

Competition Law

MARK BERRY*

The most significant recent development in the field of competition law is the Privy Council's interpretation of the monopolisation provisions of s 36 of the Commerce Act 1986 in *Carter Holt Harvey Building Group Ltd v Commerce Commission* (2004) 11 TCLR 200 ("*Carter Holt Harvey*"). This Review is devoted to that subject.

Introduction

The abuse of market power by monopolists has long been a central concern of competition laws. However, the formulation and application of an appropriate rule against monopolisation has proven to be highly problematic, largely because it is difficult to differentiate between vigorous competition (which will benefit consumers) and unlawful monopolisation (which will ultimately harm consumers). The problem is that both of these forms of competition can look alike.

Section 36 of the Commerce Act 1986 prohibits persons with a substantial degree of market power from taking advantage of such power for the purpose of restricting, preventing, deterring, or eliminating competition. Accordingly, the provision involves a preliminary market power threshold inquiry followed, where relevant, by an inquiry into whether the conduct in question may properly be characterised as having the purpose of taking advantage of that power. This commentary focuses on this second inquiry, namely, whether the conduct of a firm with a substantial degree of market power can be characterised as monopolistic.

There are various contexts in which this characterisation question can arise. First, there are common practices where the conduct may be alleged to be monopolisation, such as predatory pricing and denial of access to so-called essential facilities. Second, there are other general practices that fall outside of these common practice examples.

Against this background, monopolisation rules have tended to develop

*Barrister, Wellington.

in two ways. First, there are general rules. Second, there are specific rules applying to the most common practices. The general rules tend to become subservient where there are specific rule formulations.

The evolution of such rule formulations is well illustrated under United States antitrust law. The United States Supreme Court has fashioned a general monopolisation rule based upon two elements as follows: “(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident” (*US v Grinnell Corp*, 384 US 563, 570–571 (1966)). This bears little resemblance to the specific rules that have developed over time in relation to common practices. For example, in the case of predatory pricing there are two prerequisites to a claim under s 2 of the Sherman Act, namely: (1) the prices complained of must be below an appropriate measure of the rival’s costs; and (2) there must be a reasonable prospect or a dangerous probability of recoupment of the investment in below-cost pricing (*Brooke Group v Brown & Williamson Tobacco Corp*, 509 US 209, 223–224 (1993)).

The latest, and what will be the last, decision of the Privy Council under s 36 of the Commerce Act warrants close scrutiny. The decision in *Carter Holt Harvey* is significant for its reassessment of s 36 principles. The Privy Council reaffirmed the approach it previously articulated in relation to the general monopolisation rule formulation (in *Telecom Corporation of New Zealand v Clear Communications Ltd* [1995] 1 NZLR 385), and considered the application of this rule to the most common of monopolistic practices, namely, predatory pricing. In so doing, the Privy Council purported to follow the approach taken by the courts in Australia under s 46 of the Trade Practices Act 1974 (Cth), being the provision upon which our s 36 has been deliberately modelled, both in terms of its original formulation and most recent amendment in 2001.

The scheme of this commentary is as follows: First, there is an initial outline of some key monopolisation principles to put the Privy Council’s decision in *Carter Holt Harvey* in context. Second, there is a review of the facts and findings in the *Carter Holt Harvey* decisions. Finally, there is a critique of the *Carter Holt Harvey* judgments, and a suggested way forward. The following central themes will be advanced:

1. This review of *Carter Holt Harvey* must be undertaken in the realisation that there is no model general rule for monopolisation. More informed specific rules have grown out of this realisation that there is no model general rule.
2. The current general rule for monopolisation — the so-called “counterfactual” test — is a legitimate basis upon which to determine monopo-

lisation cases. It will apply more readily to some cases than others. But this is not a reason to resist the test.

3. There is arguably some lack of clarity whether the majority of the Privy Council intended that the counterfactual test be necessarily applied in all cases. A literal reading of the decision suggests that this is a mandatory test to apply to all cases. But, the Privy Council's reliance upon the Australian case law, which takes the position that counterfactual analysis may not be cogent in all cases, suggests that this may not be the case.
4. If, however, a mandatory counterfactual rule is considered to apply, it will presumably be a matter of momentary concern. It is difficult to imagine that our Supreme Court will not, when the opportunity first arises, align itself with the more flexible approach taken by the High Court of Australia on the counterfactual question.
5. Where there is no specific rule, and where the cogency of the counterfactual test comes into question, the preferable alternative test is not obvious. Thus far, critics of the counterfactual test have pointed to two alternatives: (a) a pure factual assessment; and (b) business justification. These are hardly more informed or predictable rule formulations.
6. It cannot be right to apply monopolisation laws in a manner that altogether deprives a firm with market power from competing. The minority decision of the Privy Council in *Carter Holt Harvey* is wrong on this ground alone, regardless of what merit may attach to the "fighting-brand" theory of the case.
7. Ultimately, *Carter Holt Harvey* is a case about predatory pricing. The majority of the Privy Council adopted and applied both general and specific rule formulations on the question of predatory pricing.
8. The Privy Council's application of the counterfactual test is based upon some general observations that the pricing conduct of Carter Holt Harvey's subsidiary, INZCO, was no different from what may have been expected had this firm been non-dominant. However, this consideration alone was not ultimately determinative of liability.
9. The Privy Council also, most significantly, placed reliance upon the specific rule for predatory pricing set forth by the High Court of Australia in *Boral Besser Masonry Ltd v ACCC* (2003) 195 ALR 609, 636 at para 139. The approach to predation in Australia is not in reality based upon the application of the counterfactual test. Indeed, the Australian approach recognises the limitations of the counterfactual approach to cases where dominant firms seek to explain pricing behaviour as a response to a competitive market. In all cases the counterfactual test will have the ability to absolve monopolists because they will be able to say that their response would have been the same in a competitive market. Therefore, the counterfactual test is a blunt instrument to assess predatory pricing.

10. The Australian approach to such cases is based upon the United States formulation of the predatory-pricing rule set forth in *Brooke Group* (above). The inquiry is whether there is below-cost pricing for a proscribed purpose with the intention of later recouping losses.
11. The Privy Council's specific rule formulation for predatory pricing (para 60(c)) is incomplete, because it is not clear whether the price-cutting element relates only to below-cost pricing or may also extend to above-cost price cuts designed to drive out rivals.
12. While the Privy Council did not resile from the application of the counterfactual test in this case, its acceptance of the approach in *Boral* suggests that the specific predatory-pricing rule assumed primacy.
13. Finally, what of the ultimate outcome? Regrettably, not all relevant facts are coherently and satisfactorily explored in the various judgments. There is also a contradictory assessment of the state of competition in the High Court decision that makes difficult the analysis of this case. It appears that, while Carter Holt Harvey was clearly engaging in below-cost pricing, it did so only to match the rival's price for a limited duration of two to three months. This price-matching did not result in the elimination of the rival. Indeed, following the cessation of the pricing promotion in question, INZCO and the rival continued to compete for another four years before both competitors made independent decisions to exit the market. The competitive conditions over these four years appeared to make recoupment of any losses unlikely. Against this background, the *Carter Holt Harvey* case does not take on the appearance of one to which liability ought to attach.

Principles Prior to *Carter Holt Harvey*

There has been a coordinated and largely consistent development of case law principles in New Zealand and Australia surrounding what constitutes "purpose" and "use" or the "taking advantage" of a substantial degree of market power under s 36 of the New Zealand Act and s 46 of the Australian Act. In summary, the key points are these:

1. When first enacted, s 36 of the Commerce Act prohibited the "use" of market dominance. This test was amended in 2001 to mirror s 46 of the Australian Act, with the result that the prohibition under both Acts is now against the "taking advantage" of a substantial degree of market power. Nothing really turns on this early difference in the provisions. The case law in both jurisdictions developed in tandem, and there is judicial comment to the effect that there is no meaningful distinction between

these elements of “use” and “taking advantage”; see *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, 213–214 (HCA); *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1, para 26 (HCA). It follows that the terms “use” and “taking advantage” are used interchangeably throughout this Review, depending on the context of the case under consideration. The leading statement of principle on “use”, prior to *Carter Holt Harvey*, was the decision of the Privy Council in *Telecom Corporation of New Zealand v Clear Communications Ltd* (above). There their Lordships opined: “[I]t cannot be said that a person in a dominant market position ‘uses’ that position for the purposes of s 36 unless he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted” (p 403). This test has subsequently come to be known as the “counterfactual” test; see *Carter Holt Harvey Building Group Ltd v Commerce Commission* (2001) 10 TCLR 247 (CA), para 72. This terminology is a little misleading, because a comparative competition assessment of the kind normally envisaged under counterfactual analysis (for example, under the substantial-lessening-of-competition test) is not at issue here. Rather, the test requires the construction of a hypothetical set of circumstances, and an inquiry into the likely rational conduct in such a comparative setting.

2. The so-called counterfactual test appeared to sit uneasily with the Court of Appeal. In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, Gault J observed that “it is not easy to see why use of a dominant position should not be determined simply as a question of fact without the need to postulate artificial scenarios” (p 577).
3. In Australia, there are two further case law refinements of some significance prior to *Carter Holt Harvey*:
 - (a) The first of these appears to be in harmony with the Court of Appeal’s concerns in *Port Nelson* about the universal application of the counterfactual test. Some Australian cases have emphasised that to ask how a firm might act if it lacked a substantial degree of market power may be consistent with the legislative test so long as the task can be undertaken with sufficient cogency; see *Melway Publishing* (above), para 52; *NT Power Generation v Power & Water Authority* [2004] HCA 48, para 145. In other words, the counterfactual test may, in appropriate cases, be a determinative inquiry where the analysis is cogent; but there may be cases where this may not be an appropriate test to apply because unrealistic assumptions may not lead to cogent analysis.
 - (b) Second, there is an ascendant view in Australian case law that if the conduct in question has been undertaken for a legitimate purpose, there is no “taking advantage” of market power; see *ACCC v Safeway*

Stores Pty Ltd (2003) 198 ALR 657 (FCAFC), para 329, for an outline of authorities. It has been acknowledged in the Australian case law that this approach is based upon the business justification defence fashioned by the United States Supreme Court in *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 US 585 (1985); see *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) 90 FCR 128 at paras 26–27 (FCAFC). A similar approach had, in fact, been earlier advocated in New Zealand by the Court of Appeal in *Clear Communications Ltd v Telecom Corporation of New Zealand* (1993) 5 TCLR 413 at 430, when it said that “it may be helpful in determining whether there had been use of the dominant position merely to consider whether the firm has acted reasonably or with justification”. But the Privy Council rejected this approach because “different minds can easily reach different views on what is reasonable or justifiable”; see *Telecom Corporation of New Zealand v Clear Communications Ltd* [1995] 1 NZLR 385 at 403.

4. As to the related-purpose element of the characterisation question, it is common ground that purpose may be inferred where there is a finding that there has been a taking advantage of a substantial degree of market power. However, it is dangerous to infer that there has been a taking advantage of market power based upon purpose; see *Telecom Corporation of New Zealand v Clear Communications Ltd* (*ibid*) at 402.

Carter Holt Harvey: The Background

The High Court decision sets out the narrative of the case in considerable detail; see *Commerce Commission v Carter Holt Harvey Building Products Ltd* (2000) 9 TCLR 535. The essential factual background can be summarised as follows.

INZCO produced a wall and ceiling fibreglass insulation product known as “Pink Batts”. INZCO distributed this product nationally through leading hardware merchants. In 1992, a Nelson-based firm, New Wool Products (“NWP”), commenced the production and supply of an innovative wholly woollen insulation product known as “Wool Bloc”. NWP preferred to sell direct to consumers, presumably to avoid distributors’ margins. It is apparent that NWP could have, had it so desired, sold through the same distributors as INZCO. Ultimately, these different methods of distribution were not seen to be of any real significance.

Wool Bloc was priced below Pink Batts and, not surprisingly, the introduction of this product had a significant effect upon INZCO’s Pink Batts sales in Nelson and in some other areas. By March 1993, Wool Bloc was used in around 20–30 per cent of new Nelson dwellings.

INZCO knew it had a problem. Its competitive response was to launch a new wool and polyester insulation product known as “Wool Line”. This was launched in December 1993. INZCO therefore had a dual product line strategy. Wool Line was clearly introduced to compete head-on for consumers with a preference for wool-based insulation products. Pink Batts, nonetheless, appeared to remain the core INZCO product.

Some real significance attaches to the pricing decisions for both “Wool Bloc” and “Wool Line”. When first introduced, INZCO’s “Wool Line” was double the price of “Wool Bloc”. Sales were understandably slow. Three months after the launch of “Wool Line”, INZCO offered this product on a “2 for 1” basis in Nelson and some other select regions throughout the country. This promotion was priced at around 17–28 per cent below the cost of production. Significantly, INZCO set its “2 for 1” promotion at a price that it believed to be a matching price for NWP’s ascendant Wool Bloc. Coincidentally, it seems, NWP decided to increase the price of its Wool Bloc by 12 per cent on 1 March 1994, without knowledge of INZCO’s proposed “2 for 1” promotion. As NWP was not contractually committed to distributors, it could presumably have reversed this price increase. But it did not. This issue is not explored in the judgments.

INZCO entered into arrangements with distributors for the “2 for 1” promotion from 1 March until 31 May 1994. This term was extended for a further three months until 31 August 1994. There was then a further extension until around the end of September that year. Therefore, up until 31 May 1994 INZCO was pricing below cost in circumstances where it understood it was merely matching NWP’s prices. However, beyond this date INZCO was, it seems, pricing below cost in circumstances where its prices were well below those of NWP. It is not clear from the judgment whether INZCO was contractually committed to grant these terms of extension and, if so, upon what terms. This, it seems, is a point of some significance in ascertaining whether or not this was merely a case of price-matching. If the distributors had the ability to exercise rights of renewal for the renewed terms at 1 March prices, at all relevant times this was a price-matching case. However, if INZCO had the ability to adjust price under either of the renewals, the case takes on a different complexion. Beyond the first term of three months there would no longer be price-matching. It is unfortunate that this point does not appear to have been explored. As it happens, the various judgments appear to proceed on the assumption that this was a price-matching case throughout the duration of the “2 for 1” promotion.

NWP did not ultimately remain in the market. But this is not an ordinary predation case where the target exited the market directly as a result of the ruinous price competition by the monopolist. The “2 for 1” promotion ended around September 1994, at which point Wool Line was priced back up to its original level. Again, distributors complained that Wool Line was

uncompetitive against Wool Bloc, even allowing for the 12 per cent increase in the price for Wool Bloc. NWP had clearly felt the effects of the “2 for 1” campaign. Production and sales slowed down. But there was a revival of its operations once the “2 for 1” promotion came to an end.

NWP continued to trade until the end of 1998. There is no suggestion in the various judgments that NWP was at this, or any other time, a failing company. The reasons for NWP’s exit from the market are not altogether clear. It would appear that NWP was not dedicated to the production and sale of insulation in the long term. Rather, it appears that NWP’s goal had been to create an innovative product and to sell or franchise its operations once they were up and running: (2000) 9 TCLR 535 at 583. Coincidentally, Carter Holt Harvey decided to sell INZCO in 1998.

For the period mid-1994 until 1998, it appears that the market circumstances that existed before the “2 for 1” promotion were restored. The High Court’s findings on the state of competition at this time are contradictory. On the one hand there was a finding that there were high entry barriers and dominance: (2000) 9 TCLR 535 at 602. But it was also accepted that there was intense competition in the South Island retail insulation market, particularly in the Nelson/Marlborough region where there were a large number of independent sellers. It was found probable that if NWP had been a casualty of the “2 for 1” promotion, another wool-based product similar to Wool Bloc would have emerged within a short time: (2000) 9 TCLR 535 at 612. If this latter state of affairs did exist, it is difficult to see that there was an environment conducive to the recoupment of losses.

At most, the courts seemed to view the “2 for 1” promotion as having disrupted NWP’s momentum: (2001) 10 TCLR 247 at para 95. Following the cessation of the “2 for 1” promotion in 1994, the market appeared to revert to the competitive equilibrium that had existed prior to the “2 for 1” promotion, until independent and unrelated decisions were made by Carter Holt Harvey and NWP to exit the market in 1998. Prices were not raised at this time for Pink Batts. The higher-priced Wool Line product did not capture customers; they could switch to Wool Bloc.

Carter Holt Harvey: The Findings

A High Court

There was common ground in the various judgments that INZCO was in a dominant position in the South Island insulation market, notwithstanding the contradictory observation just noted that the market was intensely competitive. Accordingly, the focal point under the s 36 cause of action was whether INZCO had used this position for the purpose of preventing

NWP from engaging in competition in this market or, more pertinently, of eliminating NWP from this market.

In the High Court, Williams J and Professor Lattimore, the lay member, delivered separate judgments. There is a significant problem with the approach taken by Williams J, for he did not in fact address the counterfactual test. Rather, he was prepared to find the use of a dominant position by INZCO based solely on his review of the narrative; see *Commerce Commission v Carter Holt Harvey Building Products Ltd* (2000) 9 TCLR 535 at 603–609. His analysis focused on his assessment of the intentions of INZCO personnel. Therefore, the approach taken by Williams J is essentially a purpose inquiry only. Williams J developed the following theory of the case. INZCO's strategy was to protect Pink Batts from harm. Therefore, Wool Line was pitched in the market against Wool Bloc to preserve the dominant market position for Pink Batts. INZCO's strategy was not to seek recoupment of the Wool Line losses. Rather, INZCO's conduct was seen to be predatory in the sense that it was seeking to maintain the profitability of its main Pink Batts brand.

More detailed reasoning is contained in the supplementary and concurring judgment of Professor Lattimore. The central point in Professor Lattimore's analysis of use (pp 622–626) was that INZCO would not have been likely to price Wool Line significantly below its variable costs of production had it been a non-dominant supplier of insulating products. This conclusion was not intended to convey the meaning that all pricing below cost may amount to use. It was clearly recognised that promotions of new products could legitimately involve some "loss leader" activity. However, in the case of a dominant firm, a dividing line for promotions was identified. Professor Lattimore appears to equate use with promotional activities of dominant firms where they are of such magnitude and duration as to cause harm to competitors. In other words, if INZCO had been non-dominant in the same circumstances, it would not have been likely to have priced below cost to the extent that it did, and for the duration that it did. Coupled with this proposition, Professor Lattimore found that recoupment of the losses on Pink Batts would be likely. Wool Line would constrain the expansion of Wool Bloc in the market, with the consequence that the list price for Pink Batts would be maintained, and that the market share for Pink Batts would increase. There was no elaboration of reasons to support this conclusion.

There was one other observation made by Professor Lattimore elsewhere in the judgment (p 617) concerning the concept of use. This related to an obvious point arising from the facts of this case, namely, price-matching. Professor Lattimore was of the opinion that in this case there was no defence of price-matching, or what he called "price aping". Rather, it was said that such conduct could imply the use of dominance. No reasons were advanced to support this conclusion.

B *Court of Appeal*

The Court of Appeal's treatment of the issue is non-exploratory: (2001) 10 TCLR 247, paras 72–82. In the realisation that Williams J had not addressed the counterfactual question, the Court of Appeal focused on the reasoning of Professor Lattimore on the question of use. The Court of Appeal, in essence, merely endorsed Professor Lattimore's views without further analysis. The Court's apparent dislike for the counterfactual test was again evident, and there were comments touching upon the difficulties involved in formulating an appropriate counterfactual in the present case. The Court nevertheless applied a counterfactual approach. It assumed that under the counterfactual of hypothetical competitive circumstances, INZCO and NWP would have comparable distribution structures, and that INZCO would not be able to cross-subsidise its losses from the sale of Wool Line from the "super profits" enjoyed from sales of Pink Batts. There was, surprisingly, no mention of the price-matching point.

The findings of the High Court and Court of Appeal — that INZCO had misused its dominant position — were overturned by a three-to-two majority of the Privy Council.

C *Privy Council: majority*

There is a central theme to the majority judgment that it is not the purpose of s 36 to deny a person who is dominant the opportunity to protect its position when faced with competitive threats. A contrary approach would not be in accord with the principle of competition that lies at the heart of the Commerce Act. It followed in the majority's view that INZCO should be allowed to compete, when faced with new competition, and that it was by no means self-evident that INZCO would have behaved differently if it had not been in a dominant position when it was deciding how to meet the new competition from Wool Bloc.

The majority decision was critical of Williams J's failure to address the counterfactual test. Their Lordships concluded (para 40), with some justification, that Williams J had overlooked the warning given in *Commerce Commission v Carter Holt Harvey Building Products Ltd* that, while it is legitimate to infer purpose from use, it may be dangerous to argue the converse. Professor Lattimore's decision received closer scrutiny. It was noted that he had properly addressed the counterfactual question in reaching the conclusion that a non-dominant firm would not have reduced its price by such a margin below variable cost as INZCO did. However, this position was seen to stand in conflict with Professor Lattimore's earlier statement that it was rational for INZCO to continue with Wool Line because it gave it a range

of products required by distributors and helped to keep other products out. It followed, in the majority's view, that, "[i]f it was rational for INZCO to do this in the face of competition from Wool Bloc, it would have been rational too for anyone else who was facing the same competition and was seeking to meet the demands of its distributors" (para 44). The majority took further issue (para 46) with what they saw to be the origins of Professor Lattimore's reasoning, namely, that there is no price-matching defence to allegations of predatory pricing, and that "price aping" could imply the use of dominance. The majority plainly thought that these propositions could not be reconciled with the counterfactual test.

Not surprisingly, the majority had little to say about the decision of the Court of Appeal, given that that Court had in essence merely endorsed the views of Professor Lattimore.

The majority analysis is, in fact, based upon both general and specific rule formulations. In pursuing this path, the Privy Council appeared to recognise the inadequacies of the application of the counterfactual test to these facts, and the more informed nature of a specific rule for predatory pricing.

Dealing first with the general counterfactual test, the majority reaffirmed the principle that "use" requires that a causal relationship be shown between the conduct that is alleged against the dominant firm and its dominance or market power. It was said to follow that, "if a dominant firm is acting as a non-dominant firm otherwise in the same position would have acted in a market which was competitive it cannot be said to be using its dominance to achieve the purpose that is prohibited" (para 52). The Privy Council considered the application of this test to the facts (see, for example, paras 29, 44–45, and 68). It was thought likely that INZCO would have acted the same way in responding to Wool Bloc had it been non-dominant. This approach to the counterfactual test seems more realistic than Professor Lattimore's approach. Clearly, a competitive response to match new competition at below-cost price levels can be anticipated, whether the market is competitive or not.

But, more significantly, the Privy Council recognised the need for a specific predatory-pricing rule formulation. In particular, close reliance was placed upon the decision of the High Court of Australia in *Boral Besser Masonry Ltd v ACCC* (above). This case was decided after the decision of the Court of Appeal in *Carter Holt Harvey*.

Based upon passages from *Boral*, the Privy Council observed that firms, whether dominant or not, can be expected to put their prices down when faced with the need to meet competition (paras 57 and 67). It was recognised that such a price response is not of itself determinative of the use of market power. Rather, the issue is whether the pricing conduct is likely to remove competition, and whether there is the ability to recoup losses through the charging of supra-competitive prices. It would appear, therefore, that, while the Privy Council did not resile from the relevance of the counterfactual test,

it appeared to accept that primacy attached to this more informative specific predatory-pricing rule.

The majority extracted three key propositions from all of this, incorporating both general and specific rule formulations (para 60):

1. It is “both legitimate and necessary when giving effect to section 36 to apply the counterfactual test to determine whether the defendant has used its position of dominance”.
2. “The financial ability to cut prices is not market power.” Rather, price-cutting “only becomes unlawful when the dominant firm is shown to have done so by use of its position of dominance”.
3. The use of dominance is established in the predatory-pricing context where there is “price-cutting with a view to recouping its losses without loss of market share by raising prices without fear of reprisals afterwards”. It is not clear whether this reference to price-cutting is intended to be limited to below-cost price-cutting. The apparent approval (para 67) of the approach taken in *Boral* suggests that only below-cost price-cutting is intended to be covered by s 36, but this is not clear.

There is one final point of principle to be noted in passing from the majority’s judgment. The majority cite with apparent approval a statement from *Boral* to the effect that “if the impugned conduct has a business rationale, that is a factor which points against any finding that the conduct constitutes a taking advantage of market power” (para 54). This statement hangs in isolation. It is not further developed in the judgment. This is unfortunate, as this statement does not appear to sit comfortably with the Privy Council’s earlier rejection in *Telecom Corporation of New Zealand v Clear Communications Ltd* (above) of the relevance and reliability of an inquiry into whether the conduct in question is reasonable or justified.

D *Privy Council: minority*

The minority accepted that Wool Line was at a price more or less the same as for Wool Bloc. It was unsympathetic to INZCO’s argument that if it was deprived of this opportunity to match price, it would be deprived of the ability to compete. Two key themes emerge from the minority judgment.

First, it agreed with the High Court’s fighting-brand theory of the case. It said: “Wool Line was the goat tethered in order to lure the tiger to destruction. Like the goat, the fate of Wool Line was immaterial” (para 83). Second, it advanced the conclusion that the counterfactual was unworkable in this case and that, accordingly, it was legitimate to infer use from purpose.

There is some complexity to the minority’s line of reasoning in reaching

these conclusions. On the one hand, the minority identified more clearly than in any of the other judgments what INZCO may look like as a comparator in a counterfactual setting (para 77). It would sell to builders' merchants but would have no distribution arrangements comparable to those of INZCO; it would not have a significant market share; and it would have no particular financial strength. However, the minority took the position that such a counterfactual approach was unreal in this case, because this was not the ordinary predatory-pricing situation of below-cost pricing in order to drive out a rival, coupled with the prospect of recoupment of losses occasioned through such a predatory campaign. Rather, they said that this was a story about the commercial fate of Pink Batts. INZCO wanted to see off Wool Bloc in order to protect Pink Batts.

As Pink Batts' market share and brand image was important in reaching the conclusion that INZCO was dominant, the minority had difficulty in seeing how the counterfactual test could be applied. The minority's key point was that the following inappropriate question flowed out of these circumstances: "How could a competitor who was not in a dominant position expect to protect the share of a favoured product in a competitive market by selling another product at a highly uncommercial price?" (para 81). This question is problematic. Presumably the other product referred to here is Wool Line, in which case it is difficult to see how the price for this can be said to be uncompetitive.

The solution posed by the minority was that, in this case, it would be appropriate simply to ask the statutory question of whether there was a causal connection between INZCO's adoption and maintenance of its Wool Line pricing policy and its dominant position based on Pink Batts and its distribution agreements. It was accepted (para 82) that this might well lead to an inference of use from observations as to purpose.

Significantly, there is a closing concession in the minority judgment that their approach would deprive INZCO of the ability to compete. There was no attempt to justify this requirement that INZCO be made to surrender its ability to compete.

Critique

Carter Holt Harvey is a difficult and non-typical predation case. The particular features of the case that must be taken into account include the following:

1. This appears to be a case about price-matching. On the facts this is all that INZCO appeared to do.
2. INZCO really had no choice but to match Wool Bloc. It could not be

expected to stand idly by and surrender its market position to a new entrant with a superior product.

3. The coincidental timing of the introduction of the “2 for 1” promotion and 12 per cent price increase for Wool Bloc was unfortunate, but what was to stop NWP reversing this price increase? Presumably such reversal would have done much to overcome the disruption to NWP’s momentum.
4. A competitive market was said to exist after the cessation of the “2 for 1” promotion, and for the next four years through until the end of 1998. Recoupment of losses would seem problematic in these circumstances.
5. NWP’s goals were unclear. It did not fail. Rather, its agenda all along had been to sell or franchise factories rather than insulation. Hence, nothing can really be read into its exit from the market at the end of 1998.
6. This is not a straightforward fighting-brand situation. Typically, fighting brands emerge where a higher-priced brand is attacked by a generic economy brand. A generic fighting brand is introduced to attack the competitor’s generic brand (see, for example, *Brooke Group* (above)). The reverse seems to occur here. Pink Batts was attacked by a superior and cheaper product. INZCO’s response was to match the innovation and price of the new product. In these circumstances it is difficult to know why Pink Batts would continue to attract the alleged monopoly profits, and why the market did not substantially switch to Wool Bloc and Wool Line. What happened with sales of these products over the trading period from mid-1994 until the end of 1998? It is a pity that these issues were not explored.

The *Carter Holt Harvey* decision is significant for its consideration of monopolisation principles in the context of both the general rule and the specific rule applying to predatory pricing.

A *General monopolisation rule*

It is apparent from the above discussion that there has been some tension between the Privy Council and New Zealand courts on whether the counterfactual test is the sole test for determining the monopoly characterisation question. The majority of the Privy Council noted that the New Zealand courts had shown a marked lack of enthusiasm for the counterfactual test that it had enunciated a decade earlier in *Telecom Corporation of New Zealand v Clear Communications Ltd* (above). This observation may have motivated the majority to stipulate that it was now both legitimate and necessary to apply the counterfactual test in s 36 cases. But what does the Privy Council mean by “apply” in this context? This is not altogether clear.

The Privy Council noted that the origins of the counterfactual test are to be found in Australian case law, and the Privy Council would have been aware from the judgment of the Court of Appeal in *Carter Holt Harvey* (2001) 10 TCLR 247, para 72, that the Australian case law recognised that the counterfactual test may be difficult to apply in some cases. Therefore, the Australian authority is to the effect that the application of the counterfactual test may not always be necessary.

It is not apparent that the Privy Council was looking to deviate from Australian authority. Therefore, it follows that it may be legitimate to interpret the Privy Council to be merely saying that the counterfactual test must be considered in all cases, and that such consideration amounts to the application of the counterfactual test. Under this approach it follows that, where the counterfactual test is not sufficiently cogent, there is a need to consider other approaches.

But the contrary view remains open, namely, that the Privy Council literally meant that the counterfactual test was a mandatory test to be applied in all cases. However, as this approach is not in accord with Australian law, it is difficult to imagine that it will survive. Presumably our Supreme Court will, at the first opportunity, look to align the approach under New Zealand law with that taken by the High Court of Australia under parallel legislation. This prediction of course raises a consequential question: What approach is to be followed in cases where the counterfactual test is not relied upon, where there are no specific rule formulations? Two alternative approaches have surfaced: (1) the question-of-fact approach; and (2) the business justification defence.

The factual approach was first raised in *Port Nelson* (above). There the Court of Appeal said that the use element of s 36 was simply a question of fact. The minority of the Privy Council in *Carter Holt Harvey* also said that “use” was simply a statutory question of causal connection. With respect, this test is uninformative, and potentially reduces s 36 to a purpose inquiry that is unintended by the provision. If the counterfactual test is unworkable in any given case, this fallback position does not provide a superior basis for a general rule. Indeed, the uninformative nature of this rule makes the likely outcome of the application of s 36 even more unpredictable.

A parallel point must be made in relation to the business justification defence. The Privy Council rightly noted that the Australian courts have expressed some interest in applying this test, and it has arguably left this thread dangling, notwithstanding its apparent rejection of any such approach in *Telecom v Clear*. But what does it mean to say that there is an inquiry into business justification? The United States business justification defence sounds grand in principle, but its application is plainly uncertain; see Easterbrook, “On Identifying Exclusionary Conduct” (1986) 61 *Notre Dame LR* 972. It is perhaps more likely that this inquiry may be based upon economic analysis

than pure fact and causal connection inquiries. For example, a firm with market power might say that it was legitimate to engage in certain conduct because it would reduce costs and improve efficiency. Inquiries such as this may provide a sounder basis for decision-making. But ultimately even this approach, heavily intertwined as it will be with factual assessments, amounts to a relatively uninformative and unpredictable rule formulation.

B *Predatory pricing*

There is an extensive jurisprudence on the subject of predatory pricing. *Carter Holt Harvey* brings into focus two particular inquiries relating to price predation. First, what is the appropriate analytical rule for this particular example of monopoly behaviour? Second, is there a defence of price-matching?

There have been two main waves relating to the analytical framework for predatory pricing. The first is the Areeda-Turner test dating back to the mid-1970s; see Areeda & Turner, "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act" (1975) 88 Harv L Rev 697. Areeda and Turner advocated a brightline pricing test. If the price being charged by a firm was at or above its average variable cost of production, it followed that the conduct should be presumed lawful. Such conduct should, however, be presumed unlawful should price be below this measure of cost.

However, a refinement to this test was soon to emerge, based upon structural market considerations rather than just cost-based assessments. This approach, which reflects the current-day wisdom on the subject, emphasises that successful predation is unlikely where ease of entry denies the predator its ability to recoup its investment in below-cost pricing. Joskow and Klevoric advocate a two-step rule; see Joskow & Klevoric, "A Framework for Analysing Predatory Pricing Policy" (1979) 89 Yale LJ 213. The first focuses on whether the pricing in question is likely to harm society and provide the predator with the opportunity to earn monopoly rents. This test serves to filter out cases where such an outcome is unlikely because the structure of the market means that it is unlikely to occur. The second step uses cost-based pricing tests to further explore whether there is unlawful predation. For example, pricing below average variable cost would be indicative of predation.

These economic frameworks clearly influenced the judicial approach to predation in the United States, as evidenced by the *Brooke Group* test for predation (above). While the courts have struggled to identify an appropriate measure of below-cost pricing, largely due to the complexity of this exercise, the question of recoupment is clearly relevant to the assessment of liability.

The Australian courts have also been persuaded by the merits of this approach for a specific rule for predation, unconnected to the counterfactual test. The leading decision on the point — *Boral Besser Masonry Ltd v ACCC* in the High Court of Australia (above) — reflects the influence of the United States economic literature and case law on predation.

The judgment of Gleeson CJ and Callinan J notes the judicial sentiment in earlier cases that there are dangers in allowing a term such as predatory pricing to take on a life of its own. Nonetheless, they were prepared to accept that, while the possibility of recoupment was not legally essential to a case for predation, it might be of factual importance: (2003) 195 ALR 609 at paras 126 and 130. The most detailed judgment on the point, that of McHugh J, more openly embraced the logic of the United States approach to predation and concluded that it fitted within s 46 of the Australian Act (*ibid* at paras 278–281). The Privy Council in *Carter Holt Harvey* clearly placed most reliance upon this judgment; see [2004] UKPC 37 at para 67. McHugh J stated that had he been required to apply the “taking advantage” limb of s 46, he would have applied the following two-step approach, based on United States antitrust law: Was there (1) pricing below an appropriate measure of costs (whatever that might be) for a proscribed purpose; with (2) the intention of later recouping losses by using market power to charge supra-competitive prices?

Unfortunately, the Privy Council did not fully restate the elements of this test in its formulation of predatory-pricing principles at para 60(c), because there is reference only to whether there has been price-cutting with a view to recoupment. As already noted, it appears likely that this pricing test was intended to be a below-cost pricing test. This is a point of some significance because there is the prospect that prices above average total cost can also be predatory. This is known as limit-pricing. While limit-pricing has not previously been translated into rules of legal application, most economists accept that limit-pricing occurs and can be anticompetitive. Entry may be deterred and incumbent firms may condition their pricing in response to implied threats that the price may be set below the prevailing price, but above the average total cost of the dominant firm. Nonetheless, the debate continues whether such pricing should be condemned; see Elhauge, “Why Above-Price Price Cuts to Drive Out Entrants Are Not Predatory — and the Implications for Defining Costs and Market Power” (2003) 112 Yale LJ 681. It is important that subsequent case law clarifies this point, and presumably the approach taken in *Boral* is intended to apply.

Turning to the vexed question of price-matching, it is appropriate first to note that not all instances of pricing below cost are unlawful. Price-matching is one of a range of circumstances where below-cost pricing may be permissible; see Scott, “Is a Dominant Firm’s Below Cost Pricing Always a Breach of Section 36 of the Commerce Act?” (2004) 21 NZULR 106,

122–124, for a survey of other examples where below-cost pricing may be legitimate.

The economics literature on this point is limited. There is a recognition that below-cost pricing may be legitimate and explicable in competition terms; see Bolton, Brodley & Riordan, “Predatory Pricing: Strategic Theory and Legal Policy” (2000) 88 *Georgetown LJ* 2239 at 2274–2276. But there is no elaboration of an economic framework to define boundaries between legitimate and illegitimate price-matching. It is, therefore, difficult to understand the basis of Professor Lattimore’s assumption that “price aping” implies the use of dominance.

There is no real depth of analysis in the case law on price-matching. Not surprisingly, there are differing approaches. There is a strong line of authority in some United States Circuit Court of Appeals decisions that below-cost price-matching by an incumbent does not amount to predation. As the Sixth Circuit noted in *Richter Concrete Corp v Hilltop Concrete Corp*, 691 F 2d 818 (6th Cir 1982), it is not anticompetitive for prices to be lowered to match prices already charged by competitors; indeed, “to force a company to maintain non-competitive prices would be to turn the antitrust laws on their head” (p 826). But there are other cases where a price-matching defence has not been embraced in this manner; see *US v AMR Corp*, 335 F 3d 1109, 1120, n 5 (10th Cir, 2003).

Intuitively, price-matching ought to operate as a defence to predation. But there are problems in translating this defence into a rule of legal application that informs upon whether there has been a taking advantage of market power. In one sense this defence consideration asks the same question as the counterfactual test question: firms both with and without market power will potentially respond the same way and match competitors’ initiatives. As discussed above, this consideration alone does not provide an adequate basis for determining liability. An analytical framework of the *Brooke Group* and *Boral* kind provides a more informed basis for determining predation claims. Nonetheless, price-matching may well be determinative of the purpose element of s 36 in certain cases.

While price-matching may not form part of a rule formulation, it nonetheless provides a useful way to test the logic of any outcome. For example, the logic of the Privy Council minority is irreparably harmed having regard to this consideration. The minority approach is that INZCO should have kept its prices at uncompetitive levels. This cannot be right.

Some Final Thoughts

There is talk that *Carter Holt Harvey* has killed s 36. This is not true. The counterfactual test is not a model general rule for monopolisation. But

no such model rule has emerged, notwithstanding the search for one for over a century; see Berry, “The Uncertainty of Monopolistic Conduct: A Comparative Review of Three Jurisdictions” (2001) 32 *Law & Policy in Int’l Bus* 263. For this reason, more informed specific rules have emerged.

Clearly, the counterfactual test may apply to some factual circumstances better than it does to others. For example, it appears to be a sensible basis upon which to determine refusal-to-deal cases, such as *Queensland Wire* and *Melway Publishing* (above). This may be because the test was in fact fashioned in relation to such facts in *Queensland Wire*. BHP had taken advantage of its market because it was rational to conclude that BHP would not have refused to supply Queensland Wire had there been an alternative supplier of Y-bar. Likewise, it was appropriate in *Melway Publishing* to conclude that there had been no taking advantage of market power in circumstances where a firm (now with 90 per cent market share) was merely continuing to apply a distribution policy that it had followed back when it had only a 10 per cent market share. There have been, and will continue to be, cases where the counterfactual test will form an appropriate basis for the inquiry into whether there is a causal connection between the existence and relevant use of market power.

If the mandatory application of the counterfactual test is not cogent in certain cases, the question of the necessity of this test arises. It is open to our courts to say that the application of the counterfactual test is not mandated on all occasions. Our Supreme Court, by electing in due course to follow Australian precedent, can overcome a contrary view.

It follows that the sensible way forward, which is achievable without legislative intervention, is as follows:

- First, is there an informed specific rule formulation, such as that for price predation? If so, that alone should be applied.
- Second, if there is no specific rule, then consider the application of the counterfactual test. If this test can be cogently applied, it alone should provide the basis of the assessment.
- Third, if the counterfactual test cannot be cogently applied, resort may be had to the alternative inquiries into fact alone and business justification. However, given the uncertain nature of these tests, particular care must be taken to ensure that this approach does not simply reduce to a purpose inquiry.

