

MATTHEW BERKAHN

SHARED MONOPOLIES AND TACIT COLLUSION:  
APPLYING COMPETITION LAW TO OLIGOPOLIES

LLM RESEARCH PAPER

ADVANCED COMPETITION LAW  
(LAWS 530)

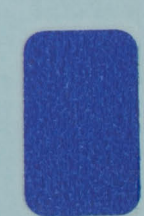
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CONTENTS

ABSTRACT..... MATTHEW BERKAHN

I. INTRODUCTION.....

II. ECONOMIC THEORY OF COMPETITION.....

    A. PERFECT COMPETITION AND MONOPOLY.....

    B. OLIGOPOLY.....

III. OLIGOPOLY IN PRACTICE.....

    A. THE OLIGOPOLY IN THE NEW ZEALAND MARKET.....

    B. ANTI-COLLUSION PROVISIONS IN THE NEW ZEALAND MARKET.....

IV. SHARED MONOPOLIES AND TACIT COLLUSION:  
APPLYING COMPETITION LAW TO OLIGOPOLIES.....

    1. NEW ZEALAND AND AUSTRALIAN CASES.....

    2. EUROPEAN COMMUNITY.....

    3. UNITED STATES.....

    B. ANTI-COLLUSION PROVISIONS.....

        1. NEW ZEALAND AND AUSTRALIAN CASES.....

        2. UNITED STATES.....

        3. EUROPEAN COMMUNITY.....

    C. ANTI-COLLUSION PROVISIONS IN THE NEW ZEALAND MARKET.....

V. CONCLUSION.....

BIBLIOGRAPHY.....

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## CONTENTS

ABSTRACT.....	1
I INTRODUCTION.....	2
II ECONOMIC MODELS OF COMPETITION.....	3
A PERFECT COMPETITION AND MONOPOLY.....	3
B OLIGOPOLY.....	6
III OLIGOPOLIES IN PRACTICE.....	18
A THE OBJECTIVES OF COMPETITION LAW.....	18
B ANTICOMPETITIVE CONDUCT IN THE PETROL INDUSTRY (I).....	25
IV COMPETITION LAW RESPONSES.....	30
A MARKET DOMINANCE PROVISIONS.....	30
1 NEW ZEALAND AND AUSTRALIAN CASES.....	30
2 EUROPEAN COMMUNITY.....	35
3 UNITED STATES.....	39
B ANTI-COLLUSION PROVISIONS.....	42
1 NEW ZEALAND AND AUSTRALIAN CASES.....	45
2 UNITED STATES.....	49
3 EUROPEAN COMMUNITY.....	54
C ANTICOMPETITIVE CONDUCT IN THE PETROL INDUSTRY (II).....	56
V CONCLUSIONS.....	58
BIBLIOGRAPHY.....	61

## I. INTRODUCTION

**ABSTRACT**

The aim of the *Commerce Act 1986* is to promote competition, and thereby consumer welfare and efficiency. To achieve these goals, New Zealand has adopted a "light-handed" approach to competition law, which suggests that anticompetitive outcomes, rather than the processes or structures which produce those outcomes, should be its focus.

The interpretation given to the key provisions of New Zealand's competition law have, however, proved to be inconsistent with this standard, when applied to oligopolies. While there is evidence that some oligopolistic industries are not competitive, anticompetitive conduct in such markets would appear to fall outside of the prohibitions of sections 27 and 36 of the *Commerce Act*. The courts have applied a process-based test to the issue of collusion, with the result that the tacit collusion of oligopolists may not be subject to liability under s 27, although the results of such behaviour are indistinguishable from those produced by explicit agreements.

Similarly, the prohibition on the use of dominance in s 36 has been held to apply only to the conduct of single firms, despite the ability of oligopolists to effectively achieve "joint dominance" and use it to produce anticompetitive outcomes.

The more realistic approach taken to these issues in the European Community, and to a lesser extent the United States, appears better suited to the stated goals of competition law, and does not conflict with the light-handed philosophy currently favoured in New Zealand.

**Word Length**

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 15,570 words.

## I INTRODUCTION

The enforcement of effective competition in oligopolistic markets has been described as "a persistent and difficult problem of antitrust policy".<sup>1</sup> In industries consisting of a small number of sellers, there exists the potential for significant deviations from competitive price and output levels, and consequently for resources to be channelled in inefficient directions and for technological innovation to be inhibited.

The difficulty in combating such outcomes lies in the fact that competition laws are typically framed, or have been interpreted, in terms which seem to assume a competitive market structure, where explicit collusion or near-monopolisation by a single firm would be necessary to produce anticompetitive results. Such conduct may not be required to produce the same results in an oligopoly. A concentrated market structure allows firms to form tacit agreements without the need for the explicit communication generally required under anti-collusion provisions, or to jointly dominant a market, through recognition of the fact that their economic fortunes are influenced by the behaviour of their rivals. Oligopolists may "learn", purely from observation over time, that profits can be enhanced for all producers, at the expense of consumers and potential market entrants, if output and pricing decisions are coordinated.

Section 27 of the *Commerce Act 1986*, and similar provisions in other jurisdictions which prohibit anticompetitive "arrangements or understandings", have generally been held to require some form of communicated agreement between the parties; while the prohibition on the use of market dominance in s 36 has been limited to situations where a single firm holds a high degree of market control.

This paper considers the economic background to the "oligopoly problem", including a comparison of the goals of New Zealand's competition policy with the observed behaviour of participants in the oligopolistic retail petrol market. The market dominance and anti-

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<sup>1</sup>Posner, "Oligopoly and the Antitrust Laws: A Suggested Approach" (1969) 21 Stanford Law Rev 1562; Goldman, "Oligopoly Policy and the *Ethyl Corp.* case" (1986) 65 Oregon Law Rev 73, 74.

collusion provisions in a number of jurisdictions are then discussed, including those of the United States and the European Community, where the approach to oligopoly regulation appears more consistent with these goals.

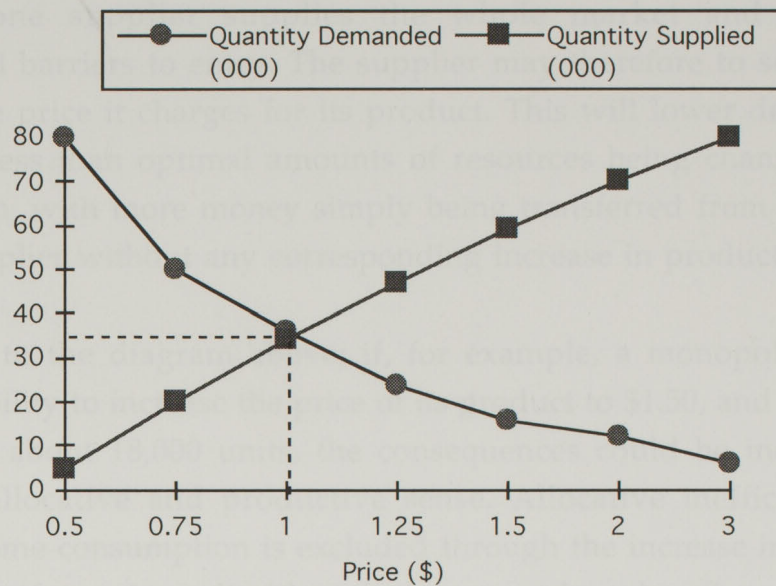
## II ECONOMIC MODELS OF COMPETITION

### A *Perfect Competition and Monopoly*<sup>2</sup>

The basic economic model of a market is one of "perfect competition". In such a market all participants are assumed to act rationally - consumers will make decisions in pursuit of their own self-interest and producers will aim to maximise their profits - and the market itself is characterised by extremely high levels of competition. The market is made up of large numbers of buyers and sellers, with each being a "price taker", in the sense that no individual participant can reasonably hope to single-handedly alter the market price from the equilibrium set by the law of supply and demand. There are also assumed to be no barriers to entry. Any producer can sell its entire output at the equilibrium price, but even a small increase in price by any seller will result in the loss of all of its sales, as all consumers are assumed to have free access to all market information, and they may freely change from one supplier to any other in order to get the best possible deal for themselves. At any price level significantly above or below this equilibrium, excess demand or supply will provide an incentive to change, and the market will eventually work its way back to the equilibrium point. Uniform pricing, at an approximately equilibrium level, is therefore a sign of a competitive industry.

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<sup>2</sup>See Areeda and Turner, *Antitrust Law: An Analysis of Antitrust Principles and their Application*, Boston, Little Brown & Co. (1978), p268-272; Baumol and Blinder, *Economics: Principles and Policy (5th ed.)*, Orlando, Harcourt Brace Jovanovich Inc. (1991), ch 25 and 27; Corones, *Restrictive Trade Practices Law*, North Ryde, The Law Book Co. Ltd (1994), p3-6; and Stiglitz, *Economics*, New York, W.W. Norton & Co. Inc. (1993), p30-31 and 396.



### Supply and Demand Conditions facing a Firm in a Perfectly Competitive Market

Above is a simple illustration of supply and demand in a perfectly competitive market.<sup>3</sup> Basically, producers will be willing to supply more at higher prices, and consumers will demand less. The point where the supply and demand curves meet, in this case at a price of about \$1 and quantity of about 35,000 units, represents the equilibrium market price<sup>4</sup> and quantity. Under perfect competition the profit rate for all suppliers is equal; no firm is able to make "excess profits".<sup>5</sup> Achieving as perfectly competitive a market as possible is thus assumed to be the best way to maintain economic efficiency, as such a market will produce the goods that consumers want at the least possible cost, and the allocation of resources among producers will be dictated solely by consumers' "money votes".

At the other end of the theoretical scale is the "monopoly", a model of a market characterised by a total lack of competition. In a monopolistic

<sup>3</sup>Adapted from Stiglitz, above n2, p87-93.

<sup>4</sup>Cost would also be \$1 per unit in this case. Cost per unit, including a "normal" return on investment, is assumed to be the same as the competitive market price. Under perfectly competitive conditions, the point at which the supply and demand curves meet is also where marginal cost and marginal revenue (ie. the cost and revenue resulting from the last item produced) are equal.

<sup>5</sup>Otherwise known as "monopoly profits", ie. returns in excess of what could be earned under competitive conditions, which result from reductions in output and increases in price from competitive levels, rather than from greater efficiency, superior knowledge and managerial ability: See Stiglitz, above n2, p402-404.



market, one supplier supplies the whole market and there are substantial barriers to entry. The supplier may therefore to some extent dictate the price it charges for its product. This will lower demand and result in less than optimal amounts of resources being channelled into production, with more money simply being transferred from consumers to the supplier without any corresponding increase in production.

Referring to the diagram above; if, for example, a monopoly supplier had the ability to increase the price of its product to \$1.50, and restrict the supply to about 18,000 units, the consequences could be inefficient in both an allocative and productive sense. Allocative inefficiency may arise as some consumption is excluded through the increase in price and restriction of supply and, although there may be other firms willing to make up this gap in supply, they are excluded from doing so due to the barriers to entry which exist in the monopolistic market. Productive or operating efficiency may be lost due to the fact that monopolies are not under the same compulsion to minimise costs as firms facing competition. Areeda and Turner note that "it is widely suspected ... that monopoly tends to beget waste and a less than zealous effort to adapt to cost-saving innovations".<sup>6</sup> While the monopolist will make an excess profit in this situation,<sup>7</sup> the loss suffered by consumers will be greater. This loss to consumers not offset by any gain to the seller,<sup>8</sup> is known as a "dead weight loss".

A further source of concern arising from monopolies is "rent seeking". Monopolies may devote their resources to obtaining or maintaining

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<sup>6</sup>*Antitrust Law: An Analysis of Antitrust Principles and their Application*, Boston, Little Brown & Co. (1978), p272. See Eaton & Eswaran, *Supporting Collusion by Choice of Inferior Technologies* (1991) University of Tasmania Department of Economics Discussion Paper 1991-06 for an analysis of this phenomenon as it applies to oligopolies.

<sup>7</sup>In this case about \$9,000 (revenue of \$1.50 x 18,000 units (\$27,000), less costs of \$1 per unit (\$18,000)).

<sup>8</sup>Economists do not regard mere redistributions of wealth, eg. from consumers to suppliers, as social costs. Efficiency, in the sense of making the "economic pie" as large as possible, is seen as the sole objective of competition policy, with questions of social equity left to other mechanisms such as the welfare system: Brock, *The Antitrust Debate in New Zealand: Commentary*, Paper prepared for the New Zealand Business Roundtable (1989), p1-3. The societal loss caused by monopoly inefficiency is difficult to determine. Freeman and Medoff, *What Do Unions Do?*, New York, Basic Books (1984), p57, estimate the cost of the economic inefficiency caused, for example, by trade unions' monopolisation of the labour supply in the United States to be around \$5-10 billion per annum. Lande and Zerbe, "Anticonsumer Effects of Union Mergers: An Antitrust Solution" (1996) 46 Duke LJ 197, 217, estimate it to be about one third of this and, for this and other reasons, recommend that the existing exemption of trade unions from the United States antitrust laws be removed.

their monopoly position, or deterring the entry of competitors, for example by lobbying for government protection.<sup>9</sup> This is not only an unproductive use of resources, but may impose further costs on third parties such as competitors or potential competitors who seek to oppose it.

### **B Oligopoly<sup>10</sup>**

The perfect competition and monopoly models are both based upon extreme assumptions that are very rarely, if ever, found in real markets.<sup>11</sup> For this reason, alternative models have been produced that some feel better represent firms existing in the marketplace. These models of "imperfect competition" share some attributes of perfect competition and some attributes of monopoly. One of these models is the "oligopoly", which is characterised by the existence of a few large firms producing a similar though differentiated product. Oligopolies develop when there are "barriers to entry" of various types keeping potential rivals out of the market. No single firm is able to eliminate all close substitutes for its product, however. Therefore, mutual interdependence among all firms in the market exists,<sup>12</sup> as well as heavy non-price competition.

With respect to the barriers to entry which are present in oligopolies, Fellner notes that "economies of scale as well as 'artificial' methods of excluding competitors" are the primary sources of "fewness" in such markets.<sup>13</sup> He goes on to describe three sets of circumstances where oligopolistic conditions are likely to exist, namely where a firm's large size results in lower production costs; where smaller entrants can be excluded by the acquisition of exclusive rights to resources, patents or licenses, or contracts with persons possessing specific skills; and where an outside organising agency (such as the Government, or a trade or

<sup>9</sup>Posner, "The Social Cost of Monopoly and Regulation" (1975) 83 J Pol Econ 807, 812; Stiglitz, above n2, p451-452; Hovenkamp, "Antitrust Policy and the Social Cost of Monopoly" (1993) 78 Iowa Law Rev 371, 373-374; and Coronos, above n2, p6.

<sup>10</sup>See Areeda and Turner, above n2, p272-281; Baumol and Blinder, above n2, p596-608; and Stiglitz, above n2, p397 and 423-445.

<sup>11</sup>See *United States v E.I. Du Pont de Nemours & Co.* (1953) 118 FSupp 41, 49-50.

<sup>12</sup>Stiglitz defines an oligopoly as a market with "sufficiently few firms that each worries about how rivals will respond to any action it undertakes": above n2, p397.

<sup>13</sup>*Competition Among the Few*, New York, Augustus M. Kelley (1960), pxi.

professional association) restricts entry into the market.<sup>14</sup> So-called "vertical integration", where a firm controls the production of intermediate products as well as final consumer goods,<sup>15</sup> or where derivative markets exist which are dependent on the market for the firm's base product,<sup>16</sup> may also strengthen an oligopolistic structure by effectively "tying" one stage of production to another, and so extending the oligopoly to all levels of an industry.

The courts have also noted the importance of barriers to entry in oligopolistic markets. While New Zealand and Australia have produced little case law to date involving oligopolies as such,<sup>17</sup> there have been a number of Australian cases where at least passing reference has been made to their characteristics. In these cases, the potential for the misuse of "market power" in oligopolies, and the link between such power and barriers to entry were particularly noted.<sup>18</sup>

For example, in *Trade Practices Commission v Ansett Transport Industries (Operations) Pty. Ltd.*,<sup>19</sup> which centred on the definition of market "dominance" under s 50 of the *Trade Practices Act 1974*, Northrop J briefly discussed the features of oligopolies, basing his comments on two text-book references:

"The word 'oligopoly' is used frequently in the literature of economics and appears to be used to describe a type of market where a small number of firms account for a large proportion of the output of that market ... Professor Areeda describes the oligopoly or shared monopoly market as a market 'where no single firm possesses sufficient power to be considered a monopoly but where the behaviour and economic

<sup>14</sup>At p44-48.

<sup>15</sup>Stiglitz, above n2, p582-583 cites the example of the Ford Motor Company, which at one time owned its own steel mill to provide the steel used in making its cars. In *Queensland Wire Industries Pty. Ltd v Broken Hill Pty. Co. Ltd* (1989) 167 CLR 177, BHP controlled the production of "Y-bar", a steel product used in the manufacture of steel fence posts, and hence also controlled the market for those posts.

<sup>16</sup>For example, the market for car parts and service is derived from the market for car sales. Motor vehicle manufacturers may offer "free" parts and service for new cars for a period, the cost of which will in fact have been incorporated into the sale price of the car.

<sup>17</sup>*Re Magnum Corp. Ltd and Dominion Breweries Ltd* (1986) 2 TCLR 177 and *Re Trade Practices Commission and Email Ltd* (1980) 3 ATPR 42,367 appear to be the only reported cases where oligopolistic behaviour has been directly considered.

<sup>18</sup>See also the comments of Leahy DJ in *United States v E.I. Du Pont de Nemours & Co.* (1953) 118 FSupp 41, 49, cited at n137.

<sup>19</sup>(1978) 32 FLR 305.

performance of several firms approaches that of a single-firm monopolist'.<sup>20</sup>

In *Queensland Wire Industries Pty. Ltd v Broken Hill Pty. Co. Ltd*,<sup>21</sup> a case dealing with the alleged misuse of market power under s 46 of the *Trade Practices Act*, Mason CJ and Wilson J noted that barriers to entry were a significant factor in assessing the degree of such power a firm enjoys:

"Significant barriers to entry are the sine qua non [ie. the essential requirement] of monopoly and oligopoly, for ... sellers have little or no enduring power over price when entry barriers are non-existent."<sup>22</sup>

No universal model of oligopolistic behaviour exists. The various models used to predict such behaviour differ mainly in their respective assessments of why and how "mutual interdependence" among firms occurs. They include the following:

*The "kinked demand" model*<sup>23</sup> is based on the observation that prices in oligopolistic markets tend to change less frequently than those in competitive markets. For example, Baumol and Blinder note that the prices of agricultural commodities like corn, soybeans and cocoa, which are sold in markets with large numbers of sellers, can change minute by minute; while the prices of television sets and cars, which are supplied by oligopolists, may resist change for months or years at a time.<sup>24</sup>

<sup>20</sup>At 322-323, citing Scherer, *Industrial Market Structure and Economic Performance*, Chicago, Rand McNally (1970), p165 (now in its third edition: Boston, Houghton Mifflin (1990)); and Areeda, *Antitrust Analysis: Problems, Text, Cases (2nd ed.)*, Boston, Little Brown & Co. (1974), p224 (now in its fourth edition: Boston, Little Brown & Co. (1988)).

<sup>21</sup>(1989) 167 CLR 177.

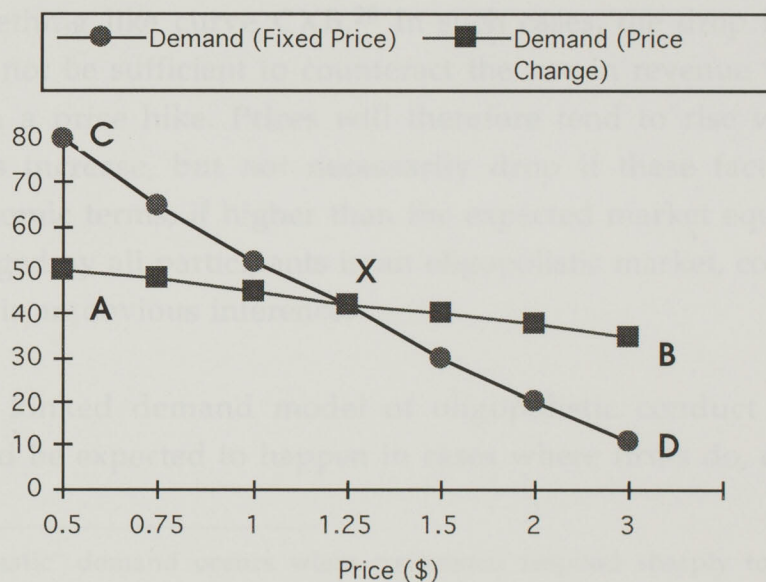
<sup>22</sup>At 189; citing Scherer, *Industrial Market Structure and Economic Performance (2nd ed.)*, Chicago, Rand McNally (1980), p11. This passage was also cited in *Re Arnotts Ltd* (1990) 24 FCR 313 and *Trade Practices Commission v Pioneer Concrete (Qld) Pty. Ltd* (1994) 16 ATPR 42,211.

<sup>23</sup>First suggested by Hayes, *Our Economic System*, New York, Holt (1928), p321 and developed by Sweezy, "Demand Under Conditions of Oligopoly" (1939) 47 J Pol Econ 568. The model seems to be generally accepted by economists, although it has been criticised by those of the Chicago school, who appear to dislike its somewhat heuristic and ad hoc nature: See Stigler, "The Kinky Oligopoly Demand Curve and Rigid Prices" (1947) 55 J Pol Econ 432 and Freedman, "The Economist as Mythmaker - Stigler's Kinky Transformation" (1995) 29 J Econ Issues 175.

<sup>24</sup>*Economics: Principles and Policy (5th ed.)*, Orlando, Harcourt Brace Jovanovich Inc. (1991), p603-606. See also Ross, "Oligopoly Theory and Price Rigidity" (1987) 32 Antitrust Bulletin 451.

The reason for this price rigidity lies in the fact that an oligopolist must take note of the likely reactions of its competitors when deciding whether or not to raise or drop its prices. It may be that firms will follow the price increases of rivals but ignore their price decreases, resulting in prices "sticking" at high levels. In such cases, a firm will feel relatively safe from losing its customers to competitors if it raises its prices. Alternatively, if price decreases are followed and increases ignored, firms will be unlikely to raise their prices much above the initial market equilibrium, for fear of having their sales taken by the other firms in the market.

To illustrate this, the kinked demand model makes use of **two** different demand curves, both passing through the initial point of market equilibrium, where the quantity which the producer is willing to supply equals the quantity demanded by consumers (indicated by **X** in the diagram below).



#### The "Kinked Demand" Model: Demand Conditions faced by a Firm in an Oligopolistic Market

In this example, demand curve **CXD** indicates the expected changes in demand if competitors do **not** respond to a given oligopolistic firm's price changes; while curve **AXB** represents what happens if competitors do match such changes. The demand curve which the firm actually faces is a combination of the two: curve **AXD**. This diagram represents a "lose / lose" situation for our hypothetical oligopolist, ie. one where the firm

has good reason to fear that only its price decreases, and not its increases, will be followed. Thus, if it raises its price above  $X$ , it will lose customers and this loss will not be made up by the increased revenue per item sold. Many of the firm's customers will choose to purchase the product from the other firms in the market, who continue to charge lower prices. Demand is thus "elastic"<sup>25</sup> above the equilibrium level. On the other hand, if it lowers its price, the resulting increase in demand will be comparatively small, as the other firms can be expected to follow the price decrease shortly after. Demand is therefore relatively "inelastic" for prices below  $X$ .<sup>26</sup> These are the conditions an oligopolist could expect to face in the absence of any collusion<sup>27</sup> between market participants. Fear of being undercut by a competitor will prevent any firm unilaterally raising its prices above the equilibrium point.

Alternatively, however, a firm might be in a situation where it has reason to feel confident that its price increases will be followed and its decreases ignored, in which case the demand curve for that firm will be something like curve  $CXB$ .<sup>28</sup> In such cases, the drop in expected sales will not be sufficient to counteract the rise in revenue which will result from a price hike. Prices will therefore tend to rise when demand or costs increase, but not necessarily drop if these factors decrease. In economic terms, if higher than the expected market equilibrium price is charged by all participants in an oligopolistic market, collusion<sup>29</sup> of some sort is an obvious inference.

The kinked demand model of oligopolistic conduct illustrates what could be expected to happen in cases where firms do, or do not, expect

<sup>25</sup>"Elastic" demand occurs when consumers respond sharply to any price change. "Inelastic" demand refers to situations where consumer response to such changes is relatively insignificant.

<sup>26</sup>The demand curve in this situation -  $AXD$  - is described by Reid, *The Kinked Demand Curve Analysis of Oligopoly*, Edinburgh, Edinburgh University Press (1981), p16, as having an "obtuse" or "normal" kink.

<sup>27</sup>See below for the distinction between the economic and legal approaches to the issue of "collusion".

<sup>28</sup>Having a "reverse" or reflex" kink: Reid, *The Kinked Demand Curve Analysis of Oligopoly*, Edinburgh, Edinburgh University Press (1981), p16. In such a case, the inelastic curve  $AXB$  would indicate the expected change in demand if competitors did **not** respond to a price change; and the more elastic curve  $CXD$  would apply if competitors did match the change.

<sup>29</sup>That is, collusion in the economic sense, which includes "conscious parallelism" as well as formal agreement. Oligopolists may learn that parallel conduct will maximise profits above the competitive level, without the need for communication between the parties.

their rivals to follow their price changes. The "collusion" and "price leadership" models go a step further, in attempting to model the processes by which such expectations may be raised.

*The "collusion" model* is based on the assumption that firms collude and cooperate in making output and price decisions, in order to increase industry profits by raising prices and / or restricting supply.

Formal collusion,<sup>30</sup> in the form of cartels or open agreements, is prohibited by the competition laws of many countries,<sup>31</sup> as is so-called "tacit" collusion,<sup>32</sup> if it amounts to an unlawful conspiracy. In economic terms, however, "collusion" does not necessarily denote a "meeting of minds" in the legal sense.<sup>33</sup> While the law emphasises the distinction between allegedly anti-competitive action taken in concert and that taken independently, economic oligopoly theory focuses solely on the **outcomes** of such action. It is assumed that the actions of competitors **must** rationally be taken into account, and so no distinction is made between expressed and tacit agreement - both are maintained because it is in the individual firm's self-interest to do so.<sup>34</sup>

As demonstrated above, the incentives for oligopolists to raise or cut their prices depend largely on the likely responses to such actions of the other firms in the industry. Economists make use of mathematical "game theory" models to analyse the potential for collusion in such circumstances. In these models, each firm is seen as a "player" in a game

<sup>30</sup>As long ago as 1776 Adam Smith, "the founder of modern economics", observed that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices": *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), reprinted: Oxford, Clarendon Press (1979), Book I, chapter x, part b; cited by Stiglitz, above n2, p424.

<sup>31</sup>At least those which have developed a "comprehensive competition law", such as the United States, Canada, New Zealand and Australia: Norman, "Policy Under Pressure: The Evolution of Antitrust Policy in Australia", in Round (ed.), *The Australian Trade Practices Act 1974: Proscriptions and Prescriptions for a More Competitive Economy*, Dordrecht, Kluwer Academic Publishers (1994), p526.

<sup>32</sup>That is, parallel conduct resulting from agreements which are implied or inferred, rather than directly expressed.

<sup>33</sup>Cases like *Re British Basic Slag Ltd* [1963] 2 All ER 807, 814 and 819; *Monsanto Co. v Spray Rite Service Corp.* (1984) 465 US 752, 764 and *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 2647, 661-662 all refer to the need for communication between the colluding parties, and a "conscious commitment to a common scheme" before liability can arise under anti-collusion provisions.

<sup>34</sup>Yao and De Santi, "Game Theory and the Legal Analysis of Tacit Collusion" (1993) 38 *Antitrust Bulletin* 113, 125-126.

of strategy. The outcomes, or "payoffs" for each participant will depend not only on the choices made by the firm itself, but also on those made by its competitors.<sup>35</sup> Yao and De Santi describe the premises of non-cooperative game theory<sup>36</sup> as follows:

"Non-cooperative game theory is based on the premise that fully rational oligopolistic behaviour requires a consideration of the interdependence of strategies, and that such a consideration leads managers to a self-reinforcing set of strategies in which each strategy is a best response to the other [participants'] strategies ... Non-cooperative game theory includes 'repeated games', ie. strategic interactions that take into account the history of the play ... Although this approach assumes a considerable amount of rationality on the part of competitors, it does appear to correspond in spirit to anecdotal evidence of business decision making and has some support from the experimental literature."<sup>37</sup>

Game theory uses a "payoff matrix" to indicate the possible choices and outcomes available to each participant; for example, the profits each participant can expect to earn depending on the pricing strategy each adopts. In the table below,<sup>38</sup> two companies (A Ltd and B Ltd) can either choose a high or low pricing strategy. If both charge high prices, they will each earn a substantial profit of \$10 million; while if both offer low prices, each will make a comparatively modest \$3 million. If only one firm charges the low price while the other does not, it will make a profit of \$12 million (by increasing its market share at the expense of its competitor) and the other firm will make a \$2 million loss.

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<sup>35</sup>Stiglitz, above n2, p426-428; and Baumol and Blinder, above n2, p601-604.

<sup>36</sup>Non-cooperative game theory assumes that each participant is free to choose any available strategy, subject only to its own self-interest and its assessment of what its competitors will do. Cooperative game theory, on the other hand, allows participants to make binding agreements which limit their possible responses.

<sup>37</sup>above n34, 122-123.

<sup>38</sup>Adapted from Baumol and Blinder, above n2, p602.



	A Ltd <i>High Price</i>	A Ltd <i>Low Price</i>
B Ltd <i>High Price</i>	A makes \$10m B makes \$10m	A makes \$12m B loses \$2m
B Ltd <i>Low Price</i>	A loses \$2m B makes \$12m	A makes \$3m B makes \$3m

In a non-repeating game situation like this,<sup>39</sup> the possibility that a competitor will drop its price virtually forces each firm to charge the low price and forego the higher profit it could earn if it had reason to expect the other to follow any price increase. Game theory suggests that each firm should rationally choose from among the alternative strategies based on the minimum payoff each strategy offers. The safest option, assuming each firm makes a single, independent, decision, is the one with the highest minimum payoff - the "maximin strategy".<sup>40</sup> In this case the best option for both participants is to charge the lower price and earn a profit of \$3 million.

In practice, of course, oligopolists do not simply make one pricing decision and stick to it. They interact over time, responding to and learning from their rivals' behaviour. Experimental economics, where the actual behaviour of participants in repeated strategic games is observed, suggests that oligopolists will develop strategies which, although apparently irrational in the short term, will result in tacit collusion over time. Professor Robert Axelrod, a mathematician and political scientist, conducted one such experiment in the late 1970s. He invited experts in game theory to submit programs for a computer game theory tournament. Each program had available to it an assumed history

<sup>39</sup>That is, one where each participant makes only one decision, and there is only one set of outcomes.

<sup>40</sup>Baumol and Blinder, above n2, p602.

of interaction between itself and a rival, which it could use in choosing from the available options for a set number of moves into the future. Many very elaborate programs were submitted, but the best outcomes were consistently produced by one employing a simple "tit for tat" strategy, whereby the players start with a cooperative first move, and then simply do whatever the other player did on their previous move.<sup>41</sup> Stiglitz describes the strategy as follows:

"If you increase your output, I will do the same, even if it does not maximise my profits. If the rival firm believes this threat, especially after it has been carried out a few times, the rival may decide that it is more profitable to cooperate and keep production low [and prices high] rather than to cheat. In the real world, such simple strategies may play an important role in ensuring that, in those markets where there are only three or four dominant firms, the firms do not compete too vigorously."<sup>42</sup>

Axelrod himself also notes the applicability of "tit for tat" to oligopolistic competition.<sup>43</sup>

With this sort of tacit collusion in oligopolistic pricing decisions, firms can feel relatively safe in charging higher prices and consequently earning higher profits, although the slightly higher return which may be gained from unilaterally lowering prices leaves open the possibility of one or more firms "cheating" on any tacit agreement. Axelrod's experiments suggest, however, that this sort of cheating is unlikely, at least in the long term, as a cut to an agreed price by an oligopolistic firm will generally be followed shortly afterwards by its competitors, leading to a drop in profits for both. Firms will therefore learn that it is more profitable to cooperate and keep prices high than it is to cheat.

*The "price leadership" model* is based on the assumption that firms copy the behaviour of a "leading" firm, even though there is no explicit agreement to do so. That firm is effectively assigned (or takes on) the task of making pricing decisions for the whole group. Such an arrangement allows the members of an oligopoly to coordinate their pricing and output behaviour to achieve the greatest collective good,

<sup>41</sup>Axelrod, *The Evolution of Cooperation*, London, Penguin Books Ltd (1984), p30-31.

<sup>42</sup>Above n2, p428.

<sup>43</sup>Above n41, p28.

without having to openly "cut a deal".

The price leader may be the firm that dominates the market, the lowest cost firm, or a "barometric" firm. Economists tend to describe price leadership as a form of tacit collusion,<sup>44</sup> although the courts have held that the existence of parallel prices in an oligopolistic market does not justify an inference that actionable collusion has taken place.<sup>45</sup> Again, the legal emphasis on the method, rather than the results, of potentially anticompetitive conduct leaves the way open for firms to claim that they are simply reacting to the same market forces as the price leader.

It is, of course, possible that the perfectly competitive market may be approximated in an oligopoly; that is, the parallel behaviour evident in such markets may be the result of something approaching normal competitive forces.<sup>46</sup> In this regard, economists refer to "Cournot" and "Bertrand" competition.<sup>47</sup>

*"Cournot" competition* refers to the situation where an oligopolist believes that its competitors are committed to producing a given quantity, and will reduce their prices, if necessary, until they can sell the production level to which they are committed. The demand curve faced by the individual firm in such a situation equals the market demand curve, shifted downwards at each price level by the quantity which its competitors are committed to producing. The firm will then choose to produce at the point where marginal revenue equals marginal cost, that is, where the extra revenue earned by selling one further unit is the same as the cost of producing that extra unit of output. Fellner describes the competitive process under Cournot competition as follows:

"If each [oligopolist] continues to assume that the other will not change his rate of output, then ultimately they will prove to be correct, although during the approach to the equilibrium ... they will be wrong. A produces a quantity which maximises his profits on the assumption that B will go on producing his present

<sup>44</sup>Baumol and Blinder, above n2, p599; Stiglitz, above n2, p428-429.

<sup>45</sup>*Re Trade Practices Commission and Email Ltd* (1980) 3 ATPR 42,367.

<sup>46</sup>See the decision of the Commerce Commission in *Re Magnum Corp. Ltd and Dominion Breweries Ltd* (1986) 2 TCLR 177, 196.

<sup>47</sup>Named for Augustin Cournot and Joseph Bertrand, the French economists and mathematicians who first studied these patterns of behaviour among oligopolists in 1838 and 1883 respectively.

output, whereupon **B** adjusts his output so as to maximise his profits on the assumption that **A** will go on producing his present output, which induces **A** to adjust his output, etc."<sup>48</sup>

These adjustments ultimately result in a stable output from each firm, in accordance with their initial assumptions. The resulting equilibrium output (and therefore market efficiency) will be lower under conditions of Cournot competition than in a perfectly competitive market, but greater than in a monopoly. A monopoly must bear all of the reduction in marginal revenue, which necessarily comes about with increased production, by itself; while under the Cournot assumption, this loss of revenue is spread among the various rival firms in the oligopoly.<sup>49</sup>

It has been noted that, although the Cournot competitive model may be treated as the "parent model" for oligopoly analysis, a realistic approach to most industries cannot be based on Cournot's theory, since the assumption that firms will follow a policy of fixed output is generally quite unreasonable in practice:

"To be sure, that firms should assume of one another ... a policy of fixed output is conceivable, but on the way to the Cournot equilibrium they would necessarily realise that their assumptions were incorrect, and then would change their assumptions."<sup>50</sup>

The only markets where this type of competition could realistically be expected to occur are those where a major part of the cost of production lies in the cost of machinery and other capital goods and where, once these are in place, variable costs are relatively unimportant. In industries such as steel or aluminium production, output may be determined largely by the market's production capacity, but it is difficult to see this assumption holding true in many other cases.

*"Bertrand" competition* recognises the fact that, in many oligopolistic industries, it is an easy matter to expand production to meet demand. Stiglitz uses the examples of a taxi company in a large city, which can easily buy a new car and hire more drivers; and a domestic airline,

<sup>48</sup>Fellner, above n13, p57-58.

<sup>49</sup>Stiglitz, above n2, p436-440.

<sup>50</sup>Fellner, above n13, p65.

which can increase the number of flights on a particular route relatively quickly if need be.<sup>51</sup> Bertrand's theory was that a firm in such a market will price its product in order to maximise its profits, on the assumption that its competitors' prices are fixed, and that they will adjust their output to meet whatever demand arises at that price. The demand curve facing an individual firm in such an industry will be more elastic than the market demand curve (ie. the curve indicating the total demand, assuming that all participants charge the same price). This is because each firm will lose large numbers of customers if it raises its prices even slightly, but the majority of those customers will simply move to its rivals, and so will not be lost to the market as a whole (see diagram below).<sup>52</sup> The competitive process, and the resulting equilibrium price and quantity, are therefore much like those in a perfectly competitive market. The process has been described as follows:

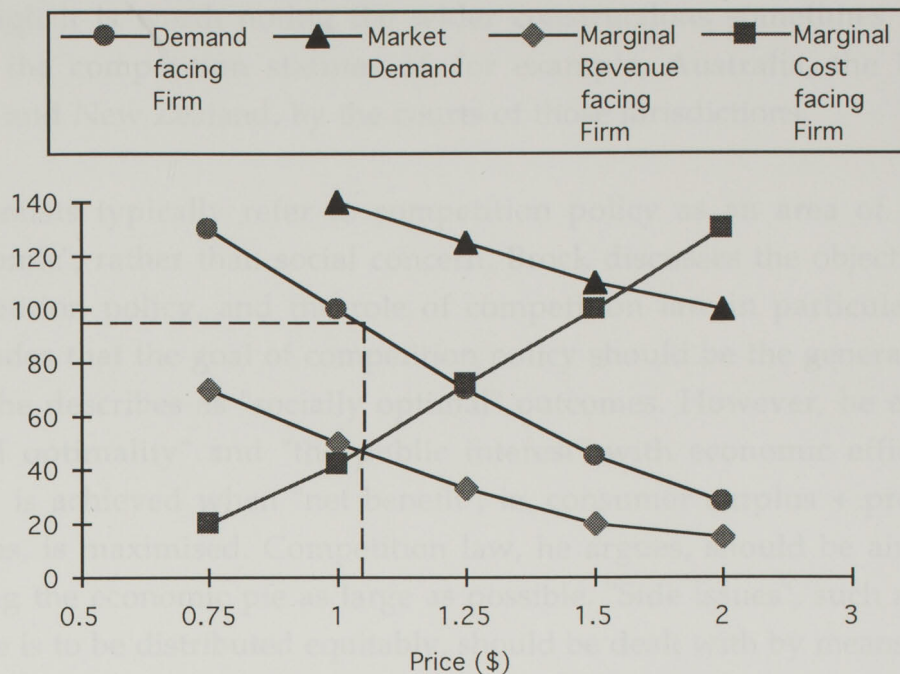
"Since each company believes its rival will not budge its prices so long as price exceeds marginal costs, each one will find that it pays it to shave its prices by a small amount. By doing so, it steals the whole [or a substantial part of the] market.<sup>53</sup> But the rival firm, thinking the same way, then undercuts still further. The process continues until the price is bid down to a point where there are zero [excess] profits [that is, to the point where marginal cost equals marginal revenue]. It does not pay to cut prices any further."<sup>54</sup>

<sup>51</sup>Stiglitz, above n2, p438.

<sup>52</sup>Adapted from Stiglitz, above n2, p438.

<sup>53</sup>Depending on how closely substitutable the firms' products are. In general, the products produced by oligopolists are close, but not perfect, substitutes; demand will be elastic, but not completely so.

<sup>54</sup>Stiglitz, above n2, p440.



**Demand Conditions facing a Firm in an  
Oligopoly facing "Bertrand" Competition**

In theory then, in the absence of express or tacit cooperation between market participants, an oligopolistic market structure does not **necessarily** lead to anticompetitive behaviour. If firms do not collude, market efficiency and consumer welfare should not suffer to an appreciable extent. But is this the case in practice? Are oligopolies in fact "anticompetitive" in terms of the *Commerce Act 1986*? In order to answer this, the objectives of this country's competition law, and how they compare to the behaviour observed among participants in the oligopolistic retail petrol market, are considered below.

### III OLIGOPOLIES IN PRACTICE

#### A *The Objectives of Competition Law*

Taking a purposive approach to the question, any regulation of oligopolies must be consistent with the aims of competition law as a whole.<sup>55</sup> Chief among these aims is the fostering of economic efficiency,

<sup>55</sup>The Court of Appeal, in *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, 564, endorsed such an approach in interpreting s 27 of the Act. On the question of whether all the parties to a "contract, arrangement or understanding" must share the proscribed purpose of substantially lessening competition, Gault J said: "The objective of the

although it is worth noting the wider constructions sometimes placed upon the competition statutes of, for example, Australia, the United States and New Zealand, by the courts of those jurisdictions.

Economists typically refer to competition policy as an area of purely "economic", rather than social concern. Brock discusses the objectives of competition policy, and the role of competition law in particular, and concludes that the goal of competition policy should be the generation of what he describes as "socially optimal" outcomes. However, he equates "social optimality" and "the public interest" with economic efficiency, which is achieved when "net benefit", ie. consumer surplus + producer surplus, is maximised. Competition law, he argues, should be aimed at making the economic pie as large as possible. "Side issues", such as how the pie is to be distributed equitably, should be dealt with by means of tax relief and the social welfare system, rather than being achieved through competition law:

**"I believe that efficiency should be the sole objective of competition policy ... Equity benefits should not be weighted in an efficiency-based approach to antitrust. Equity is best dealt with by a direct approach rather than through the indirect approach of competition policy."**<sup>56</sup>

The aims of Australia's competition law, as described by the courts of that country, generally represent a somewhat "toned down" version of the efficiency argument. In *Refrigerated Express Lines (Australia) Pty. Ltd v Australian Meat & Livestock Corporation*, Deane J explained the aims of Part IV of the *Trade Practices Act 1974* as follows:

"Part IV is headed 'Restrictive Trade Practices'. The general purpose and scope of the Part can be described by saying that it contains provisions which proscribe and regulate agreements and conduct, and which are aimed at procuring and maintaining competition in trade and commerce."<sup>57</sup>

The same judge noted, in the *Queensland Wire* case, that the "essential notions" and objectives of Part IV are economic and not moral ones.

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statutory provision must be borne in mind. The promotion of competition should not be inhibited by the artificiality of search for unanimous purposes". See also *Union Shipping NZ Ltd v Port Nelson Ltd* [1990] 2 NZLR 662, 700, cited below.

<sup>56</sup>Above n8, p2 (emphasis in original).

<sup>57</sup>(1980) 44 FLR 455, 460.

Referring particularly to s 46, he said:

"The notions are those of markets, market power, competitors in a market and competition. The objective is the protection and advancement of a competitive environment and competitive conduct by precluding advantage being taken of 'a substantial degree of power in a market' for any of the prescribed purposes."<sup>58</sup>

In the opinion of Mason CJ and Wilson J, the object of s 46 (and, by extension, Part IV of the Act in general) is to protect the interests of consumers by preventing conduct that threatens or undermines competition, rather than the economic well-being of individual competitors.<sup>59</sup>

It has been said by the United States Supreme Court that "regulating oligopoly and the [social and economic] evils associated with it is a classic exercise of the State's police powers."<sup>60</sup> The approach taken in the United States identifies the promotion of competition as the overriding aim of antitrust law, but the courts have at times taken a narrower view, seeing market concentration almost as an evil in itself, quite apart from its observed effects.

*Brown Shoe Co. v United States*<sup>61</sup> is often cited in this regard. In that case, Warren CJ referred to the "congressional concern with the protection of competition, not competitors", and its desire to restrain conduct only to the extent that it may tend to lessen competition.<sup>62</sup> This was described as "axiomatic" by Kennedy J in *Brooke Group Ltd v Brown & Williamson Tobacco Corp.*<sup>63</sup>

Somewhat unusually, however, the logical step from higher levels of competition to greater efficiency and enhanced consumer welfare does not seem to have been stressed by the American courts. The enactment

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<sup>58</sup>(1989) 167 CLR 177, 194.

<sup>59</sup>At 191.

<sup>60</sup>*Hawaii Housing Authority v Medcliff* (1984) 81 LEd (2d) 186, 198, a decision of the United States Supreme Court dealing with the legality of a compulsory land acquisition by the State designed to counter a perceived "land oligopoly" traceable to the early high chiefs of the islands.

<sup>61</sup>(1962) 370 US 294.

<sup>62</sup>At 320.

<sup>63</sup>(1993) 509 US 209, 224.



of statutes with the stated purpose of preventing market concentration<sup>64</sup> seems to have sometimes resulted in that aim being pursued even at the expense of market efficiency, and when competition is not obviously under threat in practice. For example, in the *Brown Shoe Co.* case, Warren CJ observed that large companies, through manufacturing increased volumes, can often market products at prices below those of smaller independent suppliers:

"Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected ... But we cannot fail to recognise Congress's desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasionally higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favour of decentralisation."<sup>65</sup>

These comments were mirrored in *Federal Trade Commission v Procter & Gamble Co.*, where Douglas J said: "Congress was aware that some mergers which lessen competition may also result in economies, but it struck the balance in favour of protecting competition."<sup>66</sup>

More recent cases may indicate a less rigid approach, with consumer welfare, in addition to the decentralisation of markets, being described by the United States Supreme Court as a "traditional concern" of the antitrust laws.<sup>67</sup>

The Long Title of New Zealand's *Commerce Act 1986* states that it is "an Act to promote competition in markets within New Zealand", a goal which the New Zealand courts have linked to efficiency. For example, in *Tru Tone Ltd v Festival Records Retail Marketing Ltd*, the Court of Appeal held that:

"In terms of the Long Title the *Commerce Act* is an Act to promote competition in markets in New Zealand. It is based on the premise that society's resources are best allocated in a competitive market where rivalry between firms ensures maximum

<sup>64</sup>The *Sherman Act 1890* s 2 prohibits any person "monopolis[ing] or attempting to monopolise" any line of trade or commerce.

<sup>65</sup>(1962) 370 US 294, 344.

<sup>66</sup>(1967) 386 US 568, 580.

<sup>67</sup>*Brooke Group Ltd v Brown & Williamson Tobacco Corp.* (1993) 509 US 209, 221.

efficiency in the use of resources."<sup>68</sup>

These thoughts were echoed and expanded upon by the High Court in *Union Shipping NZ Ltd v Port Nelson Ltd*, where the emphasis placed on the promotion of competition and resulting efficiency in the Act was again noted, though not without reservation:

"It is the permission of competition which the court is directed to foster. Parliament, as a matter of policy, has decided benefits will flow from that course. Whether such is a correct economic or social analysis is not a matter for the court ... It is legislation of a type where the court should not hesitate to adopt necessary purposive approaches."<sup>69</sup>

On the issue of market definition, the court avoided interpreting the Act solely as prescribed by economists, instead adopting the approach of the High Court of Australia in *Queensland Wire Industries Pty. Ltd v Broken Hill Pty. Co. Ltd*,<sup>70</sup> where attempts to precisely define the concept of a "market" were resisted:

"In the end, a court is driven back very much to the statutory direction to apply fact and commercial common sense in each case, with the comfort of knowing exact delineation may well not be necessary ... The evidence of economists naturally has its use, but in a controversial field is to be treated with the caution necessary in relation to all expert evidence."<sup>71</sup>

Economic evidence must necessarily be given some prominence in competition law cases, but the overall scheme of the legislation suggests that this should not be to the exclusion of other considerations. While efficiency is a primary objective of the Act, the existence of an exception to the otherwise blanket prohibition on anticompetitive conduct, in the form of authorisations in cases where the likely "benefit to the public" outweighs any lessening of competition, indicates that it is not the only objective.<sup>72</sup>

<sup>68</sup>[1988] 2 NZLR 352, 358, per Richardson J.

<sup>69</sup>[1990] 2 NZLR 662, 699-700.

<sup>70</sup>(1989) 167 CLR 177.

<sup>71</sup>[1990] 2 NZLR 662, 701.

<sup>72</sup>The expression "benefit to the public" in s 61(6) of the Act suggests, on its face, something beyond considerations of efficiency. Note, however, the interpretation adopted by the Commerce Commission in its Guidelines on Public Benefit (reproduced in *New Zealand Company Law & Practice* (Service No. 159), Auckland, CCH New Zealand

Unlike the United States, the stated objective of the *Commerce Act* - to "promote competition" and, by extension, efficiency and consumer welfare<sup>73</sup> - has never resulted in oligopolistic (or even monopolistic) markets being seen as undesirable per se. There is merit in the view that, New Zealand being a smaller economy than, for example, the United States or even Australia, the legislature of this country was prepared to accept higher levels of market concentration than other jurisdictions before competition law sanctions would apply.<sup>74</sup> Allan, considering the market dominance provision of s 36 in particular, notes that

"If we consider s 36 alongside its Australian counterpart [the *Trade Practices Act* 1974 s 46, where the test is for a "substantial degree of market power", rather than a "dominant position" in a market], it becomes apparent that the New Zealand legislature was prepared to tolerate a higher degree of market power within individual firms before they would meet the threshold of applicability, presumably because of the smaller economy and consequent concentration of markets. Substantial market power is necessarily to be tolerated if we are to have any firms acting at or near economies of scale. This approach allows firms to gain

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Ltd (1995), ¶¶55-865) which emphasises "efficiency gains". This view is supported by the New Zealand Business Roundtable, *Antitrust in New Zealand: The Case for Reform*, Paper prepared for the New Zealand Business Roundtable (1988), p127, and Pickford, "Competition Policy, Mergers and the Net Social Benefit Test", in Bollard (ed.), *The Economics of the Commerce Act*, New Zealand Institute of Economic Research Monograph No. 52 (1989), p113-114: "The *Commerce Act's* explicit promotion of the competition goal has been interpreted to include consumer welfare and economic efficiency objectives. However, ... the efficiency objective can sometimes conflict with the other ... The qualification of the Act's pro-competitive stance is thus justified where mergers, for example, yield **efficiency benefits** larger than the detriments from less competition and consumer welfare" (emphasis added). Easton, "The Public Interest in Competition Policy", in Bollard (ed.), *The Economics of the Commerce Act*, New Zealand Institute of Economic Research Monograph No. 52 (1989), p69-71, responds to this by saying that the Act is not, and was not intended to be, a "value-free" piece of legislation. In *Telecom Corp. of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, the High Court adopted what seems to be a suitably balanced view of the issue. Citing *Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481, 510, the court endorsed a very broad approach to the identification of public benefits flowing from business acquisitions. It held that it was undesirable to put limits on what the concept encompasses, and that "anything of value to the community generally" could be included. Particular note was, however, made of the economic goals of efficiency and progress, which the court saw as beneficial in themselves, regardless of how they were distributed among members of the public.

<sup>73</sup>See Easton, "The Public Interest in Competition Policy", and Pickford, "Competition Policy, Mergers and the Net Social Benefit Test", in Bollard (ed.), above n72, p69-71 and 113-114 respectively.

<sup>74</sup>This is, in fact, an inevitable consequence of the emphasis placed on efficiency under the New Zealand Act. It is obviously inefficient to have large numbers of competing firms in many New Zealand markets.

significant market power, at the expense of competition at least to some extent, before they will be within the threshold test of s 36."<sup>75</sup>

Brock, arguing for a less regulatory approach to competition policy, also refers to the likelihood that markets will naturally be more concentrated in a smaller country, and observes that economies of scale and scope may loom larger in the minds of regulators than the possibility of tacit collusion among oligopolists, given the growing importance of international competitiveness in an increasingly open world economy.<sup>76</sup> The New Zealand Government's recent policy of deregulating and / or privatising long established State-owned monopolies in areas such as telecommunications and domestic air transport has, despite the entry of some new competitors, also inevitably resulted in high levels of market concentration in these industries. In the words of Farrar,

"It was the fourth labour Government's policy when enacting the *Commerce Act* that it should apply generally. This Act underpinned the Government's radical liberalisation programme that abolished many of the regulatory regimes that had long been a feature of the New Zealand economy ... Rather than creating new regulatory bodies to oversee [State-owned enterprises], the Labour Government placed its faith in the *Commerce Act's* ability to curb any attempt by the newly privatised dominant firms to enter into anticompetitive arrangements or engage in predatory conduct."<sup>77</sup>

This comparatively "light-handed" approach, generally focusing on the actual effects of a particular practice or market situation rather than primarily on structural factors, is supported by Brock. Ideally, he would liberalise New Zealand's competition policy even more, removing all "per se" liability under the *Commerce Act*.<sup>78</sup>

<sup>75</sup>*Shifting Ground Within the Commerce Act: Is the Need for Collusion Dead?* (1996) Victoria University of Wellington LLM Research Paper, p60.

<sup>76</sup>Above n8, p3.

<sup>77</sup>"Closer Economic Relations and Harmonisation of Law between Australia and New Zealand", in Joseph (ed.), *Essays on the Constitution*, Wellington, Brookers (1995), p173-174. See also Jennings and Cameron, "State-owned Enterprise Reform in New Zealand", in Bollard and Buckle (eds.), *Economic Liberalisation in New Zealand*, Wellington, Allen & Unwin Ltd in association with Port Nicholson Press (1987), p121.

<sup>78</sup>"If you prohibit [a] practice, you shut off the option of experimenting with the practice during the period of prohibition. Since the law is sluggish, the period of prohibition is likely to be long ... In a rapidly changing world, the 'option value' of this lost period of experimentation is typically greater than in a quiet world where little is changing ...

## B *Anticompetitive Conduct in the Petrol Industry (I)*

The theoretical and potential anticompetitive effects of oligopolies are detailed above.<sup>79</sup> These include the incentives to enter, and then not to "cheat" on expressly or tacitly collusive pricing and production arrangements; the greater likelihood that inferior, less efficient, technologies will be used; and the resulting economic and social costs - higher prices and less diversity of output. If these effects can be shown to occur in practice, a good case can be made that competition (and therefore efficiency and consumer welfare) has been harmed, and that competition law has a role to play.

In this regard, the New Zealand petrol industry<sup>80</sup> has been the subject of close scrutiny in recent months by a number of local and international agencies. In May 1997 the International Energy Agency (IEA), a body established within the framework of the Organisation for Economic Cooperation and Development (OECD) to encourage energy conservation and stability in international energy markets, released a review of New Zealand's energy policies. While concluding that the Government's recent deregulation and privatisation policies were "bearing fruit, in the form of increased efficiency, lower costs and enhanced consumer choice and service"<sup>81</sup> in the energy industry as a whole, the IEA expressed some concerns about certain aspects of the way in which the deregulated industry was operating. In particular, the degree of market concentration and price levels relative to other countries in the New Zealand retail petrol market raised significant concerns about the strength of competition in that market. There are, the IEA concluded,

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This argues for allowing more practices and being 'bolder' in allowing practices in a rapidly changing world": Above n8, p6-7.

<sup>79</sup>See text accompanying n6-9 and n38-43.

<sup>80</sup>Other markets in which the anticompetitive effects of an oligopolistic structure have recently been noted include those for air transport, the news media and electricity supply: see Feldman, "Some Call it Oligopoly" (1996) 33 *Air Transport World* 45; Brown, *Commercial Media in Australia*, Brisbane, University of Queensland Press (1986), p11; Garnham, "The Media and the Public Sphere" (1986) 14 *Intermedia* 28, 33; Schultz, *Media Ownership*, Report of the Australian Centre for Independent Journalism, University of Technology, Sydney (1991); and International Energy Agency, *Energy Policies of IEA Countries: New Zealand 1997 Review*, Paris, OECD Publication Service (1997), p75.

<sup>81</sup>International Energy Agency, above n80, p9.

"grounds for suspecting oligopolistic pricing behaviour by the four oil companies that dominate the industry. There are entry barriers to the New Zealand market, resulting from the high cost of installing port terminals, bulk storage facilities and new retail outlets, such that the companies may be able to continue to make oligopoly profits without the threat of competition from independent importers and retailers."<sup>82</sup>

New Zealand's retail petrol market was deregulated in 1988. This involved the removal of such controls as price ceilings, and restrictions on the ownership of storage facilities and retail outlets. The IEA notes that the four dominant firms - Caltex, Mobil, Shell and BP - now own all the bulk storage facilities and most of the retail stations, as well as supplying a small number of independent retailers. There is currently no legal provision for independent operators to have mandatory access to the established firms' storage and terminal facilities.<sup>83</sup> Such access would be required if the petrol industry was dominated by a single monopolistic supplier just as, for example, Telecom was required to grant Clear access to its telecommunications network to avoid contravention of s 36 of the *Commerce Act*.<sup>84</sup>

On the issue of price, it was noted in the IEA review that the "importer margin", that is the difference between New Zealand wholesale prices and Singapore export prices<sup>85</sup> (lagged by eight weeks to account for shipping time), had declined immediately after deregulation, but had risen steadily since 1990, particularly rapidly since 1994. The New Zealand Institute of Economic Research (NZIER), in a report to the

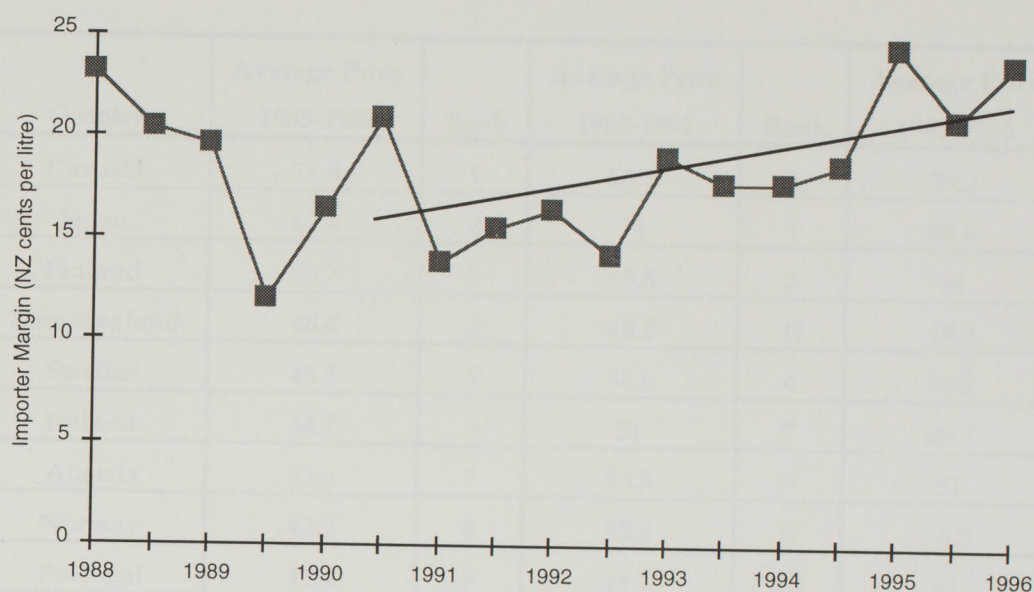
<sup>82</sup>At p55.

<sup>83</sup>At p47.

<sup>84</sup>See *Telecom Corp. of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385, 390 and van Roy, "The Privy Council Decision in *Telecom v Clear*: Narrowing the Application of s 36 of the *Commerce Act 1986*" [1995] NZLJ 54.

<sup>85</sup>Singapore was chosen as an appropriate reference point because of its importance as a refining centre (being the third largest in the world) and its close proximity to New Zealand. Although the oil companies themselves dispute its suitability (see, for example, Scott, *Conditions of Entry into Petrol Importing, Wholesaling and Retailing in New Zealand*, Report Commissioned by Mobil Oil New Zealand Ltd, in association with Law and Economics Consulting Group Inc., (1997), p12-13), it is seen as being "ideally suited to providing a world reference point for oil and petroleum products" by the Australian Competition and Consumer Commission, the Australian Institute of Petroleum, the New Zealand Ministry of Commerce and the New Zealand Institute of Economic Research, as well as the IEA: New Zealand Institute of Economic Research, *Petrol Prices: An Investigation into Petrol Prices in New Zealand*, Report to the Ministry of Commerce (1996), p6.

Ministry of Commerce prepared in November 1996, also notes that not only is there a significant difference between the cost of landed imported product plus the minimum necessary distribution and retailing costs,<sup>86</sup> and the price actually charged at the pump, but that this gap has increased by approximately 1.1 cents per litre per year since 1992. This upward trend is indicated on the graph below:<sup>87</sup>



**Unleaded Petrol Importer Margins 1988-1996**

Another sign that the competitive gains from deregulation have been lost is that New Zealand's pre-tax retail petrol prices are now among the highest in the OECD, as indicated in the table below. This shows the average petrol prices in OECD countries for the years immediately before

<sup>86</sup>The NZIER's assessment is that, if the petrol companies were competing strongly with each other, retail prices should settle at this level in the long run: *Petrol Prices: An Investigation into Petrol Prices in New Zealand*, Report to the Ministry of Commerce (1996), p1-2 and 4.

<sup>87</sup>Adapted from New Zealand Institute of Economic Research, above n85, p2. Not surprisingly, the petrol companies take issue with the NZIER's interpretation of this data. Dr Graham Scott, in a report commissioned by Mobil Oil New Zealand Ltd, refers to the "statistically determined break in trend" which the NZIER estimates to have occurred early in 1990, and says that it should have determined whether this break was the only such possible break in the data: "It is possible - indeed likely - that a number of other possible 'statistical beaks' may lurk within the data ... Without analysis it is certainly premature to attribute such a break to any particular causes ... There could be other and more valid explanations for [the observed upward trend] than NZIER's hypothesis of anti-competitive pricing by industry participants ... The depressed [margins] during 1990-1993 may have been the result of local excess capacity, which (since demand for petrol is price-inelastic) would tend to depress prices. Higher [margins] since 1994 may reflect nothing more than the fact that local demand has caught up with, and exceeded, local supply": above n85, p6 and 10.

deregulation of the New Zealand industry (1985-1988), around the time deregulation took place (1989-1992) and after deregulation (1993-1995).<sup>88</sup> The figures indicate that petrol prices in New Zealand relative to other OECD nations fell for the period immediately after deregulation, but have risen again since 1993.<sup>89</sup>

#### Pre-tax Petrol Prices for OECD Countries: 1988-1995

Country	Average Price 1985-1988	Rank	Average Price 1989-1992	Rank	Average Price 1993-1995	Rank
Canada	71.8	1	58.3	3	59.2	2
Japan	67.4	2	74	1	88.6	1
Finland	58.7	3	63.8	2	44	10
<i>New Zealand</i>	<i>48.4</i>	<i>4</i>	<i>46.2</i>	<i>11</i>	<i>49.3</i>	<i>5</i>
Sweden	45.5	5	54.6	4	39.2	18
Ireland	44.7	6	51	7	48.7	6
Austria	43.6	7	53.5	5	51	4
Norway	43.3	8	53.5	6	56.3	3
Portugal	41.4	9	44.7	15	41	15
Holland	40.7	10	48.8	9	45.1	8
Luxembourg	38.1	11	50.6	8	41.6	14
Spain	38.1	11	44	17	42.8	12
Denmark	38.1	11	46.9	10	47.5	7
Switzerland	37.8	14	46.2	11	43.4	11
Australia	37.4	15	41.8	20	34.7	20
Belgium	37.0	16	45.5	13	44.5	9
United Kingdom	35.6	17	44.4	16	37.6	19
Italy	34.8	18	45.5	13	42.2	13
Germany	34.5	19	42.2	18	40.4	17
Greece	33.7	20	38.1	21	34.6	21
France	31.2	21	37.8	22	32.9	23

<sup>88</sup>Adapted from New Zealand Institute of Economic Research, above n85, p10-11. Prices are in real 1995 New Zealand cents per litre, before tax.

<sup>89</sup>These figures are disputed by the oil companies. A survey undertaken by Shell of its outlets around the world shows New Zealand's prices to be "in the middle of the pack" of around twenty countries. The variation between the Shell study and the IEA and NZIER reports may be due to the times when price data was collected, according to Shell New Zealand Ltd chairman Charles Harrison: Weir, "NZ Petrol Prices Among the World's Highest, says Agency", *Dominion*, Wellington, 13 May 1997, p1.



United States	30.4	22	32.6	23	32.8	24
Turkey	14.7	23	42	19	32.9	22
Mexico	-	-	-	-	40.9	16

In both absolute and relative terms, New Zealand's retail petrol prices are now at similar levels to those prevailing just prior to deregulation. Recent trends suggest that prices are likely to continue rising, and that these increases will continue to outstrip increases in costs. These points led the NZIER to conclude that the market for petrol in New Zealand is not a competitive one, and that the major companies were earning significant supranormal profits, resulting in harm to both consumer welfare and industry efficiency:

"For every 1 cent per litre increase in the price of petrol, the oil companies' combined revenue increases by approximately \$27 million per annum ... Current margins may be 6 cents per litre higher than the levels established after deregulation. If this is a rough measure of the degree to which competitive pressures are failing, then total oil company revenue may now be too high by about \$160 million per annum ... In addition, there is a small dead weight loss of approximately \$1 million per annum for a 6 cent per litre excess in price ... In competitive conditions, one would expect to see margins squeezed over time, not increasing. Margins can only be increased above competitive levels if there are barriers to entry ... Increased margins suggest at least tacit collusion."<sup>90</sup>

Despite these apparently anticompetitive outcomes, it appears that the petrol companies would currently be successful in defending any action brought against them pursuant to the *Commerce Act 1986*. The difficulties in applying the provisions of the Act to oligopolies arise from the approach taken by the New Zealand courts to the key issues of what constitutes a "contract, arrangement or understanding", and what amounts to a "dominant position in a market" in terms of the Act. The alternative interpretations given to these concepts, and their potential application to the conduct of the major petrol companies, are considered below.

<sup>90</sup>Above n85, p13-14. While the oil companies themselves take issue with the data used, the statistical methods employed, and the conclusions reached by the NZIER and other agencies such as the Ministry of Commerce and the IEA, the consensus among these agencies is that the companies' pricing policies are anticompetitive, and suggest tacit collusion.

## IV COMPETITION LAW RESPONSES

### A *Market Dominance Provisions*

Section 36 of the *Commerce Act* regulates the "use" of a "dominant position in a market". Such a position may not be used to restrict entry into, prevent or deter competitive conduct in, or eliminate any person from that or any other market.<sup>91</sup>

The wording of s 36 derives from that used in the Treaty establishing the European Community,<sup>92</sup> and may be contrasted with the apparently lower threshold in the Australian *Trade Practices Act 1974*.<sup>93</sup>

Some guidance is given in s 3(8) and (9) of the New Zealand Act as to when a person has a dominant position in a market for the purposes of the above sections. Dominance is equated with the ability to exert a "dominant influence" over the production, acquisition, supply or price of goods or services in a market. In assessing the degree of influence which the person or group has, regard is given to such matters as market share, technical knowledge, access to materials and capital; and the extent to which that person is constrained by the conduct of competitors, potential competitors, suppliers or purchasers in the market.

#### 1 *New Zealand and Australian cases*

The approach taken in early New Zealand cases such as *Re News Ltd & Independent Newspapers Ltd*<sup>94</sup> and *Re Magnum Corp. Ltd & Dominion Breweries Ltd*<sup>95</sup> relied heavily on economic definitions of "dominance",

<sup>91</sup>The term also appears in s 47 of the Act, which prohibits acquisitions of business assets or shares which result in the gaining or strengthening of a dominant position.

<sup>92</sup>*Treaty of Rome* article 86, which prohibits "any abuse by one or more undertakings of a dominant position within the Common Market or in a substantial part of it".

<sup>93</sup>Section 46 of the Australian Act (Misuse of Market Power) prohibits corporations "taking advantage" of a "substantial degree of power in a market" for similar purposes to those given in s 36 of the *Commerce Act*. Section 50 prohibits business acquisitions which result in a "substantial lessening of competition". Both of these sections were amended in 1986, substituting the present wording for the previous tests based on "substantial control" and "dominance" of a market respectively.

<sup>94</sup>(1986) 6 NZAR 47 (Commerce Commission Decision No. 164).

<sup>95</sup>(1986) 2 TCLR 177 (Commerce Commission Decision No. 182).

mirroring the approach taken in leading European Community decisions. Economic literature equates "dominance" with high levels of "market power",<sup>96</sup> a term which is commonly defined as "the ability of a firm to raise its prices above the competitive level without driving away so many customers as to make the price increase unprofitable".<sup>97</sup> A similar view of dominance was adopted in *News Ltd*, where the Commission held that

"A person can be considered to have a dominant influence in a market when that person is able to make significant business decisions, particularly those relating to price and supply, without regard to the competitors, suppliers or customers of that person ... It may reasonably be inferred that this **ability to act independently** is presumed to arise only where there is an absence of competition".<sup>98</sup>

In *Magnum Corp. Ltd*<sup>99</sup> the Commission at first instance discussed the distinction between the s 27 prohibition on contracts, arrangements and understandings which have the purpose or effect of "substantially lessening competition" and the s 36 and 47 prohibition on using or acquiring a "dominant position in a market", and concluded that the dominance test appears to set the higher standard. The Commission again stressed

"**Independence of behaviour**, ... a lack of restraint on the behaviour of the dominant party - restraint that would be assumed to be associated with conditions of effective competition."<sup>100</sup>

Similarly, on an application for judicial review of the Commission's decision, the High Court stated that:

"Undertakings are in a dominant position when they have the **power to behave**

<sup>96</sup>Hampton, "Section 36(1) of the *Commerce Act 1986*: An Analysis of its Constituent Elements", in Ahdar (ed.), *Competition Law and Policy in New Zealand*, North Ryde, The Law Book Co. Ltd (1991), p186.

<sup>97</sup>Landes and Posner, "Market Power in Antitrust Cases" (1981) 94 *Harvard Law Rev* 937.

<sup>98</sup>(1986) 6 *NZAR* 47, 50 (emphasis added). In a later decision, the Commission tempered this unqualified "independence of behaviour" formulation somewhat by stating that "no person, not even a monopolist, acts [completely] without regard to competitors, suppliers or customers ... Dominance exists where a person ... can behave to a large extent independently of that person's competitors": *Re Broadcast Communications Ltd* [1990] *NZAR* 433, 448 (Commerce Commission Decision No. 248).

<sup>99</sup>(1986) 2 *TCLR* 177.

<sup>100</sup>At 196 (emphasis added).

independently, which puts them in a position to act without taking into account their competitors, purchasers or suppliers",<sup>101</sup>

citing *Re Continental Can Co. Inc.*,<sup>102</sup> an influential European case where such independence was seen as an inevitable consequence of such structural factors as market share, access to technology and materials, etc.

Davison CJ agreed with the Commission that its "economic" approach should override the ordinary dictionary meaning of "dominance", and that "the concept of dominance must be looked at in a market context", ie. "as having sufficient market power to behave to an appreciable extent in a discretionary manner ... This interpretation stresses **independence of behaviour**".<sup>103</sup>

Hampton has stated that this interpretation leaves "little scope" for applying s 36 to the aggregated power of two or more firms in a market, but does not discount the possibility entirely:

"The concept of an 'association of persons'<sup>104</sup> probably does not extend to 'shared monopoly', that is, where two or more unrelated firms, each of whom is individually not in a position to dominate a market but who together control a dominant portion of the market, act to protect that position by restraining competition. The omission of any specific provision for the control of oligopolies, such as that which was in Part III of the *Commerce Act 1975*,<sup>105</sup> reinforces this view. If the legislature had intended s 36 to apply to joint dominance, it could have used the words 'one or more persons' instead of 'a person'. While the section does not specifically cover joint dominance, circumstances could arise in a tightly oligopolistic market in which more than one firm could arguably be said to be in a position to exercise a dominant influence over the market."<sup>106</sup>

<sup>101</sup>*Lion Corp. Ltd v Commerce Commission* [1987] 2 NZLR 682, 691 (emphasis added). See also *Auckland Regional Authority v Mutual Rental Cars Ltd* [1987] 2 NZLR 647, 679 and Land, "Monopolisation: The Practical Implications of Section 36 of the Commerce Act 1986" (1988) 18 VUWLR 51, 56.

<sup>102</sup>[1972] CMLR D11, D17; affirmed on appeal by the European Court of Justice [1973] ECR 215.

<sup>103</sup>[1987] 2 NZLR 682, 690 (emphasis added).

<sup>104</sup>For the purposes of the *Commerce Act*, "person" includes "any association of persons whether incorporated or not": s 2(1).

<sup>105</sup>Sections 61 and 62 of that Act allowed the Minister of Trade and Industry to make orders regulating any "complete or partial monopoly or oligopoly", which was found by the Commission to be contrary to the public interest.

<sup>106</sup>"Section 36(1) of the *Commerce Act 1986*: An Analysis of its Constituent Elements", in Ahdar (ed.), above n96, p183.

Case law prior to 1992 also allows for the possibility that two or more firms - particularly in an oligopolistic market - could effectively achieve joint dominance. In *Magnum Corp. Ltd* the Commission implied that, in a highly concentrated market where participants are not "disciplined" by their competitor's presence and actions, more than one firm could be dominant in terms of the Act,<sup>107</sup> and in *Tytel Pty. Ltd v Australian Telecommunications Commission*, Jackson J said that "the terms of s 46(1) [of the *Australian Trade Practices Act 1974*] do not seem necessarily to require that only one corporation satisfy the test at any one time".<sup>108</sup> These comments were made with regard to the pre-1986 test under the Australian Act, a test not dissimilar to that under s 36.

However, in more recent cases, this economic interpretation has been rejected in favour of a "dictionary" approach to the question of dominance. This may be traced to the Court of Appeal's decision in *Telecom Corp. of New Zealand Ltd v Commerce Commission*,<sup>109</sup> a case turning on whether Telecom was dominant in the cellular telephone market. The High Court,<sup>110</sup> in line with the approach taken in previous decisions, had held that dominance should be equated with "high market power", that "the essence of market power is discretionary power, the discretion to adopt production and selling policies different from those that a competitive market would constrain", and that market structure - "a firm's external competitive environment" - was the primary determinant of market power.

In the Court of Appeal, Cooke P held that the expression "high market power" was too low a test, if by this the High Court meant something less than

"a prevailing, commanding, ascendant, governing, primary, principal or leading influence ... **Clearly there could be no more than one dominant influence over each of the aspects of a market specified in the Act**".<sup>111</sup>

Richardson J took a similar approach. He also criticised the High Court

<sup>107</sup>(1986) 2 TCLR 177, 196.

<sup>108</sup>(1986) 67 ALR 433, 437.

<sup>109</sup>[1992] 3 NZLR 429.

<sup>110</sup>*Telecom Corp. of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473.

<sup>111</sup>[1992] 3 NZLR 429, 434 (emphasis added).

for equating words like "high", "large" and "appreciable" with "dominant", and said:

"Clearly the dominance test sets a rigorous threshold. It is not sufficient that the influence be advantageous or powerful. It must be dominant. The word comes from the Latin *dominus* meaning master. **Only one person can be dominant in a particular aspect of a market at any one time.** Not surprisingly standard dictionaries give meanings such as 'ruling', 'governing', 'commanding', 'reigning', 'ascendant', 'prevailing' and 'paramount'.<sup>112</sup>

In *Commerce Commission v Port Nelson Ltd*,<sup>113</sup> McGechan J noted that previous case law on the meaning of dominance could be divided into two broad categories - those cases employing a definition derived from "economics usage", and those using the ordinary or dictionary meaning of the word.

He drew attention to the preference shown for the economic interpretation by the European courts and in early New Zealand cases, an affinity which he traced to the origins of ss 3(8) and (9) and 36 of the *Commerce Act* in article 86 of the European Community Treaty and *Re Continental Can Co. Inc.*<sup>114</sup>

His Honour then noted how the Court of Appeal in the *Telecom* case had

"rejected the developing 'economics' based standard ..., and adopted a standard derived from dictionary meaning ... equat[ing] 'dominance' to 'commanding' or 'ruling'; a very high standard indeed",<sup>115</sup>

and one which he was bound to follow. He concluded that dominance involves "a high degree of market control", but that "some degree of background market realism" should be taken into account:

"To be dominant, the firm must be able to act, within the limits of commercial reality, without significant competitive constraints. Within that, the firm must be

<sup>112</sup>At p442 (emphasis added).

<sup>113</sup>(1995) 6 TCLR 406; affirmed by the Court of Appeal [1996] 3 NZLR 554.

<sup>114</sup>At p436-437.

<sup>115</sup>At p439.

able to dictate more adverse terms of trading to any significant competitors or suppliers. It is to this dictatorial element the concept of 'command' primarily is directed ... One commands when all who matter necessarily follow".<sup>116</sup>

The Australian test of a "substantial degree of power in a market" or (in the case of business acquisitions) a "substantial lessening of competition" is, as noted above, now certainly lower than in New Zealand.<sup>117</sup>

Some Australian cases on the previous "dominance" test seem to have put undue emphasis on structural factors such as market share, without taking adequate account of the actual competitive restraints a firm faces,<sup>118</sup> but in general the Australian approach has been in line with that applied in New Zealand prior to the Court of Appeal decision in *Telecom*. For example, in the QCMA case<sup>119</sup> the Trade Practices Tribunal held that s 46 took effect when a firm "is sufficiently free from market pressures to 'administer' its own production and selling policies at its discretion", such discretion arising from the structure of the market.

This was followed in *Queensland Wire Industries Ltd v Broken Hill Pty. Ltd*, where the High Court of Australia described market power as:

"The ability of a firm to raise prices above the supply cost without rivals taking away customers in due time ... A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions."<sup>120</sup>

## 2 European Community

Unlike New Zealand, where the application of market dominance

<sup>116</sup>At p441-442.

<sup>117</sup>The amendments to ss 46 and 50 were made because "a corporation does not need to be able to dominate a market to satisfy the s 46 threshold. That is too high a degree of market power": *Trade Practices Revision Bill 1986 Explanatory Memorandum*, cited in Corones, above n2, p120.

<sup>118</sup>See, for example, *McLean v Shell Chemical (Australia) Pty. Ltd* (1984) 2 FCR 593 and *Williams v Papersave Pty. Ltd* (1987) 16 FCR 69.

<sup>119</sup>*Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481, 515.

<sup>120</sup>(1989) 167 CLR 177, 189 & 200. See also *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 1; *QIW Retailers Ltd v David's Holdings Pty. Ltd* (1994) 49 FCR 211; and Trade Practices Commission, *Misuse of Market Power Background Paper*, Canberra, Trade Practices Commission (1990), para. 15, where the Commission defined market power as "the ability to be able to act with some degree of freedom from competitive restraints, exerted by its actual or potential competitors, suppliers and customers".

provisions to oligopolies now appears very unlikely, and Australia, where their application remains uncertain at best, the European Community's dominance test in article 86 of the EC Treaty specifically refers to "abuse by one or more undertakings of a dominant position". The approach taken still appears to be based on cases like *Continental Can*, along with the later decisions in *United Brands Co. Inc. v European Commission*<sup>121</sup> and *Hoffman-La Roche & Co. v European Commission*,<sup>122</sup> to which reference was made in earlier New Zealand cases in support of the "independence of behaviour" interpretation.<sup>123</sup> For example, a 1993 article on market dominance limits its treatment of the test under article 86 of the EC Treaty to a consideration of these three cases,<sup>124</sup> and the recent *Tetra Pak*<sup>125</sup> case does not appear to depart from the interpretation adopted in these earlier decisions:

"Dominant positions are not just enjoyed by large companies. Even comparatively minor enterprises may find themselves able to control a particularly narrow market ... The decision in *Tetra Pak* should be of note to all companies who are able to operate in a market without having to have particular regard to activities of their competitors".<sup>126</sup>

As well as the general provision of article 86, mergers which create or strengthen a dominant position are also subject to the *European Community Merger Regulation 1989*. Although both provisions refer to a "dominant position", the test for merger control makes no explicit

<sup>121</sup>[1978] 1 CMLR 429.

<sup>122</sup>[1979] 3 CMLR 211.

<sup>123</sup>These three cases were referred to, for example, in *Lion Corp. Ltd v Commerce Commission* [1987] 2 NZLR 682, 688-689; *Re Broadcast Communications Ltd* [1990] NZAR 433, 448; *Telecom Corp. of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473; and *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406.

<sup>124</sup>Patterson, "The Rise & Fall of a Dominant Position in New Zealand Competition Law: From Economic Concept to Latin Derivation" (1993) NZULR 265, 267-271.

<sup>125</sup>*Tetra Pak International v European Commission* [1992] 4 CMLR 551; affirmed by the European Court of First Instance [1997] 4 CMLR 726.

<sup>126</sup>Singleton, "Abuse of a Dominant Position" (1992) 142 NLJ 1000. An example of joint dominance under article 86 appears in the "Magill" case, *Radio Telefis Eireann v European Commission* [1995] 4 CMLR 718. This case concerned three television companies operating in Ireland and Northern Ireland who had refused to license the copyright in their programme listings to Magill TV Guide Ltd, an independent publisher wishing to produce a comprehensive weekly TV guide. The European Court of Justice held that the defendants had jointly breached article 86, by inhibiting the creation of a new product and monopolising the derivative TV guide market: See van Melle, "Refusals to License Intellectual Property Rights: The Impact of *RTE v EC Commission* (Magill) on Australian and New Zealand Competition Law" (1997) 25 ABLR 4.



reference to the possibility of dominance by more than one firm.<sup>127</sup> In its first year of operation, this apparent loophole led the European Commission to effectively ignore the possibility of joint dominance among oligopolists in merger cases,<sup>128</sup> with clearance being given in a number of cases involving high market concentrations, without detailed assessment of the possibility of collusion. The existence of competitors with similarly high market shares to the merged firm was regarded by the Commission as an indication of their ability to influence its behaviour and prevent sufficiently independent conduct.<sup>129</sup>

However, since the 1992 *Nestlé* case,<sup>130</sup> the European Commission has shown a willingness to intervene to control oligopolies under the merger regulation, by interpreting it to include situations of joint dominance. That case involved a takeover bid by Nestlé, a Swiss-based multinational food company, for Perrier, a French company which distributes bottled mineral water.

The merger was challenged on the grounds that it would strengthen the "jointly held dominant position" of Nestlé and its nearest rival (BSN) in the French bottled water market, and that this was likely to harm the interests of consumers. Even before the merger the market was highly

<sup>127</sup>Dupré, *EEC Merger Control and the Oligopoly: Legal and Economic Analysis in the Light of the American Experience*, Florence, European Universities Institute Monographs in Law No. 1 (1993), p1; Morgan, "The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 *Antitrust Bulletin* 203, 208.

<sup>128</sup>Ridyard, "Joint Dominance and the Oligopoly Blind Spot under the EC Merger Regulation" (1992) 13 *ECLR* 161.

<sup>129</sup>For example, in *Re Renault & Volvo* (Unreported, Decision of the European Commission, 7 November 1990), the first case to be decided under the regulation, a merger was allowed between two large car and truck manufacturers despite the industry's oligopolistic structure, in which as few as three significant suppliers were present in some submarkets. Similarly, in *Re Mitsubishi & UCAR* (Unreported, Decision of the European Commission, 14 January 1991), a merger was cleared which gave the resulting firm a 35-40% share in the European market for graphite electrodes. The firm's two closest competitors held market shares of between 15-25% each, giving a three firm concentration of around 75%, with no other large competitors. In *Re Alcatel & AEG Kabel* (Unreported, Decision of the European Commission, 18 December 1991), the possible application of the merger regulation to an oligopoly was explicitly mentioned for the first time, but rejected on similar grounds to those relied on in the New Zealand case of *Magnum Corp. Ltd* (1986) 2 *TCLR* 177, 196 - that there was no evidence of a lack of effective competition despite the oligopolistic structure.

<sup>130</sup>*Re Nestlé & Perrier* (Unreported, Decision of the European Commission, 22 July 1992); affirmed by the European Court of First Instance, 27 April 1995; discussed by Morgan, "The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 *Antitrust Bulletin* 203, 223-232 and Raffaelli, "Oligopolies and Antitrust Law" (1996) 19 *Fordham International LJ* 915, 927-932.

concentrated, with Perrier, BSN and Nestlé accounting for nearly 95% of French mineral water sales. Prices charged by these firms had risen steadily and in parallel over the previous five years, with Perrier apparently acting as price leader. There was also evidence of joint entry-detering behaviour by the market leaders to protect the established oligopoly. Morgan notes that applicability of the "kinked demand" model<sup>131</sup> to this situation:

"The incentive for coordinated pricing is greater in markets with low price elasticity of demand (where price increases are met with a smaller than proportionate fall in quantity demanded, resulting in higher revenues for producers) ... The Commission noted that the past behaviour of prices suggested that mineral water suppliers had already recognised the possibility of increasing profits by jointly increasing prices, and that the merger was seen as increasing the likelihood of Nestlé and BSN jointly maintaining high prices or even raising them further."<sup>132</sup>

The Commission concluded that many of the classic conditions facilitating oligopolistic coordination were present in this case, and that

"The maintenance or development of whatever competition there remains in that market therefore requires particular protection. Any structural operation restricting even more the scope for competition in such a situation has to be judged severely."<sup>133</sup>

The likelihood of joint dominance is now discussed as a matter of course in European merger cases,<sup>134</sup> although an oligopolistic market structure is not treated as determinative of the issue. Each case since *Nestlé* has been considered on its own merits, with the Commission making an assessment of whether the members of an oligopoly are likely to compete as a result of a merger, or act together to jointly dominate the industry.<sup>135</sup>

<sup>131</sup>See text accompanying n23-29 above.

<sup>132</sup>"The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 Antitrust Bulletin 203, 225.

<sup>133</sup>¶118 of the decision, cited by Morgan, "The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 Antitrust Bulletin 203, 229.

<sup>134</sup>Morgan, "The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 Antitrust Bulletin 203, 233.

<sup>135</sup>Morgan, "The Treatment of Oligopoly under the European Merger Control Regulation" (1996) 41 Antitrust Bulletin 203, 242; Raffaelli, "Oligopolies and Antitrust Law" (1996)

### 3 *United States*

Mergers in the United States are subject to the *Clayton Act 1914 s 7*, which prohibits mergers or acquisitions that substantially lessen competition or tend to create a monopoly in any line of commerce. Although early cases brought under this provision tended to view oligopolies as "shared monopolies" and to treat them as unlawful per se at times, the test currently applied is similar to that used in the European cases. The *Sherman Act 1890* is framed in similar terms,<sup>136</sup> but its applicability to oligopolies is not so clear cut.

An early discussion of the issue appears in *United States v E.I. Du Pont de Nemours & Co.*,<sup>137</sup> a case brought pursuant to the *Sherman Act s 2*. Leahy DJ, in the District Court, noted that all practicable forms of competition are in fact "imperfect", lying between the theoretical economic concepts of perfect competition and monopoly and possessing, in varying degrees, monopolistic characteristics. He defined "monopoly power" as consisting of the ability to arbitrarily raise prices or exclude competitors,<sup>138</sup> and immediately went on to describe the features of oligopolies, and their potentially anticompetitive nature, as follows:

"There is much debate among economists with respect to market behaviour in industries which are oligopolistic. While some economists take the view that ... oligopolies controvert the spirit of the antitrust laws, others contend that oligopolies are able to pass along the benefit of efficiency of size to the consumer and are not socially disadvantageous. Some admit that, in oligopolistic industries, a considerably higher degree of competition than that which exists would be 'workable' or effective."<sup>139</sup>

<sup>19</sup> Fordham International LJ 915, 927. See, for example, *Re Kali und Salz, MdK & Treuhand* (Unreported, Decision of the European Commission, 14 December 1993), where a merger in an oligopolistic market was allowed with conditions; and *Re Pilkington-Techint & SIV* (Unreported, Decision of the European Commission, 21 December 1993) and *Re Mannesmann, Vallourec & Ilva* (Unreported, Decision of the European Commission, 31 January 1994), both approved unconditionally.

<sup>136</sup>Section 2 of the *Sherman Act* prohibits monopolisation, attempted monopolisation and conspiracy to monopolise in any market.

<sup>137</sup>Known as the "cellophane case" (1953) 118 FSupp 41; affirmed by the Supreme Court (1956) 351 US 377.

<sup>138</sup>(1953) 118 FSupp 41, 54, following *United States v Aluminium Co. of America* (1945) 148 F2d 416, 429.

<sup>139</sup>(1953) 118 FSupp 41, 49, citing Fellner, above n13, p290. Fellner says that "the degree of competition which oligopolistic firms consider to be desirable from their own point of

In stating that "monopoly ..., in economics, is not the simple test of perfect monopoly", and apparently including oligopoly in his widened definition, Leahy DJ seems to suggest that the *Sherman Act* prohibition on "monopolisation" could be extended to oligopolies.

Since then, however, no United States court has been willing to confirm the applicability of s 2 to a "shared monopoly" situation. In *Shapiro v General Motors Corp.*, Young DJ referred to the "uncertain success which the Justice Department is likely to have" in prosecuting large companies in highly concentrated industries under s 2;<sup>140</sup> while in *Harkins Amusement Enterprises Inc. v General Cinema Corp.*, the United States Court of Appeals said:

"Because oligopoly markets - those with few sellers - often exhibit the lack of competition, high prices and low output of monopoly markets, commentators<sup>141</sup> have suggested that s 2 could be invoked to attack a shared monopoly even though no individual firm possessed the power to control prices or exclude competition ... [The] theory is a novel one ... One court directly addressing the issue stated bluntly, 'an oligopoly, or a shared monopoly, does not in itself violate s 2 of the *Sherman Act*.'"<sup>142</sup>

A more definite view was, however, adopted in *Brown Shoe Co. v United States*,<sup>143</sup> a merger case brought under s 7 of the *Clayton Act 1914*. Although the market for shoes was at that time composed of a relatively large number of suppliers and retailers, the District Court<sup>144</sup> had found a "definite trend" towards a few large manufacturers supplying an ever increasing proportion of the retail market, thereby foreclosing other manufacturers from competing effectively. The proposed merger would,

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view is likely to fall short of the social optimum by a considerable margin".

<sup>140</sup>(1979) 472 FSupp 636, 647.

<sup>141</sup>See, for example, Turner, "The Scope of Antitrust and Other Economic Regulatory Policies" (1969) 82 Harvard Law Rev 1207, 1231; Posner, above n1, at 1595-1598; and Hay, "Oligopoly, Shared Monopoly and Antitrust Law" (1982) 67 Cornell Law Rev 439.

<sup>142</sup>(1988) 850 F2d 477, 490; citing *Terminal Systems Inc. v ITT World Communications Inc.* (1982) 535 FSupp 225, 228-229. Jelderks J, in *Phoenix Electric Co. v National Electrical Contractors' Association* (1994) 861 FSupp 1498, 1514 was equally noncommittal on whether or not a shared monopoly might ever breach s 2. He found that, as in *Harkins*, the market in question actually consisted of "numerous sellers", and that therefore the issue did not arise.

<sup>143</sup>(1962) 370 US 294.

<sup>144</sup>(1960) 179 FSupp 721.

the court held, result in further substantial lessening of competition and an increased tendency towards monopoly.

This was affirmed by the Supreme Court, with the majority concluding that, in enacting antitrust legislation, "Congress was desirous of preventing the formation of ... oligopolies, with their attendant adverse effects upon local control of industry and upon small business".<sup>145</sup> It was held that the trend in the market was toward oligopoly, and that the present competitive "vigour" in the industry could not immunise the merger from illegality under the *Clayton Act*.

The judgments in *Federal Trade Commission v Procter & Gamble Co.*<sup>146</sup> present a mix of attitudes towards the regulation of mergers involving oligopolies. Harlan J favoured per se illegality, in line with *Brown Shoe Co.*, while the majority took a more effects-based approach.

The Commission had challenged a business acquisition by Procter which, together with its two nearest competitors, accounted for 80% of the national soap, detergent and cleanser market, under s 7 of the *Clayton Act*. The Commission contended that the acquisition would dissuade new entrants to the liquid bleach market, discourage active competition from those firms already in the industry for fear of retaliation from Procter, and diminish potential competition by eliminating Procter, the most likely prospect, as a potential new entrant to the market.

The Supreme Court agreed, with the majority holding that the potentially anticompetitive effects of the acquisition could easily be seen, and that

"the core question is whether a merger may substantially lessen competition, and necessarily requires a prediction of the merger's impact on competition, present and future ... There is every reason to assume that the smaller firms would become more cautious in competing due to their fear of retaliation by Procter. It is probable that Procter would become the price leader and that the oligopoly would become more

<sup>145</sup>(1962) 370 US 294, 333, per Warren CJ, delivering the opinion of the majority; citing the Senate Report on the *Clayton Act*, the Federal Trade Commission's 1948 report on merger policy, and Stigler, "Mergers and Preventative Antitrust Policy" (1955) 104 U Pa Law Rev 176, 180.

<sup>146</sup>(1967) 386 US 568.

rigid."<sup>147</sup>

Although concurring with the majority opinion, Harlan J did not consider the effects of the acquisition to be as obviously anticompetitive as Douglas J. He saw the "key to a s 7 analysis" to be based purely on market structure changes, rather than actual evidence of market behaviour, and that the mere presence of a strengthened oligopolistic structure should be sufficient to disallow the acquisition, as this entailed the reasonable probability of substantially increased barriers to entry and of the enhancement of Procter's pricing power.<sup>148</sup>

The emphasis on market concentration continued into the 1970s, with the Supreme Court generally taking the view that proof of a highly concentrated market, and an increase in concentration due to a merger, was prima facie evidence of a violation of the antitrust laws.<sup>149</sup> In more recent years, however, this approach has softened somewhat, with the focus shifting to the "likelihood of coordinated interaction" among oligopolists. Structural factors (including levels of market concentration) which may facilitate or limit the potential for such conduct play an evidential role only.<sup>150</sup> Nevertheless, the United States retains a "collective dominance" test with regard to its merger control provisions.<sup>151</sup>

## B *Anti-Collusion Provisions*

The *Commerce Act 1986* s 27 prohibits "contracts, arrangements or understandings" which have the purpose, effect or likely effect of

<sup>147</sup>At 580, per Douglas J.

<sup>148</sup>At 595 and 604.

<sup>149</sup>"Companies that have controlled sufficiently large shares of a concentrated market are barred from merger by s 7 [of the *Clayton Act*], not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigour": *United States v General Dynamics Inc.* (1974) 415 US 486, 501; "It is ... incumbent upon [the acquiring firm] to show that the market share statistics give an inaccurate account of the acquisition's probable anticompetitive effects": *United States v Citizens & Southern National Bank Inc.* (1975) 422 US 86, 120.

<sup>150</sup>Rule and Meyer, "Towards a Merger Policy that Maximises Consumer Welfare: Enforcement by Careful Analysis, Not by the Numbers" (1990) 35 *Antitrust Bulletin* 251. See *United States v Waste Management Inc.* (1984) 743 F2d 976 and *Cargill Inc. v Montfort of Colorado Inc.* (1986) 479 US 104.

<sup>151</sup>Dupré, *EEC Merger Control and the Oligopoly: Legal and Economic Analysis in the Light of the American Experience*, Florence, European Universities Institute Monographs in Law No. 1 (1993), p15, 49 and 146. Dupré concludes that "the US and EEC are coming closer in their antitrust analysis".

"substantially lessening competition in a market". Sec 30 specifically deems price fixing to fall within the s 27 prohibition.<sup>152</sup>

The focus is thus on collusive action arising from an agreement. Borrowdale notes that

"The emphasis on agreement is soundly based, as cooperation increases the risk of anticompetitive action, expands market power, creates an anticompetitive restraint not otherwise possible and surrenders important decision-making autonomy on a matter of competitive significance."<sup>153</sup>

In a competitive industry, the structure of the market ensures that these outcomes will not result unless actual communication occurs between market participants, but this is not true in the case of an oligopoly. Firms in a highly concentrated market may "learn" that they can raise their prices significantly above competitive levels without fear of being undercut by their rivals, despite no communication ever having taken place. Nevertheless, the test generally employed to identify an actionable agreement under s 27 and its equivalents seems to assume competitive market conditions. Communication between the parties, or at least a conscious mutual commitment, is a necessary condition for liability to arise.

The test is derived from the leading United Kingdom case, *Re British Basic Slag Ltd*,<sup>154</sup> where Cross J said:

"All that is required to constitute an arrangement not enforceable in law is that the parties to it shall have **communicated** with each other in some way, and that as a result of the communication each has intentionally aroused in the other an

<sup>152</sup>At the time of writing, the Commerce Commission had just filed a statement of claim in the High Court accusing three of the four major oil companies with price fixing under s 30 of the *Commerce Act*. It is unclear whether the alleged "arrangement or understanding" to fix petrol prices resulted from actual communication between the three parties, or merely from tacit collusion. This information is, according to the Commission, "evidence that will be used in court, and will not be released before it is presented to the judge": Facsimile message from Vince Cholewa, Commerce Commission Communications Officer, accompanying the Commission's media release, "Three Oil Companies Charged with Price Fixing", issued 4 September 1997. See also Weir, "Three Oil Firms Accused of Price Fixing", *Dominion*, Wellington, 4 September 1997, p15.

<sup>153</sup>*Butterworths Commercial Law in New Zealand (3rd ed.)*, Wellington, Butterworths (1996), p622.

<sup>154</sup>(1962) LR 3 RP 178; affirmed by the Court of Appeal (1963) LR 4 RP 116.

expectation that he will act in a certain way."<sup>155</sup>

In the Court of Appeal, Diplock LJ endorsed the need for communication of the terms of the arrangement between the parties:

"It is sufficient to constitute an arrangement between **A** and **B** if (1) **A** makes a **representation** as to his future conduct with the expectation and intention that such conduct will operate as an inducement to **B** to act in a particular way, [and] (2) such representation is **communicated** to **B**, who has knowledge that **A** so expected or intended."<sup>156</sup>

The same standard has been held to apply in the United States and Australia,<sup>157</sup> as well as New Zealand. In *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd*, Barker J said that

"An arrangement or understanding comes into existence as a result of some communication between the parties; the communication can however occur by written or spoken word the one to the other, or by one observing and interpreting the other's behaviour."<sup>158</sup>

<sup>155</sup>At 196 (emphasis added). It should be noted that the legislation under consideration in the *British Basic Slag* case, the *Restrictive Trade Practices Act 1956* (UK), required that the agreement in question include the acceptance of "restrictions" by the parties to it. "Restriction" was defined by the Act to include "any negative obligation, whether express or implied, and whether absolute or not", and it was for this reason that Diplock LJ held that a mutual obligation to act in a certain way was required to constitute an agreement: (1963) LR 4 RP 116, 154. No such provision appears in the New Zealand, American or Australian Acts.

<sup>156</sup>(1963) LR 4 RP 116, 155 (emphasis added).

<sup>157</sup>In *United States v Standard Oil Co.* (1963) 316 F2d 884, 890 it was held that "unless the individuals involved understood from **something that was said or done** that they were, in fact, committed to raise prices, there was no violation of the *Sherman Act*"; while Australian cases like *Top Performance Motors Pty. Ltd v Ira Berk (Qld) Pty. Ltd* (1975) 1 ATPR 17,113, 17,116; and *Trade Practices Commission v Nicholas Enterprises Pty. Ltd* (1979) 2 ATPR 18,333, 18,342 also refer to the need for communication and a mutual intention to follow a common course of action, citing the *British Basic Slag* case. While the Australian and American courts have at times accepted that collusion has taken place without evidence of explicit communication between the parties, they appear to have taken the view that such communication **must** have occurred, given the observed outcomes. The outcomes themselves do not seem to have been sufficient to establish collusion in the absence of any explicit communication: See, for example, *Trade Practices Commission v Allied Mills Industries Pty. Ltd* (1980) 3 ATPR 42,452, 42,458; *Interstate Circuit Inc. v United States* (1939) 306 US 208, 226; and *Milgram v Loew's Inc.* (1951) 192 F2d 579.

<sup>158</sup>[1987] 2 NZLR 647, 662; citing the Australian Trade Practices Commission, *Inquiry into Prices and Distribution of Motor Vehicle Spare Parts*, Canberra, Submission to the New South Wales Prices Commission (1978). See also *Commerce Commission v Wellington Branch New Zealand Institute of Driving Instructors* (1990) 4 TCLR 19, 24.



Barker J's reference to communication by "observing and interpreting", although it suggests that s 27 could be an appropriate remedy for combating anticompetitive pricing by oligopolists, has never been applied by the New Zealand courts to such conduct. A distinction has been drawn in most cases between explicit acts of collusion on one hand and tacit undertakings on the other, despite the fact that the two categories are, in effect, indistinguishable.<sup>159</sup>

The unsuitability of a test requiring explicit communication to concentrated industries, where such communication may be unnecessary and the only evidence of collusion may be parallel pricing behaviour where one would expect rivals to undercut, is evident from the cases which have considered the meaning of an arrangement or understanding in an oligopoly context. The few New Zealand and Australian cases on this issue have concluded that collusion is not an inevitable result of an oligopolistic market structure, and should not be inferred merely from parallel conduct which produces apparently anticompetitive outcomes.

### 1 *New Zealand and Australian cases*

The New Zealand case of *Re Magnum Corp. Ltd and Dominion Breweries Ltd*<sup>160</sup> actually concerned an application by Magnum to the Commerce Commission for clearance or authorisation to merge with DB under the *Commerce Act* s 66. The issue before the Commission was whether or not this proposal would result in the merged company acquiring or strengthening a "dominant position in a market". In each of the markets under consideration,<sup>161</sup> the Commission found that there were a few major participants (including the parties to these proceedings) holding up to a 40% market share each, and barriers to

<sup>159</sup>Posner, above n1, at 1575.

<sup>160</sup>(1986) 2 TCLR 177 (Commerce Commission Decision No. 182), affirmed by the High Court in *Lion Corp. Ltd v Commerce Commission* [1987] 2 NZLR 682.

<sup>161</sup>Both Magnum and DB were involved in the wholesale and retail liquor markets and in hotel accommodation. Magnum also had significant interests in wine making; DB in beer brewing. In addition, Brierley Investments Ltd was a major shareholder in both companies, and planned to increase its stake in Magnum. This was a cause for concern among other interested parties, notably Lion Corp. Ltd, DB's major competitor in the beer industry.

entry.<sup>162</sup>

In equating "dominance" with "market power" (ie. the ability to behave "independently of the presence, actions and reactions of existing and potential competitors, purchasers and suppliers"),<sup>163</sup> the Commission drew a distinction between such independence of behaviour, which it held to be inherent in the concept of dominance, and the notion of interdependent, parallel, conduct which characterises oligopolistic markets. The Commission saw the conditioning of a firm's behaviour by an awareness of its competitors' actions as evidence of competitive conditions, even in very concentrated markets. It held that high market concentration in itself did not inevitably lead to collusion. In the absence of demonstrable collusion with its principal competitor, Lion Corp. Ltd, the Commission was of the opinion that the merged entity would still be "disciplined" by Lion's presence and actions, and therefore would not be dominant in terms of the Act:

"It is sometimes presumed that such concentration as exists in an oligopoly leads to cooperative behaviour or to interdependence in pricing and other strategic decisions that is equivalent to tacit collusion. While it is arguable that concentration or increased concentration itself might facilitate collusive behaviour, the Commission does not accept that collusion - explicit or implicit - let alone successful collusion, will necessarily follow."<sup>164</sup>

This is, in itself, not incorrect; Posner notes that

"voluntary actions by the sellers are necessary to translate the bare conditions of an oligopolistic market into a situation of non-competitive pricing ... Tacit collusion is voluntary behaviour."<sup>165</sup>

However, the judgment of Lockhart J in *Re Trade Practices Commission*

<sup>162</sup>The lack of access to retail outlets and customer brand loyalty were seen as "significant deterrents" to potential local and off-shore entrants to the beer brewing market. However, entry to the wine industry, the Commission believed, would be relatively easy for any firm with adequate financial and other resources: (1986) 2 TCLR 177, 182-185.

<sup>163</sup>(1986) 2 TCLR 177, 196.

<sup>164</sup>At 196.

<sup>165</sup>"Oligopoly and the Antitrust Laws: A Suggested Approach" (1969) 21 Stanford Law Rev 1562, 1575.

and *Email Ltd*<sup>166</sup> extends this finding, by concluding that market concentration, **even coupled with obviously parallel conduct**, does not necessarily lead to an inference of collusion. The case was brought by the Commission against *Email* for conduct which allegedly breached s 45(2)(b) of the *Trade Practices Act 1974*. The Commission claimed that *Email* and another company were parties to an "arrangement or understanding" with the purpose or likely effect of substantially lessening competition in the market for the manufacture and supply of kilowatt hour meters, used to measure electricity consumption. The two companies were the only suppliers of the meters in Australia at that time, with *Email* holding a market share of around 70%.

Both companies issued identical price lists, submitted identical tenders, and sent to each other their respective price lists, as well as updated lists whenever they changed their prices or introduced any new product. The Commission based its claim of collusion on circumstantial evidence, there being no direct evidence of communication between the companies to the effect that their prices and tenders would be the same. Chief among this evidence was the fact that the companies' actions constituted "parallel conduct" from which, the Commission alleged, the inference could be drawn of the requisite arrangement or understanding.

Lockhart J accepted that the parallel conduct of the parties could be explained by "commercial considerations" - flowing inevitably from the structure of the market - rather than by collusion. Referring to expert evidence on the nature of oligopolies, his Honour held that:

"In this particular market there was a state of pure oligopoly where sellers ... are obliged to sell at one price, allowing for temporary or transient deviations. The result of pure oligopoly is that prices cannot diverge for more than short periods. The process by which this result is reached is either through price leadership of the dominant firm or barometric type, or collusion. **The result does not justify an inference as to the process.** Barometric price leadership occurs where one firm ... moves ahead in signifying its reading of the marketplace, and other firms are obliged to follow."<sup>167</sup>

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<sup>166</sup>(1980) 3 ATPR 42,367.

<sup>167</sup>At 42,373 (emphasis added).

Thus, it appears that outcomes which, in economic terms, can only be explained by collusion (which, in the wider economic sense, includes "price leadership")<sup>168</sup> would be held by the courts of Australia, and probably New Zealand, to be insufficient to satisfy the evidential requirements of an "arrangement or understanding" in terms of the *Commerce and Trade Practices Acts*.

Allan suggests an alternative approach to the issue. He notes that, with regard to s 27 of the New Zealand Act,

"the point has been reached that when [for example] customers act purely out of self interest with no reason to even suspect anti-competitive purpose on the part of their supplier, there can be breach of s 27. The search for some form of 'arrangement or understanding' appears to have been made redundant and, through a process of elision, that part of s 27 which says 'enter into a contract or arrangement, or arrive at an understanding containing a provision' seems to have lost any purpose or effect. Instead, the courts have regarded the unilateral actions of one firm as equating to the elided words."<sup>169</sup>

He goes on to suggest that s 27, as currently interpreted, may therefore be an appropriate tool for dealing with oligopolies:

"In *Port Nelson Ltd v Commerce Commission*,<sup>170</sup> the New Zealand Court of Appeal [held] that where one party has the requisite purpose, ... whenever other parties, acting in their own self-interest, contract with the first party there will be a breach of s 27."<sup>171</sup>

This approach focuses, not on tacit collusion between the oligopolists themselves, but on contracts between a firm and its **customers**. Allan

<sup>168</sup>Miller and Round, "Price Fixing, Price Leadership or 'Ordinary Commercial Considerations': Guilt under Section 45 of the *Trade Practices Act*" (1982) 10 ABLR 251, 260 state that, in the *Email* case, "it is likely that the two firms did not require an explicit agreement or contract to reach a market result similar to that which colluding oligopolists would reach, namely the coordination of price through, in this case, price leadership. Expert economic testimony confirmed, for the court, that 'not only would the court not be justified in inferring that the parallel conduct was the result of collusion; but it was in fact the result of market forces based on commercial considerations'. This observation cannot be faulted, but the real reason for the operation of these 'market forces' would appear to have been that explicit collusion was unnecessary to reach a collusive result with regard to price" (emphasis in original).

<sup>169</sup>Above n75, p62.

<sup>170</sup>[1996] 3 NZLR 554, 563-564.

<sup>171</sup>Above n75, p2.

suggests that, if it can be shown that any firm in an oligopolistic market has an anticompetitive purpose, the "contract" requirement of s 27 is satisfied when that firm sells its products to a customer. Although removing the problem of establishing collusion without direct evidence, this approach faces the difficulty of showing that the contract in question has the purpose or likely effect of "substantially lessening competition in a market".<sup>172</sup> It is difficult to imagine a situation where an individual transaction between an oligopolist and a customer could be said, in itself, to have substantially lessened competition. It is the agreement between the supplying firms which produces the effect on competition; the terms faced by the firms' customers are merely the results of this agreement. It is submitted, therefore, that the decision in *Port Nelson Ltd* does not extend the scope of s 27 to cover oligopolies.

## 2 *United States*

The tendency, also apparent to a limited extent in Australia, to rely on academics (particularly economists) to define the features and effects of oligopolies, also seems to apply to the American courts; indeed, an influential 1962 article on the subject by Donald Turner<sup>173</sup> has been cited in over sixty United States antitrust cases, including six decided in the Supreme Court.<sup>174</sup> However, as in New Zealand and Australia, and in contrast to the economic literature, the American collusion cases have generally focused on the **process** by which the parallel conduct in question has come about, rather than on its anticompetitive **outcomes** as such.<sup>175</sup>

<sup>172</sup>"Substantial" has been defined to mean "real or of substance" and "not insubstantial or nominal": *Commerce Act 1986 s 2(1A)*; *Re Fisher & Paykel Ltd* [1990] 2 NZLR 731, 758-759.

<sup>173</sup>"The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal" (1962) 75 *Harvard Law Rev* 655.

<sup>174</sup>Lopatka, "Solving the Oligopoly Problem: Turner's Try" (1996) 41 *Antitrust Bulletin* 843, 844. These cases were *White Motor Co. v United States* (1963) 372 US 253, 268; *United States v General Motors Corp.* (1966) 384 US 127, 145; *Albrecht v Herald Co.* (1968) 390 US 145, 162; *First National Bank of Arizona v Cities Service Co.* (1968) 391 US 253, 287; *City of Columbia v Omni Outdoor Advertising Inc.* (1991) 499 US 365, 396; and *Brown v Pro Football Inc.* (1996) 116 S Ct 2116, 2122, at the time of writing the most recent antitrust case to be heard by the Supreme Court.

<sup>175</sup>Note, however, that the United States courts have taken a sterner view of parallel conduct than the Australian Federal Court did in *Email*, if the parallelism is facilitated by the explicit exchange of price information by competitors in a concentrated market. In *United States v Container Corp.* (1969) 393 US 333, 335, Douglas J said that such an exchange "is of course sufficient to establish the combination or conspiracy, the initial ingredient of a violation of s 1 of the *Sherman Act* ... This is obviously quite different

The equating of "conscious parallelism" among oligopolists with unlawful "conspiracy",<sup>176</sup> an issue at the heart of what has been described as the "oligopoly problem",<sup>177</sup> appears to have been first attempted in the United States in *American Tobacco Co. v United States*.<sup>178</sup> In this case, the Government alleged that the three leading American cigarette manufacturers<sup>179</sup> had conspired to fix the prices of their products. All three had charged identical prices for their cigarettes between 1928 and 1940. Any price rise initiated by one of the companies was almost immediately followed by the others. These parallel increases in price continued throughout the depression, although costs were declining, leading to substantial increases in profits for these companies, despite declining sales as some customers switched to cheaper brands.

In the words of Turner;

"Any economists worthy of the name would immediately brand this price behaviour as non-competitive. One can hardly find clearer evidence of an absence of effective competition than an increase in prices in the face of declining costs and weakening demand."<sup>180</sup>

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from the parallel business behaviour condoned in *Theatre Enterprises v Paramount Film Distributing Corp.* (1954) 346 US 537" (see below). The editorial comment to the *Email* case notes that "an American court ... would have found a conspiracy ... on these facts": (1980) 3 ATPR 42,367, 42,368, citing *Container Corp.*

<sup>176</sup>*Sherman Act 1890 s 1*

<sup>177</sup>Baker, "Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory" (1993) 38 Antitrust Bulletin 143; Lopatka, "Solving the Oligopoly Problem: Turner's Try" (1996) 41 Antitrust Bulletin 843.

<sup>178</sup>(1946) 328 US 781, discussed at length by Turner, "The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal" (1962) 75 Harvard Law Rev 655.

<sup>179</sup>These three companies accounted for between 68% and 91% of all cigarette sales in the United States throughout the 1930s. No other company had more than a 10% market share during this period.

<sup>180</sup>"The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal" (1962) 75 Harvard Law Rev 655, 661. Nicholls, *Price Policies in the Cigarette Industry: A Study of "Concerted Action" and its Social Control 1911-1950* (1951), p89, cited by Posner, above n1, at 1586, concludes that "the fact that all saw fit to follow Reynolds' increase in 1931 suggests a strong element of cartel-like behaviour". Posner himself, however, describes the behaviour of the companies as "evidence ... of irrationality" if the case was simply one of raising prices in the face of declining costs and demand. Instead, he suggests that the companies' behaviour could have been indicative of successful product differentiation, leading to a higher price and higher advertising outlays - a pattern which could conceivably occur under competitive conditions.

The Supreme Court affirmed the decision of the District Court jury and the Court of Appeals that an unlawful conspiracy had occurred:

"A friendly relationship within such a long established industry is, in itself, not only natural, but commendable and beneficial, as long as it does not breed illegal activities. Such a community of interest in any industry, however, provides a natural foundation for working policies and understandings favourable to the insiders and unfavourable to outsiders. The verdicts indicate that practices of an informal and flexible nature were adopted, and that the results were so uniformly beneficial to the petitioners in protecting their common interests as against those of competitors that, entirely from circumstantial evidence, the jury found that a combination or conspiracy existed among the petitioners."<sup>181</sup>

The court concluded that

"No formal agreement is necessary to constitute an unlawful conspiracy ... The essential combination or conspiracy ... may be found in a course of dealings or other circumstances, as well as in any exchange of words. Where the circumstances are such as to warrant a ... finding that the conspirators had a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement, the conclusion that a conspiracy is established is justified."<sup>182</sup>

After this early success, however, the later case of *Theatre Enterprises Inc. v Paramount Film Distributing Corp.*<sup>183</sup> is thought by some commentators to have "foreclosed" the idea that provisions which prohibit anticompetitive collusion are appropriate weapons against allegedly anticompetitive behaviour in oligopolies.<sup>184</sup> The case concerned the refusal by a number of major motion picture producers and distributors to allow the screening of newly released films in all but a few selected theatres. Despite "a great deal of testimony by the defendants to the effect that the decision of each was an independent

<sup>181</sup>(1946) 328 US 781, 794, per Burton J. As well as the identical prices charged by the three petitioners, this circumstantial evidence included the fact that the companies had refused to purchase tobacco from auction markets unless the others were also present (driving down the prices at such markets), and that each company had instructed its buyers to bid only up to identical "price ceilings" at the markets they did attend.

<sup>182</sup>(1946) 328 US 781, 809-810.

<sup>183</sup>(1954) 346 US 537.

<sup>184</sup>Stevens and Dean, "Horizontal Price Fixing and Competitor Collusion: In Search of Workable Boundaries", in Ahdar (ed.), above n96, p171; Pass and Sparkes, "Control of Tacit Collusion in Britain" (1981) 15 JWTL 521, 522-523. See Posner, above n1, at 1576-1578 for an opposing view.

one, based purely on individual considerations",<sup>185</sup> Theatre Enterprises Inc. claimed that this constituted a "combination or conspiracy in restraint of trade" in breach of s 1 of the *Sherman Act*.

Clark J, delivering the opinion of the Supreme Court, said:

"The crucial question is whether the respondents' conduct toward the petitioner stemmed from independent decisions or from an agreement, tacit or express. To be sure, business behaviour is admissible circumstantial evidence from which the fact finder may infer agreement ... [But although] circumstantial evidence of consciously parallel behaviour may have made heavy inroads into the traditional judicial attitude toward conspiracy, ... 'conscious parallelism' has not yet read conspiracy out of the *Sherman Act* entirely."<sup>186</sup>

It was thus held that proof of parallel business behaviour did not conclusively establish agreement, and that such behaviour without more did not constitute a breach of the *Sherman Act*.

The latest consideration of tacit collusion in an oligopolistic market by the Supreme Court appears in *Brooke Group Ltd v Brown & Williamson Tobacco Corp.*,<sup>187</sup> a case brought by one oligopolist against another.

The cigarette market in the United States is highly concentrated, with six companies, including the two parties to these proceedings, dominating. Brooke had pioneered the economy segment of the cigarette market, developing a line of generic cigarettes, offered at a price roughly 30% lower than that of the branded product. Brown & Williamson began offering generic cigarettes at an even lower price, precipitating a price war which eventually resulted in Brown & Williamson selling its product at a loss. Brooke claimed that Brown & Williamson was guilty of anticompetitive price discrimination pursuant to the *Clayton Act* s 2(a),<sup>188</sup> in that its "predatory" prices were designed to eliminate

<sup>185</sup>Turner, "The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal" (1962) 75 Harvard Law Rev 655, 657.

<sup>186</sup>(1954) 346 US 537, 540-541.

<sup>187</sup>(1993) 509 US 209.

<sup>188</sup>Section 2(a) prohibits "discrimination in price between different purchasers of commodities of like grade and quality ... where the effect of such discrimination may be to substantially lessen competition or to create a monopoly in any line of commerce, or to injure, destroy or prevent competition".



competition, and restrain growth, in the economy segment of the market, allowing Brown & Williamson, and other companies, to earn excess profits on its branded cigarettes. It alleged that the scheme had been devised through a process of tacit collusion between Brown & Williamson and other cigarette companies.

The court defined the requirements for liability under s 2(a), namely that the prices complained of must be below an appropriate measure of the firm's costs, and that the firm must have a reasonable prospect of recouping its investment in below-cost prices,<sup>189</sup> and held that the second of these was not satisfied in this case. Kennedy J referred to the allegation of tacit collusion -

"the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit maximising, supracompetitive level by recognising their shared economic interests and their interdependence with respect to price and output decisions"<sup>190</sup> -

and concluded that a predatory pricing scheme requiring concerted action was "generally implausible" and "incalculably difficult to execute" as, in order to succeed, the conspirators would have to agree on how to allocate the losses when prices were initially lowered (in the situation of a single firm charging predatory prices, these losses would fall on that firm only) and the future gains when these losses were recouped. These problems become even more apparent in cases where, as Brooke alleged, there has been no express coordination:

"Firms that seek to recoup predatory losses through the conscious parallelism of oligopoly must rely on uncertain and ambiguous signals to achieve concerted action. The signals are subject to misinterpretation, and are a blunt and imprecise means of ensuring smooth cooperation, especially in the context of changing or unprecedented market circumstances. This anticompetitive minuet is most difficult to compose and to perform, even for a disciplined oligopoly ... On the whole, tacit collusion among oligopolists must be considered the least likely means of recouping predatory losses. In addition to the difficulty of achieving effective tacit coordination and

<sup>189</sup>(1993) 509 US 209, 222-223; citing, inter alia, *Matsushita Electric Industrial Co. v Zenith Radio Corp.* (1986) 475 US 574, 585 and *Cargill Inc. v Montfort of Colorado Inc.* (1986) 479 US 104, 117.

<sup>190</sup>(1993) 509 US 209, 227.

the high likelihood that any attempt to discipline will produce an outbreak of competition, the predator's present losses in a case like this fall to it alone, while the later supracompetitive profits must be shared with every other oligopolist in proportion to its market share, including the intended victim."<sup>191</sup>

Brooke's allegations were thus held to be "economically irrational", although it was conceded that a predatory pricing scheme designed to preserve or create a stable oligopoly could be subject to liability under the antitrust laws: "However unlikely that possibility may be as a general matter, when ... the facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability". No indication was given, however, of what might need to be shown before the court would accept that such a scheme was in operation.

Stevens J, dissenting, expressed doubts about whether effective tacit collusion was as difficult as the majority had concluded. Referring to the "anticompetitive minuet" described by Kennedy J, he said:

"I would suppose ... that the professional performers who have danced the minuet for 40 to 50 years would be better able to predict whether their favourite partners would follow them in the future than would an outsider ... In any event, the jury was surely entitled to infer that at the time of the price war itself, Brown & Williamson reasonably believed that it could signal its intentions to its fellow oligopolists, assuring their cooperation."<sup>192</sup>

Despite such statements, the test for collusion under the United States antitrust laws is still very much based on proof of communication between the parties. In the recent case of *Brown v Pro Football Inc.*, Breyer J stated that antitrust liability could be premised upon "little more than uniform behaviour among competitors", but only if such conscious parallelism was "preceded by conversations implying that later uniformity might prove desirable ... or accompanied by other conduct that, in context, suggests that each competitor failed to make an independent decision".<sup>193</sup>

### 3 *European Community*

<sup>191</sup>At 228-229.

<sup>192</sup>At 258.

<sup>193</sup>(1996) 116 SCt 2116, 2122.

In contrast, recent European cases have treated the communication of the parties' intentions merely as evidence of collusive behaviour, rather than as a necessary component of such conduct, as it appears to be in other jurisdictions. The position under article 85 of the European Community Treaty seems to be that, if it appears the conduct in question can only be explained by concerted action, and the European Commission alleges such, the parties will then have to provide an alternative rational explanation to avoid liability.

Article 85(1) refers to three categories of behaviour, the first two of which - "agreements" and "decisions of associations" - are generally quite easy to establish. The concept of "concerted practices", however, is more vague, and is intended to cover cooperative activity between firms which falls short of an actual agreement. Goyder notes that:

"Those who negotiated the terms of article 85 would have been well aware of the likelihood that in many sectors of European industry and commerce (particularly in those where there is a strong oligopolistic element) effective concertation of commercial policy could be arranged without the need for formal agreement, indeed often without the need for creation of **any external evidence at all**."<sup>194</sup>

The term has been given a wide definition by the European courts. *ICI Ltd v European Commission*,<sup>195</sup> for example, concerned three uniform price increases by all the leading European producers of dyes and pigments in 1964, 1965 and 1967. Advocate General Maydras described the market as oligopolistic - being comprised of about 10 very large firms - and noted that, while this might sometimes naturally lead to parallel price **decreases**, it was less likely to account for concerted price **increases**, unless there was some form of agreement between the parties.<sup>196</sup> He found the parties' parallel conduct "sufficiently suspicious" to conclude that it had resulted from collusion, particularly as there was evidence of contact between the firms. The court agreed that there had been concerted practices by the defendants, and held that although producers were free to take their competitors present and foreseeable conduct into account in making pricing decisions, it was a breach of article 85 to

<sup>194</sup>*EC Competition Law* (2nd ed.), Oxford, Clarendon Press (1993), p97 (emphasis added).

<sup>195</sup>The "dyestuffs" case [1972] CMLR 557.

<sup>196</sup>See discussion of the "kinked demand" model above.

eliminate uncertainty as to the other parties' conduct through coordinated action. Uniformity in such matters as the amounts of the price increases, their dates and the exact range of products covered led the court to conclude that the firms had made advance announcements to each other and had so "substituted cooperation for the risks of competition".<sup>197</sup>

It has been suggested by Goyder that the intentional communication of information between the parties, either directly or through an intermediary, is an important element in establishing a concerted practice,<sup>198</sup> although it was found not to be essential in *Re Woodpulp*,<sup>199</sup> where a "suspicious lack of variation" in the quoted prices levels of several woodpulp producers was held by the Commission to have raised the presumption of a concerted practice. It was not suggested that there had been any communication between the firms, merely that their individual systems for quoting prices - each involving regular quarterly adjustments - contained sufficiently common features. The Commission accepted that the presumption could be displaced by evidence of a "genuine equilibrium" of prices in the market.

### *C Anticompetitive Conduct in the Petrol Industry (II)*

Returning to the example of the New Zealand petrol industry; it appears, given the interpretations discussed above, that the New Zealand courts would not accept that the major petrol companies were guilty either of using a dominant position in a market, or of entering an arrangement or understanding, for anticompetitive purposes.

Under s 36 of the *Commerce Act*, it would be necessary to show that a **single firm** held a "prevailing", "commanding" or "governing" influence in the market.<sup>200</sup> While it might be possible to show that each of the major petrol companies holds an "advantageous or powerful" position

<sup>197</sup>[1972] CMLR 557, 622. The need for competition, "to maintain prices at the lowest possible level, and to encourage the movement of products ... so as to permit an optimum sharing out of activities on the basis of productivity and the adaptive capacity of undertakings", was held to outweigh the desire of the producers for price stability.

<sup>198</sup>*EC Competition Law* (2nd ed.), Oxford, Clarendon Press (1993), p100.

<sup>199</sup>[1985] 3 CMLR 474. See van Gerven and Varona, "The *Woodpulp* case and the Future of Concerted Practices" [1994] *Common Market Law Rev* 575.

<sup>200</sup>Cooke P in *Telecom Corp. of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429, 434; Gault J in *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, 573.

in the industry, this has been held to be insufficient to establish dominance in terms of s 36.<sup>201</sup>

While McGechan J's judgment in *Port Nelson*<sup>202</sup> represents a less extreme view to that expressed in *Telecom*, it still appears to discount any possibility of an oligopoly being considered a "shared monopoly" possessing "joint dominance" in a market, a point noted with respect to the petrol companies by Scott, who also draws support for this conclusion from the Commerce Commission's latest *Business Acquisition Guidelines*. Dr Scott states that

"the market shares of the four major oil companies range from 18% to 27.5% of the total market ... Only one firm in a market can possess a 'dominant position'. More importantly, the New Zealand Commerce Commission's recent *Business Acquisition Guidelines* contain what it refers to as 'safe harbour' provisions regarding dominance. In connection with mergers, it believes that 'a dominant position in a market is generally unlikely to be created or strengthened' when the merged entity has less than roughly a 40% market share, or when the merged entity has less than roughly a 60% market share and it 'faces competition from at least one other market participant having no less than in the order of a 15% market share'."<sup>203</sup>

Under a test allowing for joint dominance, however, such as that used in the United States<sup>204</sup> or the European Community, the behaviour of the leading petrol companies could well be caught. Such a test would require the court to assess whether the members of the oligopoly were in fact competing, or acting in concert to jointly exclude competitors, raise prices or maintain them at higher than competitive levels.<sup>205</sup>

<sup>201</sup>Richardson J in *Telecom Corp. of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429, 442.

<sup>202</sup>(1995) 6 TCLR 406.

<sup>203</sup>*Conditions of Entry into Petrol Importing, Wholesaling and Retailing in New Zealand*, Report Commissioned by Mobil Oil New Zealand Ltd, in association with Law and Economics Consulting Group Inc., (1997), p17; citing Commerce Commission, *Business Acquisition Guidelines 1996*, Wellington, Commerce Commission (1996), p17. The lack of any recognition in the Guidelines of the potential for coordinated anticompetitive behaviour by oligopolists has, however, concerned some commentators: see Hay, *The Draft New Zealand Merger Guidelines*, Paper presented to the Seventh Annual Workshop of the Competition Law and Policy Institute of New Zealand Inc. (1996), p20-21; and Berry, "The Commerce Commission's First Business Acquisitions Guidelines: A Comment" (1997) 3 NZBLQ 75, 79.

<sup>204</sup>At least with respect to merger cases.

<sup>205</sup>See, for example, *Re Nestlé & Perrier* (Unreported, Decision of the European

Under s 27 of the New Zealand Act, it appears that an actionable "arrangement or understanding" would only be established if it could be shown that there had been some sort of communication between the petrol companies. This is certainly the case in Australia and the United States,<sup>206</sup> although the few New Zealand cases on this issue have not discounted the possibility that the communication required could be by way of one firm "observing and interpreting" another's behaviour.<sup>207</sup> It remains to be seen whether the action recently brought by the Commerce Commission against three of the four major petrol companies for price fixing<sup>208</sup> results in any clarification of the New Zealand position on anticompetitive arrangements and understandings.

If an approach like that taken under article 85 of the European Community Treaty was adopted in New Zealand, the economic evidence produced by agencies like the IEA and NZIER might be sufficient to raise a presumption of collusion<sup>209</sup> between the major players in the petrol industry. It would then be up to the companies themselves to displace that presumption by presenting evidence of an alternative explanation.

## V CONCLUSIONS

The light-handed approach to competition policy adopted by the New Zealand legislature recognises that anticompetitive behaviour is not inevitable in highly concentrated markets, and that it is the misuse of market power, whether achieved through single-firm dominance or multi-firm collusion, which is the appropriate focus of competition law.

It appears, however, that the interpretation generally given to New Zealand's market dominance and collusion provisions has failed to take

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Commission, 22 July 1992).

<sup>206</sup>See, for example, *Re Trade Practices Commission and Email Ltd* (1980) 3 ATPR 42,367 and *Brown v Pro Football Inc.* (1996) 116 SCt 2116, 2122.

<sup>207</sup>Barker J in *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647, 662.

<sup>208</sup>See Commerce Commission, "Three Oil Companies Charged with Price Fixing", Media Release, Issued 4 September 1997; and Weir, "Three Oil Firms Accused of Price Fixing", *Dominion*, Wellington, 4 September 1997, p15.

<sup>209</sup>See, for example, *Re Woodpulp* [1985] 3 CMLR 474.

account of the unique features of oligopolies. There is evidence that some oligopolistic markets, such as that for the retail sale of petrol, are not competitive, and are thus operating at lower than optimal efficiency, resulting in significant transfers of wealth from consumers to producers as well as "dead weight" losses. This certainly conflicts with the purpose of the *Commerce Act*, as spelt out in the Long Title, and in cases like *Tru Tone Ltd*<sup>210</sup> and *Union Shipping NZ Ltd*<sup>211</sup> - to promote competition, and so to encourage market efficiency and enhance consumer welfare.

It is submitted that, when the *Commerce Act* was enacted, the intention was that a *Continental Can*-type test should be applied to the concept of "dominance" in New Zealand cases. Indeed, the Department of Trade and Industry in its background paper on the Bill, referred extensively to the case and stated that although new to New Zealand, "the meaning and scope of the concept have been clarified by the case law of the European court". Such an interpretation, while not assuring the application of s 36 to "jointly dominant" oligopolies, certainly allows for the possibility. The application of the similarly phrased European and United States merger control provisions to joint dominance is now firmly established, without condemning oligopolies per se, an approach in line with the light-handed New Zealand view of the significance of market structure. A definition of dominance which discounts the possibility of joint anticompetitive behaviour among oligopolists, such as that adopted in the *Telecom* decision,<sup>212</sup> appears contrary to the purpose of the Act. The effects of misusing a dominant position, whether that dominance is solely or jointly held, are equally anticompetitive.

Similarly, the approach to collusion favoured in the United States and Australia - to require evidence of communication between the allegedly colluding parties before liability will arise, economic evidence notwithstanding - also appears to be at odds with the objectives of competition law. The European approach relies much more on the anticompetitive outcomes of apparently collusive behaviour (rather than the means by which it is put into practice), recognising that it is these effects that competition law is aimed at curbing, although allowing

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<sup>210</sup>[1988] 2 NZLR 352, 358.

<sup>211</sup>[1990] 2 NZLR 662, 699.

<sup>212</sup>[1992] 3 NZLR 429, 434 and 442.

for the possibility of alternative explanations. The objectives of the *Commerce Act* would, it is suggested, be better served if such an approach was adopted in New Zealand, particularly in cases involving oligopolistic industries.



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