52, 894-5. This interpretation accords with the objectives of Part IV but does create some difficulties - s 46 refers to purposes related to individual competitors e.g. (1)(c) 'detering or preventing a person from engaging in competitive conduct'. In effect, the 'competitive conduct' requirement has been interpreted as importing a concept of competition, rather than being satisfied where the purpose is merely to harm individual competitors.

{20} Establishing that a corporation has a purpose of harming competition requires evidence of a purpose to alter the structure of the relevant market in a way that will maintain or increase the corporation's market power. This is to be distinguished from a purpose of engaging in competition itself. It is far from clear how Melway's refusal to supply directories to Auto Fashions could be designed to increase its market power. It seems far more credible that Melway's purpose was to support its distribution system.

3. Conclusion

{21} This decision of the Full Federal Court is an unfortunate one. Firms with market power that seek to enforce their selective distribution systems, particularly if the means of enforcement involves a refusal to supply, are at risk of being in breach of s 46. The reasoning of the majority gives little encouragement for the firm to argue that the distribution system has been established for efficiency reasons.

{22} What was essentially a straightforward case has been made difficult. Perhaps the result reflects concerns held by the Full Federal Court over the combination of Melway's market power and the less than obvious efficiency justification for a selective distribution system in this instance. Nevertheless, it is an unsatisfactory decision. It is difficult to resist the conclusion drawn by Heerey J that 'if the majority view is correct, the achieving of a substantial degree of market power brings a new peril to any firm which operates a distribution system'.