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UNILATERAL MISUSE OF MARKET POWER
SECTION 36 OF THE COMMERCE ACT 1986

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Abstract

Section 36 of the Commerce Act prohibits persons that possess a dominant market position from using that dominance for the purpose of restricting, preventing, deterring or eliminating competition. This provision has, however, proved troublesome to interpret and apply, with one of the more contentious issues being the search for a consistent approach that can be used to identify and define when trading behaviour ceases to be merely competitive behaviour, and should be characterised as an anticompetitive misuse of market power.

The object of this paper is to examine and appraise how the New Zealand judiciary has proceeded to distinguish anticompetitive conduct in applying section 36 of the Commerce Act 1986.

The paper is in three parts. Part I explores the theory underlying the prohibition against unilateral misuse of market power, and also includes an examination of the approach adopted in the United States of America, a jurisdiction regarded as being at the forefront of competition law. Part II examines and comments on New Zealand case law. And Part III discusses some of the more contentious issues to have evolved from the application of section 36 of the Commerce Act 1986 to unilateral misuse of market power.

The text of this paper comprises approximately 17,700 words.

I. Unilateral Misuse of Market Power

A. Introduction

The purpose of New Zealand's Commerce Act 1986 (the "Act") is stated as, "An Act to promote competition in markets within New Zealand...". In line with conventional opinion, the New Zealand Government considered that market-competition was a means to foster and encourage an efficient use of society's resources. The central pillars of this notion are, first, that free and open market competition encourages producers to direct their production activities in response to consumer signals; and second, that firms, when faced with actual or potential competition, will, in the interests of maximising profit, seek to reduce the costs of production, and enhance product offerings.

It is the goal of competition law to ensure that the competitive market continues to operate (relatively) freely and unencumbered. In carrying out this role, the Act prohibits certain trade practices (including price fixing, resale price maintenance, and misuse of a dominant market position), and establishes a test for culling out mergers and acquisitions that would result in persons obtaining or strengthening potentially anticompetitive levels of market power. The Act also provides for price control to be imposed where consumer detriment results from a lack of competition in specific markets.

Section 36 of the Act prescribes for a restrictive trade provision colloquially referred to as 'misuse of a dominant market position'. This provision prohibits persons that possess a dominant market position from using that dominance for the purpose of restricting, preventing, deterring or eliminating competition. This provision has, however, proved troublesome to interpret and apply. One of the more troublesome matters concerning the application of section 36 of the Act has been the search for a consistent approach that can be used to identify and define when trading behaviour ceases to be merely competitive behaviour, and could be characterised as an

anticompetitive misuse of market power. Judge Frank Easterbrook of the American Supreme Court described the difficulty as following:¹

Aggressive, competitive conduct by a monopolist is highly beneficial to consumers. Courts should prize and encourage it under the antitrust laws. Aggressive exclusionary conduct by a monopolist is deleterious to consumers. Courts should condemn it under the antitrust laws. There is only one problem: competitive and exclusionary conduct often look alike.

As Judge Frank Easterbrook suggests, the matter of delineating between competitive and anticompetitive conduct is not always clear-cut. The intention of this paper is to examine how the New Zealand judiciary has sought to distinguish competitive from anticompetitive behaviour in applying section 36 of New Zealand's competition statute. This paper will initially address the rationale for competition law, particularly the misuse of market power prohibition, and then complete a more detailed examination of the judicial approach adopted in New Zealand. The paper also surveys and contrasts the approach adopted in the United States of America, a jurisdiction that is often recognised as the birthplace of contemporary competition law.

The New Zealand Government is presently considering amendments to New Zealand's Commerce Act, including section 36 of the Act. Accordingly, in addition to forming some conclusions on the present application of section 36, I will also take the opportunity to comment on the proposed amendments, and their anticipated effect.

B. Why Regulate for Competition?

We should regulate where that regulation enhances the efficiency with which resources are allocated. We should not regulate for competition if that regulation lessens the efficiency with which resources are allocated

Philip L. Williams²

Obviously, the goal of competition law is to promote competition in the market place. But what actually is competition, and what benefits does it bring?

¹ "On identifying Exclusionary Conduct", (1986) 61 Notre Dame L. Rev., 972.

² Philip L. Williams, "Why Regulate for Competition?", in Michael James (ed), *Regulating for Competition? Trade Practices in a Changing Economy*, Published by the Centre for Independent Studies Limited (1989).

When using the word 'competition' we generally mean it in terms of rivalry, or a contest. Perhaps a running race, or a chess tournament, where participants challenge each other for the spoils of victory. Such an understanding equally applies to the concept of competition in the market place, where market participants rival each other for custom, and a larger share of the available profits.

Why then do governments seek to encourage competition? Robert Bork suggests that when discussing the desirability of competition it is things such as low prices, innovation, and choice among differing products that we have in mind.³ These are the benefits that accrue to society as a result of market participants battling it out in an attempt to secure a larger share of the available profits. Such considerations certainly seem desirable outcomes for a government to strive for, and admirable goals for competition law.

Areeda and Turner suggest that antitrust laws, through fostering 'competition', make a substantial contribution to economic performance in two important respects.⁴ First, such laws encourage efficiency in the use and allocation of economic resources (referred to as allocative efficiency); and second, antitrust laws foster the development of more efficient production techniques, and new and improved products and services.

How does this notion of 'allocative efficiency' work? It is generally accepted that in freely competitive market economies, consumers, through their purchase decisions, influence the economy's production decisions so that production reflects what society values. However, consider what might result from a shift in consumer preferences. Such a shift might initially result in increased demand for a particular product, leading to higher prices for that product, and higher than average (supernormal) profits being earned by producers of that product. Other producers, in seeking a share of the supernormal profits, may then choose to redirect their production to meet the increased demand for this product. Theoretically, producers will continue shifting into areas that earn supernormal profits, and expand production, until the industry

³ Robert.H.Bork, *The Antitrust Paradox - A policy at war with itself*, (1993), Free Press, New York.

⁴ Phillip E. Areeda and Donald F Turner *Antitrust law : an analysis of antitrust principles and their application*, Little Brown and Company, Boston.

once again delivers average profits (marginal cost equates with marginal revenue), and consumers once again pay a true market equilibrium price. In essence, the concept of allocative efficiency is a consequence of market economies and low market entry barriers. Antitrust laws can contribute by encouraging competition 'within' markets, as well as ensuring that potential entrants are not unduly prevented from 'entering' any markets.

What about the notion of competition encouraging the development of efficient techniques and improved products and services (as Areeda and Turner also suggest)? These benefits basically derive from the fact that rational firms engage in commerce for the purpose of earning profit. In the interests of maximising profit, and being faced with competitors (and potential competitors), rational firms have incentives to develop new and improved products in order to retain and attract custom. Similarly, firms also have incentives to develop more efficient production and operational processes, as reducing these costs leads to higher profit margins.

It is for these reasons that governments decide to regulate for competition. Competition creates incentives for the market mechanism to better allocate society's resources, and also fosters the development of innovative products, and more efficient production practices. In essence, competition enhances the efficiency with which society's resources are allocated and utilised. Such considerations go to the heart of the most basic of economic questions, that being, how can society make the best use of its scarce resources?

However, won't competition naturally manifest in market economies? This is not necessarily so. As intimated above, rational people engage in business to earn profits. Obviously, engaging in competition is one of the ways that businesses can increase their profits, however, it is not necessarily the surest or most profitable strategy. For instance, businesses may, through subverting or suppressing competition, attain the ability to extract higher profits than would be possible in a competitive market. For example, through forming an alliance with its competitors, a business may create a defacto monopoly market structure, where competitors may agree to sell at higher than market equilibrium prices, and consequently earn higher profits. To similar effect, businesses may choose to acquire competitors, or perhaps

engage in threatening and intimidating conduct designed to drive competitors from the market. By successfully engaging in such strategies businesses are potentially able to extract higher profits than would exist in a competitive market, while also avoiding the pitfalls associated with aggressive competition. Consequently, in the interests of maximising profits, and in the absence of competition law, businesses, if given the choice, are very likely to adopt anticompetitive. Accordingly, governments form the view that competition may not actually naturally manifest in market economies, and consider it necessary to actually 'regulate' for competition.

C. Rules Targeting Unilateral Misuse of Market Power

Yvonne van Roy states that the object of section 36 of the Commerce Act is to prevent dominant firms from using the market power which arises from their dominant position for anti-competitive purposes.⁵ However, what is anticompetitive use of market power?

Clearly, rules that target 'misuse of market power' only apply to those who actually possess market power. The simple objective of such rules is to prevent firms from engaging in conduct designed to frustrate and obstruct the competitive process, as opposed to competing on commercial merits. In this regard, firms that do not possess market power do not raise much concern. This is because they are perhaps unlikely to be successful in engaging in strategies to deter or eliminate competitors, and subvert the competitive process. Indeed, it is very likely that competitors would have the capabilities to successfully respond to any such offensives. Accordingly, if a firm does not possess market power, then the rules pertaining to misuse of market power place no constraint on how that firm conducts its business affairs.

However, firms with market power may be able to use their market presence in attempting to deter or eliminate competitors, and may arguably possess, or acquire, the ability to dictate terms to the marketplace. For instance, if a powerful market incumbent was successful in eliminating competitors, then it may be able to, with relative impunity, restrict 'market' output, and increase prices.

⁵ *Guidebook to New Zealand Competition Laws*, (1991) CCH New Zealand Ltd, para 714.

It is important to recognise, however, that whether or not a firm is able to restrict market output, or increase market prices, is not actually relevant to the application of section 36 of the Commerce Act. Analysis under section 36 confines itself to a firm's combative strategies, as opposed to whether the firm is extracting monopoly profits, or not, and asks only whether a firm's conduct could be characterised as anticompetitive. (Indeed, the fact that a firm may be extracting monopoly profits could be argued as pro-competitive, as in normal circumstances the existence of supernormal profits would perhaps attract competitors to enter the market.)

Section 36 does not prohibit the actual 'possession' of market power (or even monopoly power). It would be undesirable if this was so, as sometimes market forces may actually dictate that a monopoly is the most efficient structure for serving a market. This is perhaps especially so with an economy as small as New Zealand's, where it is quite likely that a number of goods and services may be more appropriately (and efficiently) provided by (near) monopolists.⁶ Accordingly, it would certainly not be desirable for the Commerce Act to prohibit the mere possession of market power. Consequently, firms are freely able to develop and acquire market power through (deemed) competitive means, such as superior performance, and market efficiencies.

It is important to appreciate the requirement that such rules, while preventing anticompetitive behaviour, do not act to prohibit or discourage dominant firms from engaging in efficient (even if aggressive) legitimate competitive conduct. For society actually benefits from dominant firms engaging in competition, through lower prices, innovation, and a better choice of products. And given that Parliament's intention in enacting the Commerce Act was to promote competition, it would be a particularly unsatisfactory outcome if decision-makers shied away from aggressively competing because of the inappropriate targeting of section 36, or because firms had a (mistaken) fear, or lack of assurance, as to the provision's actual application. Accordingly, it is

⁶ The Department of Trade and Industry recognised this issue, stating: "...indeed, dominant firms may often be the most efficient structure in terms of both supply of the local market and export competitiveness." DTI letter to Parliamentary Select Committee, 7 October 1985.

crucial that decisions made pursuant to section 36 are economically sound, as well as possess a high degree of certainty and consistency.

Neither does the fact that some competitors may actually be forced out of business necessarily raise any section 36 issues. After all, a natural consequence of competition is that there are usually losers, as well as winners. What section 36 does prohibit, is the 'abuse' of market power.

Typical of the conduct that may constitute misuse of market power, as opposed to competing on merits, could be erecting barriers that obstruct or deter potential competitors from entering a market. For example, denying access to an essential element that competitors require in order to compete, or perhaps instigating spurious legal challenges to obstruct a potential competitor from establishing a competing plant, may, in certain circumstances, be examples of conduct that would constitute misuse of market power. Predatory pricing⁷ is also another example of conduct that may constitute misuse of market power. In terms of unilateral misuse of market power, anticompetitive conduct is conduct designed to frustrate, as opposed to partake in, the competitive process. In the language of section 36 of the Act, it is a use of market power for the purpose of restricting preventing, deterring or eliminating competition.

Paradoxically however, the examples of anticompetitive conduct in the preceding paragraph, may, dependant on the circumstances, also be examples of 'acceptable' competitive conduct. This goes to the heart of the problem of identifying anticompetitive use of market power. That is, how to distinguish anticompetitive (and ultimately inefficient) conduct from efficiency enhancing competitive conduct. What defines when a firm goes beyond merely acting as one of the forces that shape a market, to where the firm's conduct could perhaps be argued to constitute unduly manipulating the market. For example, consider a firm that significantly slashes the price of its product. The firm may argue that it has engaged in price-cutting to

⁷ Essentially, predatory pricing is where a firm engages in a practice of below-cost pricing to drive out competitors (and deter potential competitors), with a view to increasing its prices and recouping losses once competitors have been eliminated and/or deterred.

increase its market share - a legitimate business strategy. However, the firm's competitors may allege something more sinister, suggesting that the firm slashed its prices to drive them out of business. What is the answer? The problem is that a conclusion of competitive conduct is as equally plausible as a conclusion of anticompetitive conduct.

Determining such matters is further complicated by the general absence of incontrovertible evidence. A 'smoking gun' is not readily apparent, and confessions are rarely offered. Conclusions must often be drawn from external observation. And unfortunately, as demonstrated above, external observation of a firm's conduct may not always enable a compelling conclusion, one way, or the other.

So how are we to determine when a firm's conduct constitutes a misuse of market power?

D. The United States and Unilateral Misuse of Market Power

Many of the principles that underlie today's antitrust laws were conceived in the United States of America ("United States") towards the end of the 19th century. In terms of unilateral misuse of market power, one of the more significant milestones was the passing of the Sherman Act in 1890, a statute that forms the basis for today's generally accepted approach to anticompetitive use of market power.

The Sherman Act 1890 was specifically intended to address the matter of aggregation of capital and the helplessness of individuals before it. Section 2 of the Sherman Act 1890 declared monopolisation as illegal, and shares some similarities with section 36 of the Commerce Act (as discussed later). Section 2 of the Sherman Act states:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanour...

Given its long history of dealing with antitrust matters, an examination of the approach adopted in the United States to determining misuse of market power provides some useful background to a study of how New Zealand deals with the issues.

Determining a Breach of Section 2 of the Sherman Act 1890

As evident, the prohibition in section 2 captures both monopolising, and attempting to monopolise. The courts have added gloss to the section over the years, with today's approach having its foundation in the 1966 Supreme Court decision, *United States v Grinnell Corp.*⁸ In laying down the foundation for the current approach to misuse of market power, the Supreme Court defined illegal monopolisation as requiring two distinct elements. First, the possession of monopoly power in the relevant market; and second, the wilful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.⁹ Hoverkamp restates the second requirement as showing that a defendant had 'exercised' monopoly power.¹⁰

However, little guidance as to what actually constitutes 'exercising' monopoly power is given. Some assistance may be gleaned from the judgement in *United States v United Shoe Machinery Corp.*¹¹ In that case the Court suggested that 'exclusionary behaviour' (exercising market power) involves practices that deter potential rivals from entering a market, or deter existing rivals from increasing output. However, such an explanation is still not ideal, as obviously not all behaviour that deters competitors should necessarily be classified as anticompetitive. This ambiguity perhaps aptly demonstrates the difficulty inherent in interpreting and applying such antitrust provisions.

How then have the courts in the United States sought to distinguish a monopolist's 'exclusionary practices' worthy of condemnation from those that should be permitted? One of the more significant developments for doing so evolved from the Supreme Court decision in *Standard Oil Co. of N.J v United States*¹². In determining whether *Standard Oil* had exercised its monopoly power, the Court adopted an approach based

⁸ *United States v Grinnell Corp.* 384 U.S. 563, 570-71, 86 S.Ct. 1698, 1704 (1966).

⁹ *United States v Grinnell Corp.* above n 8, 570-71.

¹⁰ Herbert Hovenkamp *Economics and Federal Antitrust Law* (1985) West Publishing Co., page 137.

¹¹ *United States v United Shoe Machinery Corp* 110 F.Supp. 295 (D.Mass.1953), affirmed per curiam, 347 U.S. 521, 74 S.Ct. 699 (1954).

¹² *Standard Oil Co. of N.J v United States*, 221 U.S. 1, 31 S.Ct. 502 (1911).

on the 'rule of reason'. Chief Justice White stated that the law prohibited as illegal all contracts or trading activity that were:¹³

... unreasonably restrictive of competitive conditions, either from the nature or character of the contract or act, or where the surrounding circumstances were such as to justify the conclusion that they had not been entered into or performed with the legitimate purpose of reasonably forwarding personal interest and developing trade...

The Court's inquiry concerned identifying whether the conduct had been entered into for the legitimate purpose of forwarding business. The Court, after assessing the relevant circumstances, would be expected to make a decision based on 'reason'. Justice Stevens, in the *National Society of Professional Engineers case*, discussed the 'rule of reason':¹⁴

Congress, however did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the Courts to give shape to the statute's broad mandate by drawing on common law tradition. The rule of reason with its origins in common-law precedents long antedating the Sherman Act has served that purpose. It has been used to give the Act both flexibility and definition and its central principle of antitrust analysis has remained constant. Contrary to its name, the rule does not open the field of antitrust inquiry to any argument in favour of a challenged restraint that may fall within the realm of reason. Instead it focuses directly on the challenged restraints impact on competitive conditions.

Hoverkamp suggests that the contours and confines of the 'rule of reason' are rather ambiguous. He suggests that in effect, the 'rule of reason' simply empowers courts with the judicial discretion to analyse the conduct in question, and determine whether the conduct had been entered into, or performed, with the legitimate purpose of reasonably forwarding business interests, as opposed to being engaged in for reasons that result in detriment to consumers.¹⁵

Legitimate Business Justification

The most recent United States development in determining the matter of misuse of market power involves the evolution of the defence of 'legitimate business justification'. The development of this defence stems from two relatively recent

¹³ A.D. Neale & D.G. Goyder, *The Antitrust Laws of the U.S.A.*, (1980) Third edition, Cambridge University Press, page 27.

¹⁴ *National Society of Professional Engineers v U.S.*, 435 U.S. 679, 98 S.Ct 1355 (1978).

¹⁵ Herbert Hovenkamp *Economics and Federal Antitrust Law* (1985) West Publishing Co., page 142.

decisions of the Supreme Court.¹⁶ *Aspen Skiing Co. v Aspen Highlands Skiing Corp.*,¹⁷ and *Eastern Kodak Co. v Image Technical Services*.¹⁸

Aspen Skiing v Aspen Highlands

Aspen Highlands filed a complaint alleging that *Aspen Skiing*, in breach of section 2 of the Sherman Act 1890, had monopolised the market for downhill skiing services at Aspen. What *Aspen Skiing* had done was to discontinue its sale of the all-Aspen ticket (Which enabled access to *Aspen Skiing's* and *Aspen Highlands's* ski fields) and instead had sold a multi-lift ticket that only enabled access to its own (three) ski areas.

The District Court Judge instructed the jury to consider whether *Aspen Skiing* had violated section 2 of the Sherman Act by wilfully acquiring, maintaining, or using monopoly power by anti-competitive or exclusionary means, or, for anti-competitive or exclusionary purposes. The District Court Judge elaborated:¹⁹

In considering whether the means or purposes were anti-competitive or exclusionary, you must draw a distinction here between practices which tend to exclude or restrict competition on the one hand and the success of a business which reflects only a superior product, a well-run business, or luck, on the other.

...

If there were legitimate business reasons for the refusal, then the defendant, even if he is found to possess monopoly power in a relevant market, has not violated the law. We are concerned with conduct which unnecessarily excludes or handicaps competitors. This is conduct which does not benefit consumers by making a better product or service available-or in other ways-and instead has the effect of impairing competition.

The Jury found the offence proved. On appeal, the Supreme Court unanimously upheld that the District Court Judge's instruction to the jury was correct, and concluded that the evidence supported the Jury's finding that there were 'no valid reasons' for *Aspen Skiing* refusing to deal with *Aspen Highlands*.²⁰

¹⁶ Mark N Berry *The Uncertainty of Monopolistic Conduct: A Comparative Review of Three Jurisdictions*, pending publication.

¹⁷ *Aspen Skiing Co. v Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1984).

¹⁸ *Eastern Kodak Co. v Image Technical Services* 504 U.S. 451 (1992).

¹⁹ *Aspen Skiing Co. v Aspen Highlands Skiing Corp.* above n 17, 596.

²⁰ *Aspen Skiing Co. v Aspen Highlands Skiing Corp.* above n 17, 611.

The legacy of *Aspen Skiing v Aspen Highlands* is that the Court expressly chose to address whether the defendant could provide a 'legitimate business justification' for its conduct.

Eastern Kodak v Image Technical Services

The next significant milestone in the development of the defence of 'legitimate business justification' was *Eastern Kodak v Image Technical Services*. The respondents were independent service organisations ("ISOs"), and were involved in servicing copying and micrographic equipment manufactured by *Eastern Kodak*. *Eastern Kodak* then adopted policies to limit the availability of replacement parts to ISO's, making it difficult for them to compete in servicing *Eastern Kodak's* copying and micrographic equipment. The respondents alleged breach of sections 1 and 2 of the Sherman Act. With regard to section 2, the respondents alleged that *Eastern Kodak* had unlawfully monopolised, and also attempted to monopolise, the sale of service and parts, for *Eastern Kodak's* machines.

The District Court had granted summary judgement for *Eastern Kodak*, but this was overturned by the Court of Appeal.

The Supreme Court majority, after restating the elements for monopolisation as laid down in *United States v Grinnell Corp*, held that the respondents had indeed presented sufficient evidence demonstrating that *Eastern Kodak* had taken 'exclusionary' action to maintain its parts monopoly, and that *Eastern Kodak* had used its control over parts to strengthen its monopoly share of the service market. Notably, the majority judgement then stated, "Liability turns, then, on whether 'valid business reasons' can explain Kodak Co.'s actions."

In defence of its conduct, *Eastern Kodak* proffered three business justifications. These were, (1) to promote interbrand equipment competition by allowing *Eastern Kodak* to stress the quality of its service, (2) to improve asset management by reducing *Eastern Kodak's* inventory costs, and (3) to prevent ISOs from free riding on *Eastern Kodak's* capital investment in equipment, parts and service.

The Supreme Court (majority) decided that *Eastern Kodak's* asserted business justifications were insufficient to prove that it was entitled to judgement.

The Development of Common Law Rules

Another interesting development in the United States judiciary's approach to misuse of market power has been the evolution of (common law) rules pertaining to a variety of specific trade practices that the courts have deemed as illegal monopolisation per se. Thus, specific tests have been developed for practices as price discrimination, predatory pricing, tying arrangements, vertical integration, and refusals to deal. Although the underlying basis for addressing these trade practices is still the Sherman Act 1890, the courts have developed these supplementary rules to assist with identifying and classifying anticompetitive conduct. For example, the doctrine of 'essential facilities' provides that where facilities cannot practically be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms. And the doctrine of 'predatory pricing' prohibits firms from driving rivals out of business by selling at below cost. These supplementary rules enable the courts to approach some of the more frequently encountered antitrust issues with a degree of certainty and consistency, and also serve to signal to businesses some of the particular trade practices that fall foul of the Sherman Act.

Conclusion

In determining when a business has misused its dominant market position the United States judiciary apply a three-stage test. First, does the defendant possess monopoly power in the relevant market? Second, has the defendant engaged in 'exclusionary' conduct? (i.e. the wilful acquisition or maintenance of that monopoly power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident). And third, is the defendant able to provide a 'legitimate business justification' for engaging in the conduct?

However, even with its rich history of dealing with matters concerning misuse of market power, the approach adopted by the United States courts to determine misuse of market power still seems to carry an unsatisfactory degree of uncertainty. Application of the 'rule of reason' is arguably largely dependent on subjective analysis, in that matters are generally determined by whether the presiding 'judge'

considers that the conduct is 'reasonable' in the circumstances. Such an approach does not perhaps adequately enable those in the boardroom to implement commercial strategies with the desired degree of certainty that an allegation of monopolisation will not follow. (Although the development of supplementary rules do provide decision makers with some extra degree of assurance.)

Despite this criticism however, the question asked by the courts, that being, has the defendant engaged in the conduct for the legitimate purpose of reasonably forwarding personal interest and developing trade, is to be applauded for its obvious relevance. Such a line of inquiry certainly seems to carry merit in determining whether a person has engaged in anticompetitive conduct. In addition to this, the development of the 'legitimate business justification' defence also appears to be a sensible advance, seemingly providing for a logical and fair approach to determining whether market power has been abused.

II. The New Zealand Approach to Unilateral Misuse of Market Power

[The prohibition in section 36 of the Commerce Act 1986 (the "Act") applies to persons who hold a dominant position in a market. Person is defined in the Act as including a local authority, and any association of persons whether incorporated or not. In this paper, I have not confined myself to using the term person(s), choosing instead to refer to person(s), firm(s), producer(s) or business(es) on the basis that some of the examples and discussion lend themselves more appropriately to the use of one term over the others.]

A. Introduction

New Zealand's prohibition against unilateral misuse of market power is found in section 36 of the Commerce Act 1986. The provision is substantively based on section 46 of Australia's Trade Practices Act 1974, and reads:

- 36 Use of dominant position in a market**
 No person who has a dominant position in a market shall use that position for the purpose of-
- (a) Restricting the entry of any person into that or any other market; or
 - (b) Preventing or deterring any person from engaging in competitive conduct in that or any other market; or
 - (c) Eliminating any person from that or any other market.
-

Although modelled on Australia's provision, there are some obvious differences in the language used in the New Zealand provision.²¹ However, despite these differences in language, the Australian and New Zealand courts have generally developed their approach to their respective provisions in tandem, with both jurisdictions willingly seeking assistance from each others decisions.

Reflecting the present concerns with section 36 of the Act, the parliamentary debate that took place on the introduction of the provision drew attention to the inherent difficulty in distinguishing aggressive competition from anticompetitive conduct, and canvassed fears that clause 36 of the Bill might end up curtailing big business in New Zealand.²² As initially introduced, establishing a breach of clause 36 required proving two distinct elements. First, that a defendant held a dominant market position, and second, that a defendant had acted with a culpable (anticompetitive) purpose (ie. to restrict, prevent, deter or eliminate competition.).

However, as the elimination of smaller competitors is perhaps an inevitable consequence of competition, fears were expressed that the provision as it stood might result in large companies facing the possibility of legal action (and claims for compensation) from competitors that may have been forced out of business merely as a result of general market conditions. In response to these concerns, the Select Committee reformulated clause 36 of the Bill so that it was made clear that a culpable party must have 'used' its market power to restrict, prevent, deter or eliminate competition. Accordingly, in conducting an examination of section 36 it is helpful to consider the three distinct limbs: whether a person holds a dominant position in a market; whether a person has 'used' that dominant position; and whether a person has acted for one of the proscribed 'purposes'.

²¹ The most obvious distinction is that the Australian provision refers to "take advantage of a substantial degree of power in a market", as opposed to New Zealand's, "use a dominant position in a market".

²² For instance, see Bolger, 11 June 1985, page 4683.

B. Holding a Dominant Position in a Market

It is important to reiterate that the section 36 prohibition only applies to persons who hold a dominant position in a market. However, the actual definition and application of the concept of 'dominance' has been contentiously litigated throughout the history of the Act. Parliament's use of such an imprecise term has fuelled the need for such comprehensive debate. Much has been written on 'dominance', and in this paper I do not intend to discuss the concept at any great length.

Section 3(8) of the Commerce Act specifies factors to be considered in determining when a person may hold a 'dominant position in a market'. It states that a 'dominant position in a market' constitutes having the ability to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market. To determine this, the Act requires a consideration of market share, technical knowledge, and access to materials and capital. The Act also requires an examination of the constraint placed on the entity by competitors and potential competitors. Essentially, the 'dominance' requirement exists to ensure that the section 36 prohibition only applies to a person who is in a position to act independently of rivals, or potential rivals.

As intimated above, the concept of 'dominance' has been extensively litigated, with many commentators suggesting that the current interpretation is narrower than what Parliament actually intended, resulting in a relatively restricted application of section 36.²³ A strict (narrow) interpretation obviously removes a number of businesses from the ambit of the section. In contrast, a broad definition of 'dominance' extends section 36's coverage to a wider gamut of businesses than Parliament would perhaps have intended. The interpretation given to 'dominance' clearly has a very significant impact on the efficacy of section 36.

Why limit the application of section 36 to companies that hold a dominant market position? As indicated earlier, it is natural that when commercial organisations engage in competition they plan to make it more difficult for competitors to be

²³ For instance, see Yvonne van Roy *The Privy Council decision in Telecom v Clear: Narrowing the application of s 36 of the Commerce Act 1986*, *New Zealand Law Journal* (February 1995), page 54.

profitable. In the normal course of business, if a firm without market power engaged in conduct aimed at obstructing or deterring competitors, then it is very likely that competitors would respond. The ensuing struggle is indicative of a desirable competitive market situation. In contrast however, firms that do possess dominant market positions may be capable of actually driving competitors from the market, or deterring potential competitors from entering the market. Using the clout that stems from possessing market power, such firms may in fact be able to significantly influence the structure, and operation, of the market. Accordingly, the Government has formed the view that only firms that possess a significant degree of market power (a dominant position in a market) should be subjected to the section 36 restrictions on how they may conduct themselves.

What does dominant market position actually mean? Early New Zealand High Court discussions on 'dominance' referred with approval to the approach adopted by the European Community Commission in *Re Continental Can Inc.*²⁴ In delivering this decision the European Community Commission emphasised 'dominance' as the power to behave independently; and being able to act without taking into account competitors, purchasers or suppliers. A similar approach was adopted by the Commerce Commission with regard to business acquisitions; interpreting dominant position as, "having sufficient market power to enable the dominant party to behave to an appreciable extent in a discretionary manner without suffering detrimental effects in the relevant market(s)".²⁵ Such an approach has been labelled the 'economic approach'. In accord with this approach, the New Zealand High Court in *Telecom v Commerce Commission*²⁶ equated dominance with 'high market power'.

However, The Court of Appeal in *Telecom v Commerce Commission*²⁷ rejected the 'economic approach' for determining 'dominance' and adopted a standard derived from the dictionary meaning of the word, equating 'dominance' to 'commanding' or 'ruling'.

²⁴ *Re Continental Can Inc.* [1972] CMLR D11.

²⁵ *Re Proposal by Magnum Corp Ltd* (1987) NZBLC (Com) 104,073.

²⁶ *Telecom Corporation of New Zealand v Commerce Commission* (1991) 4 TCLR 473,509;(1991) 3 NZBLC 102,340, 102,368

²⁷ *Telecom Corporation of New Zealand v Commerce Commission* (1992) 3 NZLR 429.

This is generally understood to be a higher standard to satisfy than the High Court's 'high market power'. For example, only one firm may command or rule a market, whereas more than one firm may possess high market power. Despite widespread criticism of the 'dictionary' interpretation of 'dominance', this approach has since been expressly recognised as binding in law.²⁸ And, as evident, the interpretation given to 'dominance' does have a significant impact on the effective application of section 36 of the Commerce Act. (However, the Minister of Economic Development has signalled an intention to replace the present 'dominance' threshold (Discussed later)).

C. Using Dominance for a Prohibited Purpose

A firm that satisfies the section 36 dominance requirement is subject to constraints on how it may behave. One would expect that section 36 would not prohibit a person from utilising superior business acumen and resources to grow market share. Nor would it be expected that a person was precluded from taking advantage of economies of scope, or economies of scale, or engaging in aggressive competition, even if it did result in restricting opportunities for competitors.

As a literal reading of section 36 of the Act suggests, a firm cannot use its dominant market position for the purpose of restricting, preventing, deterring or eliminating competition. It is now generally agreed that two distinct elements are born out of this behavioural restriction; first, 'use of a dominant position', and second, doing so for a 'prohibited purpose'. However, the relative emphasis and interrelationship of the two elements has proved to be a little uncertain, even today. What does section 36 of the Act actually prohibit? And what does anticompetitive use of market power actually mean?

It is with a view to shedding light on these questions that this paper proceeds to examine some of the more significant decisions made pursuant to section 36 of the Act. The following analysis will hopefully provide some insight into where the 'line' that distinguishes legitimate from illegitimate exercise of market power has been drawn, and illuminate some of the methodologies that the courts have employed to determine when that 'line' has been crossed.

²⁸ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 442.

*Auckland Regional Authority v Mutual Rental Cars*²⁹

The first New Zealand case to substantively discuss section 36 of the Act was *Auckland Regional Authority v Mutual Rental Cars*. *Mutual Rental Cars* argued that through limiting the number of rental car providers at Auckland Airport (to two), *Auckland Regional Authority* was acting in breach of sections, 27, 29 and 36 of the Act. *Auckland Regional Authority* commenced proceedings, seeking declarations on the matter.

Barker J held that *Auckland Regional Authority* did possess a dominant market position,³⁰ and then proceeded to discuss the American doctrine of 'essential facilities'³¹. After considering the merits of this doctrine, Barker J stated:³²

...exclusion from that market by means of the gateway, prima facie indicates anti-competitive intention unless the exclusion can be explained by reference to *reasonable constraints in the circumstances*: an agreement to exclude others arbitrarily must be taken as having the purpose to monopolise.

.....

The availability of space, level of service proposed for the public, and other considerations will operate as *reasonable constraints*. ...ARA does not currently advance any constraints of space etc as its reasons for refusing to treat with budget.

Barker J concluded that *Auckland Regional Authority* had breached sections 27, 29 and 36 of the Commerce Act. Two significant developments for the application of section 36 emerged from this decision. First, Barker J seemed to import the American doctrine of 'essential facilities' into New Zealand law. And second, more importantly for the scope of this paper, Barker J ultimately distinguished between competitive and anticompetitive conduct on the basis that *Auckland Regional Authority* had not provided any 'reasonable constraints' for its refusal to grant *Mutual*

²⁹ *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647; (1987) 2 TCLR 141; (1988) 2 NZBLC 103,041.

³⁰ *Auckland Regional Authority* held a dominant position in the market for rental car operators at Auckland Airport.

³¹ This doctrine states that where facilities cannot practicably be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms. The 'essential facilities' doctrine is one of a number of common law developments in American antitrust law.

³² *Auckland Regional Authority v Mutual Rental Cars* above n 29, 175.

Rental Cars a licence. In effect, Barker J simply asked whether the conduct was reasonable in the circumstances.

It is also interesting to note that Barker J did not actually consider 'use' of dominance as an issue to be determined, however, this may be because of his reliance on the American 'essential facilities' doctrine.

Queensland Wire v Broken Hill³³

In 1989 the High Court in Australia was called upon to consider the term 'take advantage of' in section 46 of the Australian Trade Practices Act 1974 (The Australian equivalent to New Zealand's section 36). The Court concluded that the term simply meant 'use', and did not require a finding of hostile intent, or abuse. Significantly, however, the Court carried out a separate inquiry to determine whether 'use' had been shown.

The Australian Trade Practices Commission has restated the test for 'use of market power' that emulated from *Queensland Wire v Broken Hill*, as:³⁴

...to ask whether the corporation in question would have behaved differently if it were operating in a competitive market, ie whether its conduct was made possible by the absence of competitive conditions.

NZ Magic Millions v Wrightson Bloodstock³⁵

This was the first section 36 case to come before the New Zealand courts subsequent to the Australian High Court's judgement in *Queensland Wire v Broken Hill*. The case was brought by *NZ Magic Millions*, which sought an injunction to restrain *Wrightson Bloodstock* from holding auction sales of thoroughbred yearlings on dates which clashed with *NZ Magic Millions'* own sale dates.

Interestingly, Tipping J made no reference to *Queensland Wire v Broken Hill*, preferring to determine the matter simply in terms of *Wrightson Bloodstock's* 'purpose' when engaging in the alleged anticompetitive conduct:³⁶

³³ *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177; 83 ALR 577; ATPR 40-925.

³⁴ *Misuse of Market Power - A background paper* - February 1990, Trade Practices Commission, 27.

It is not a breach of s 36 if a person, albeit with a dominant position, simply acts in a competitive manner. It would be an irony if such conduct could be attacked because it is competition which the Act is designed to promote. However, if someone with a dominant position takes some action for a *purpose proscribed by s 36* then clearly they are using a dominant position in a manner which section 36 prohibits.

In forming his conclusion Tipping J stated that, "...Wrightson's conduct seemed *hard to justify* in economic terms unless it had an anticompetitive purpose."

The distinction between legitimate and illegitimate behaviour appeared to be dependent on whether *Wrightson Bloodstock* could substantiate its conduct (in commercial/economic terms). Tipping J concluded that as *Wrightson Bloodstock* could not justify its conduct on such grounds, then it had acted with an anticompetitive purpose.

Union Shipping v Port Nelson Ltd³⁷

The decision in *Union Shipping v Port Nelson Ltd* was delivered not long after Tipping J's judgement in *NZ Magic Millions v Wrightson Bloodstock*. It involved determining whether *Port Nelson Ltd* had breached section 36 of the Act through its efforts to require *Union Shipping* to use *Port Nelson Ltd* forklifts and employee drivers on the Nelson water front.

The judgement was delivered by McGechan J, aided by Mr G Blunt, an economist appointed to assist.³⁸ In determining the matter McGechan J initially focussed on the issue of 'proscribed purpose', and having concluded that purpose meant more than intention, and actually implied object or aim, stated:³⁹

If PNL merely sought to recover from a stevedore such as USSL a *commercially reasonable levy* in return for use of PNL wharf and back up land facilities, it would be difficult, to categorise such a demand as being for the purpose of deterring competitive conduct. It would present at least equally, as being demanded for the *legitimate business pro competitive purpose* of obtaining a reasonable return on

³⁵ *NZ Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731; (1990) 3 NZBLC 101,501.

³⁶ *NZ Magic Millions Ltd v Wrightson Bloodstock Ltd*, above n 35, Brookers Commercial Cases, unreported judgement, 43.

³⁷ *Union Shipping New Zealand Ltd v Port Nelson Ltd* [1990] 2 NZLR 662; (1990) 3 NZ BLC 101,618.

³⁸ Sections 77 and 78 of the Commerce Act provide for the appointment of lay members to assist the bench.

³⁹ *Union Shipping v Port Nelson*, above 37, 85-86.

assets. *It is only insofar as the levy exceeds the commercially reasonable that an inference of deterrent purpose is readily open.*

As evident, McGechan J appears to have addressed the matter of anticompetitive purpose in terms of what would be 'commercially reasonable' behaviour. This approach is very consistent with the line adopted in previous High Court decisions, that being to examine conduct in terms of whether it was reasonable, or could be justified.

In departure from precedent however, McGechan J then proceeded to carry out a separate inquiry into 'use of dominance' (In light of *Queensland Wire v Broken Hill*). On this matter McGechan J stated:⁴⁰

...if a person simply acts in a normal competitive fashion, as he would whether dominant or not, that person hardly can be said to be *using dominance*.

McGechan J then concluded that imposing a requirement for plant hire would be acting as would be expected in a competitive situation, and consequently, would not be use of a dominant position, but that because *Port Nelson Ltd's* demands were only possible because of its dominant position, it was in this instance, 'using' its dominant position.

Commentary

Although McGechan J carried out a separate inquiry regarding 'use of dominance', thereby endorsing the three-limbed approach to misuse of market power that had been adopted by the Australian High Court in *Queensland Wire v Broken Hill*, it is however difficult to distinguish the evidence relevant to proving 'use of dominance', from the evidence relevant to demonstrating a 'proscribed purpose'. It seems the conclusion that *Port Nelson Ltd* had charged excessive levies was central to proving anticompetitive 'purpose', as well as proving 'use of dominance'. Perhaps this interrelationship between the two elements stands as an illustration of what Gault J referred to when delivering the Court of Appeal's judgement in *Electricity Corp Ltd v Geotherm Energy Ltd*.⁴¹ In delivering the judgement his Honour suggested that

⁴⁰ *Union Shipping v Port Nelson*, above 37, 78.

⁴¹ *Electricity Corp Ltd v Geotherm Energy Ltd*. [1992] 2 NZLR 641.

although the two requirements must be kept in mind, there will be circumstances in which 'use' of the market position and the 'purpose' may not be easily separated.

Notwithstanding this confusion in separating the 'use of dominance' inquiry from the inquiry into 'purpose', the *Union Shipping v Port Nelson Ltd* case is notable for its recognition that 'use of dominance' required separate analysis in determining a breach of section 36. Despite this, however, the courts still appeared to emphasise that the 'purpose' of a defendant's conduct primarily determined the existence of a breach of section 36. Further comment from Gault J in *Electricity Corp Ltd v Geotherm Energy Ltd* perhaps typifies the then prevailing view:⁴²

The distinction between vigorous legitimate competition by a corporation with substantial market power and conduct that contravenes the section is in the purpose of the conduct. Market power can be exercised legitimately, or illegitimately.

Interestingly, the three New Zealand decisions discussed above were all determined on grounds of whether the alleged anticompetitive conduct could either be justified as legitimate business conduct, or explained as commercially reasonable conduct.

Clear Communications v Telecom (High Court)⁴³

During the 1980's the New Zealand Government deregulated a number of its statutory monopoly industries. To ensure the development of competitive trading arenas, and to discourage private regulation taking the place of government regulation, the Government placed reliance on the Commerce Act, and in particular, section 36 of the Act. The telecommunications dispute between *Clear Communications* and *Telecom* set the scene for testing the ability of section 36 to perform its intended role. Eventually reaching the Privy Council, the litigation left a potent and lasting legacy for future proceedings under section 36 of the Act.

Clear Communications entered the New Zealand telecommunications market and sought access to *Telecom's* Public Service Telecommunications Network ("PSTN"). Although *Telecom* did not dispute that it was required to provide access to

⁴² *Electricity Corp Ltd v Geotherm Energy Ltd*, above n 41 649.

⁴³ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1992) 5 TCLR 166.

competitors, including *Clear Communications*, the companies were unable to agree to the terms of that access.

The case came before Ellis J (assisted by Professor M. Brunt) at the High Court in Wellington on 8 June 1992. At trial, *Telecom* proposed a pricing model (the Baulmol Willig rule)⁴⁴ for charging access to its PSTN. The Baulmol Willig rule required *Clear Communications* to indemnify *Telecom* for the opportunity cost of allowing *Clear Communications* access to the PSTN. The opportunity cost included *Telecom's* lost profit due to *Clear Communications* servicing what were previously *Telecom* customers. *Clear Communications* particularly resented having to indemnify *Telecom* for alleged 'excessive monopoly profits', and claimed that through invoking this charging basis for interconnection to the PSTN, *Telecom* was in breach of section 36 of the Commerce Act.

Counsel for *Clear Communications* submitted that as a result of the decision in *Queensland Wire v Broken Hill*, if it could be proved that *Telecom* had engaged in conduct that was not possible in a competitive market, then a breach of section 36 was inevitable.⁴⁵ Ellis J disagreed, stating that a purpose to damage the competitive process must also be proved.⁴⁶

Ellis J then remarked on the, "... close, and perhaps inseparable aspects of *use* and *purpose*".⁴⁷ However, interestingly, in determining whether there had been a breach of section 36, Ellis J never separated the analysis of 'use' and 'purpose', instead preferring to sweep the two elements together.

Ellis J decided that failure to use an access charging basis that incorporated the incremental cost imposed on *Telecom*, and that shared the Kiwi Share Obligation,

⁴⁴ Named after its creators, Professors Baumol and Willig, the rule basically states that someone selling to a competitor the facilities necessary to provide a service that the seller could otherwise provide should demand a price equal to the revenues that would have been obtained if the seller had provided the service.

⁴⁵ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 53-54.

⁴⁶ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 54-55.

⁴⁷ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 56.

would foster the development of an uneconomic bypass, and the proliferation of uneconomic operators.⁴⁸ (This is perhaps a recognition of the wider object of the Act, that being the promotion of 'efficient' competition.)

The case ultimately seemed to turn on the lack of suitable alternative charging mechanisms put before the Court. Ellis J concluded:⁴⁹

In the end it is our judgement that implementation of the rule is more likely than the alternatives to improve competition in New Zealand telecommunications. In that case Telecom cannot be said to be using its position of dominance for the purpose of preventing or deterring Clear from engaging in competitive conduct...

It is interesting to note the Court's view on the charging basis *Telecom* had attempted to impose prior to the Baumol Willig rule. *Telecom* had initially sought to charge *Clear Communications* for access on the basis that it was treated as a PABX customer. Therefore, charging *Clear Communications* ordinary rental and traffic charges, as opposed to recognising its position as a network operator.

On discussing this charging basis, Ellis J stated:⁵⁰

...we do conclude that Telecom has till now demanded more money or contribution from Clear than it can justify. It must follow that such demands, on the basis of our interpretation of section 36 would prevent or deter Clear from engaging in competitive conduct in the national telecommunications market. It is obvious that Telecom could only do this by use of its dominant position in the market.

Note how the Court approached the issue on the basis that *Telecom* was unable to justify what the court considered were excessive charges. Note also that Ellis J, in addition to commenting on the 'purpose' of such conduct, also remarked that *Telecom* could only have behaved as it did because of its dominant position in the market. Evidently, a direct application of McGechan J's approach in *Union Shipping v Port Nelson*.

⁴⁸ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 95.

⁴⁹ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 95.

⁵⁰ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd*, CP590/91, Ellis J, 98.

*Clear Communications v Telecom (Court of Appeal)*⁵¹

On appeal, Gault J took the opportunity to restate the judicial approach to section 36:⁵²

To determine whether particular conduct involves use of a dominant position for any of the purposes specified in s 36 has been said to require consideration of whether the conduct would have been open if the party concerned were not in a dominant position - if it were in a fully competitive market. Such a test reflects the underlying purpose of the section which is to promote competition. Even monopolists are entitled to act competitively and the section must not be applied so as to constrain them. It is the purpose of the conduct which distinguishes what is proscribed from what is legitimate. If the conduct in question does not involve use of a dominant position in the market, purpose alone will not contravene. In most circumstances the use and purpose will not be easily separated and need not be.

Gault J then proceeded to develop a test that he suggested applicable to the genre of 'essential facilities' cases:⁵³

...it may be helpful in determining whether there has been use of the dominant position merely to consider whether the firm has *acted reasonably or with justification*.

Note that Gault J expressly referred to 'use' of dominance in the test he put forward. Interestingly, Gault J adopts a somewhat disconcerting approach when he further suggests that anticompetitive purpose could in fact be inferred from the inevitability of the consequences of refusing to deal except on terms that lead to a competitive disadvantage.⁵⁴

In reaching a decision, his Honour concluded:⁵⁵

...Telecom's terms for interconnection were more onerous *than could have been insisted upon in a fully competitive market*. They were not *justified*. Insistence upon them was use of Telecom's dominant position and necessarily they prevented Clear from entering the market.

Significantly, Gault J diverged from precedent in emphasising the 'use of dominance' element as the important determinant of a breach of section 36. Previously, in determining matters under section 36, 'use of dominance' had taken a somewhat

⁵¹ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413.

⁵² *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413, 429-430.

⁵³ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413, 430.

⁵⁴ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413, 437.

⁵⁵ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413, 437.

backseat to anticompetitive 'purpose'. (However, Gault J did purport to confine his analysis to cases involving 'essential facilities').

*Telecom v Clear Communications (Privy Council)*⁵⁶

Telecom then appealed to the Privy Council, which held that it had not breached section 36 of the Commerce Act. The Privy Council decided that the Baumol Willig rule did provide a proper model for demonstrating what would be charged in a contestable market.

Significantly, their Lordships affirmed that 'use of dominance' determined whether a person had acted anticompetitively. Their Lordships further indicated that a purpose to deter competition was implicit in engaging in competition. On this point, Lord Browne-Wilkinson⁵⁷ stated:⁵⁸

It is unavoidable that, as a competitor, Telecom will be seeking in one sense to *deter* Clear from competing successfully.

The Board suggested that *Telecom's* attempt to argue the non-existence of anticompetitive purpose was a hopeless task, on the grounds that it would be improbable that *Telecom* did not have the purpose to deter its bitter rival.⁵⁹

In addressing the 'use' and 'purpose' elements, Lord Browne-Wilkinson further stated:⁶⁰

If a person has used his dominant position it is hard to imagine a case in which he would have done so otherwise than for the purpose of producing an anticompetitive effect; there will be no need to use the dominant position in the process of ordinary competition. Therefore, it will frequently be legitimate for a Court to infer from the defendant's use of his dominant position that his purpose was to produce the effect in fact produced.

Their Lordships then proceeded to formulate a test for determining when dominance had not been used:⁶¹

⁵⁶ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* (1995) 1 NZLR 385; (1994) 6 TCLR 138.

⁵⁷ Lord Browne-Wilkinson delivered the judgement on behalf of their Lordships.

⁵⁸ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd*, above n 56, 154.

⁵⁹ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd*, above n 56, 155.

⁶⁰ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd*, above n 56, 154.

...it cannot be said that a person in a dominant market position "uses" that position for the purposes of s.36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.

The Privy Council, on the basis of this test, concluded that a firm in a competitive market would also use the Baumol Willig rule to seek indemnification for opportunity cost, and consequently, ruled that *Telecom* was not therefore 'using' its dominant position.⁶²

Commentary

In delivering its judgment, the Privy Council well and truly dismissed the line of New Zealand decisions that had emphasised anticompetitive purpose as the crucial determinant of a breach of section 36. The Privy Council instead recast the test for determining breach of section 36, stating that anticompetitive conduct is dependent on whether it could be proved that a defendant had 'used' market power. And further suggesting that a person is unlikely to use market power unless it is for a purpose to restrict, prevent deter or eliminate competition.

An even more significant legacy of the Privy Council's decision was the application of a hypothetical test to determine 'use of dominance'. (This aspect of the judgement has attracted significant criticism - discussed later). Prior to the Privy Council's decision, the New Zealand courts had consistently inquired as to whether a defendant could justify its conduct, or had acted reasonably. The Privy Council dismissed such an inquiry on the grounds that it would result in too much uncertainty for monopolists.

In considering the purpose of section 36 of the Act it is interesting to note the Privy Council's remarks in response to Gault J's suggestion that it would be "unrealistic" to leave the matter of monopoly profits to regulatory intervention. Gault J in fact goes

⁶¹ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd*, above n 56, 155.

⁶² Critics of the Privy Council decision suggest that in a competitive market Telecom would not be earning monopoly profits, and that in charging access based on these alleged monopoly profits Telecom is not acting in a way that a person not in a dominant position would. The Privy Council suggested that the issue of monopoly profits should be left to the price control provisions in the Commerce Act, and not to section 36.

on to state, "I cannot accept that the objects of the Commerce Act are served by a method of pricing that secures the profits of a firm in a dominant position".⁶³ This is arguably central to the Court of Appeal's finding that Telecom had breached section 36 of the Act. Their Lordships, however, in response to these remarks, suggest (rightfully) that section 36 of the Act is not concerned with monopoly rents, only competition, and that price control in Part iv of the Act exists to deal with monopoly rents.

*Commerce Commission v Port Nelson Ltd*⁶⁴

The next substantive case to come before the courts was *Commerce Commission v Port Nelson Ltd*. This case involved former *Port Nelson Ltd* marine pilots, who had established the Tasman Bay Marine Pilots Association ("TBMPA") to engage in competition with *Port Nelson Ltd* for pilotage at the Port of Nelson. *Port Nelson Ltd* responded to this initiative by; (1) refusing to hire tugs to ships that did not use *Port Nelson Ltd* pilots, (2) offering a 5% discount to port users who used the whole range of *Port Nelson Ltd* services, and (3) reducing the minimum pilotage charge for small vessels (up to 2,500 GRT) from \$200 to \$100. The *Commerce Commission* commenced proceedings under sections 27 and 36 of the Commerce Act.

Proceedings under section 36

In delivering judgement, McGechan J, despite acknowledging that the Privy Council's ruling in *Telecom v Clear Communications* had attracted criticism, ruled, that whatever the Privy Council's hypothetical test's validity in economic theory, it was however binding in law. McGechan J then proceeded to apply the test to the market for pilotage services at the Port of Nelson.⁶⁵

If, therefore, PNL is in a dominant position in the pleaded 'pilotage services market' it will not *use* that dominant position if it merely acts in the way a hypothetical firm, not in such a dominant position, but otherwise in the same circumstances, would have acted.

The Court concluded that *Port Nelson Ltd* was dominant in wharves, tugs, and through enforcing the tug-tie, also pilotage.

⁶³ *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413, 436.

⁶⁴ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406.

⁶⁵ *Commerce Commission v Port Nelson Ltd*, above at n 64, 445.

With regard to the tug-tie, McGechan J considered that a non-dominant firm would not impose such a requirement, as it would then risk losing customers. McGechan J then however suggested that there could perhaps be commercial reasons for *Port Nelson Ltd* imposing the tug-tie, and that such reasons should be considered as part of the breach analysis. In doing so, McGechan J, in contrast to the Privy Council's inference that anticompetitive 'purpose' could be assumed from establishing 'use' of dominance, decides that legitimate 'purposes' for such conduct might exist.

McGechan J concluded:⁶⁶

Once the major postulated *justification* by way of liability control⁶⁷ is rejected as a real purpose, there remains little else of substance. As stated, I am satisfied the substantial - indeed overwhelming - purpose for the tug tie as constituted was to prevent, deter, and eliminate TBMPL from competitive pilotage.

Approaching the questions of both "use" and purpose in that way. I am satisfied a non-dominant firm in the same circumstances would not have imposed a tie, and that the purpose of the tug/pilot tie was to prevent or deter TBMPL from engaging in competition in pilotage, and as matters developed, to eliminate TBMPL.

His Honour ultimately determined the matter of anticompetitive 'purpose' by inquiring as to whether the conduct could be (commercially) justified. It is interesting to recall that the Court of Appeal in *Clear Communications v Telecom* had previously promulgated concepts of 'reasonableness' and 'justification' in terms of determining whether 'use' of dominance had been made out. An approach that was dismissed by the Privy Council. In deciding the case, McGechan J appears to have amalgamated the Privy Council's hypothetical test for determining 'use of dominance' with the approach adopted by the courts previously, that being to determine culpability by reference to the proscribed 'purposes' and concepts of 'reasonableness' and 'justification'.

(In regard to the matter of the 5 % discount and the \$100 minimum pilotage charge, McGechan J held that a non-dominant firm would also be likely to introduce such

⁶⁶ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 557-558.

⁶⁷ This refers to Port Nelson Ltd's argument concerning insurance cover.

measures, and that therefore no use of dominance had been made out. (McGechan J did however conclude that anticompetitive purpose was made out.⁶⁸)

Proceedings under section 27

One of the most significant outcomes from McGechan J's judgement is his ruling in favour of the *Commerce Commission's* claim that *Port Nelson Ltd* had contravened section 27 of the Act. Section 27 is generally understood to target collusion, and prohibits contracts, arrangements or understandings, that have the purpose, effect, or likely effect, of substantially lessening competition in a market.⁶⁹ In finding that *Port Nelson Ltd's* \$100 minimum pilotage charge and the 5% discount had the 'purpose', and 'likely effect' (not actual 'effect' however), of substantially lessening competition in the Port Nelson pilotage market, McGechan J appears to have extended the application of section 27 to also capture 'unilateral misuse of market power'.

How did section 27 come to succeed where section 36 failed? If we recall, the proceedings concerning the \$100 minimum pilotage charge and the 5% discount were unsuccessful under section 36 because the *Commerce Commission* was unable to prove 'use' of market power. (McGechan J decided that that engaging in such conduct made commercial sense in the circumstances.)

⁶⁸ McGechan J pointed to the background of animosity, and to Port Nelson Ltd's acute concern over the imminent competition from TBMPA.

⁶⁹ section 27 reads: **Contracts, arrangements, or understandings substantially lessening competition prohibited—**

- (1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (3) Subsection (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.
- (4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

Proceedings under section 27 of the Act, however, do not require proving either 'dominance', or 'use of dominance'. The requirements to be met in showing a breach of section 27 are, (1) entering into a contract, arrangement or understanding, (2) that has the purpose, effect or likely effect, of (3) substantially lessening competition in a market.

McGechan J held that the first requirement was established through the relationship *Port Nelson Ltd* had with its customers (port users). This conclusion was assisted by the fact that the New Zealand Court of Appeal had previously ruled 'unilateral purpose' as relevant to determining the matter of exclusionary 'contracts or arrangements' under section 29 of the Commerce Act.⁷⁰ McGechan J extended this analysis to 'contracts, arrangements and understandings' under section 27 of the Act. (Also, for the purposes of section 27, section 3 (5) of the Act enables the court to aggregate a number of contracts, arrangements or understandings, in determining the effect on competition.)

In reaching his decision on the \$100 minimum pilotage charge McGechan J held that the charge was substantially below-cost, and then proceeded to examine *Port Nelson Ltd's* 'purpose' for arriving at this charge:⁷¹

...it was conceived against a background of animosity, and of acute concern over the risk to PNL of imminent TB MPL competition. It was correspondingly likely PNL would seek to design a minimum charge figure which would restrict or eliminate that competition.

McGechan J concluded:⁷²

...in the end I am satisfied by the accumulation of other circumstances....that a real and substantial purpose of the \$100 minimum charge was to substantially lessen competition in the pilotage services market. That real and substantial purpose was to eliminate TB MPL, and to deter any other like minded firms.

McGechan J then concluded that the \$100 minimum charge had the purpose to substantially lessen competition in the market for port services at the Port of Nelson.

⁷⁰ *Tui Foods Ltd v NZ Milk Corp Ltd* (1993) 5 TCLR 406; 4 NZBLC 103,286. Also see *NZ Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731.

⁷¹ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 541.

⁷² *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 542.

(As referred to above, unilateral purpose was considered sufficient for establishing a breach of section 27.)

As to the 'likely effect' of substantially lessening competition, his Honour adopted a very uncomplicated approach. McGechan J held that as *Port Nelson Ltd* were carrying out pilotage services at below-cost, then it was logical to draw a conclusion that this would have the 'likely effect' of deterring competition for pilotage, and that consequently, in this instance, it would be 'likely to have the effect' of substantially lessening competition for pilotage.

In regard to the 5% discount, his Honour held that it amounted to inducing and being party to contracts containing provisions that had the purpose and likely effect of substantially lessening competition in the pilotage market. (The Court of Appeal remarked that the feature of the discount that made it objectionable was that it attached to incontestable as well as contestable services, and that its structure was designed to exclude competition in contestable services, as opposed to encourage incremental purchases.⁷³)

McGechan J ruled that *Port Nelson Ltd* (acting alone) had, by offering pilotage at \$100, and by offering the 5% discount as structured, engaged in conduct in breach of section 27 of the Commerce Act. Consequently, McGechan J seems to have extended the application of section 27 to establish a new test for dealing with what appears to be, ostensibly, 'unilateral' misuse of market power. (Discussed later.)

Port Nelson Ltd v Commerce Commission⁷⁴

The Court of Appeal did not disturb any of the findings of McGechan J. One of the grounds of appeal was that in determining a breach of section 27, McGechan J had employed language more appropriate to an analysis of section 36. Specifically, that the section 27 threshold of 'substantially lessening competition' is not the same as substantially lessening the effectiveness of a particular competitor. The Court of Appeal responded to this by pointing out that McGechan J's references to 'detering

⁷³ Refer *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLR 217, 225.

⁷⁴ *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLR 217.

other competitors' (for instance, refer quotation at footnote 72) indicated that his Honour was aware of the requisite section 27 threshold.

Gault J, in delivering the judgement of the Court, did however take the opportunity to further clarify the meaning of 'substantially lessen competition' as it applied to section 27, and stated:⁷⁵

...the section requires proof of the substantial lessening of competition - not merely aggressive competitive conduct. The purpose or (likely) effect must be more than short term and must impact upon the competitive process in the particular market structure.

Notably, on the question of 'use' of dominance, the Court of Appeal commented that the Privy Council's hypothetical test was formulated in a 'price cutting' context, and stated:⁷⁶

While it is not easy to see why use of a dominant position should not be determined simply as a question of fact without the need to postulate artificial scenarios, we are content in this case to adopt that approach, as did the High Court.

Although apparently signalling that the Privy Council's test will not always be appropriate, the Court of Appeal declined to decide the matter at hand as a question of fact, stating that it was content to apply the Privy Council's test in this instance. With these remarks the Court of Appeal seem to leave the matter of 'use of dominance' in a very confusing state. On the one hand, New Zealand's highest Court, the Privy Council, has formulated a hypothetical test for determining 'use of dominance', whereas on the other hand, the Court of Appeal has remarked that such a test has limitations, and is not mandatory.

Purebred Jersey Breed Soc. v Jersey Breeders Assn.⁷⁷

In *Purebred Jersey Breed Soc. v Jersey Breeders Assn.*, Penlington J appeared to adopt a similar approach to that of McGechan J in *Commerce Commission v Port Nelson Ltd*. Both parties provided services for the recording and registration of pedigree jersey cattle, with the plaintiff being a breakaway group from the *Jersey*

⁷⁵ *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLR 217,235-236.

⁷⁶ *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLT 217, 242.

⁷⁷ *Purebred Jersey Breed Soc (NZ) Inc v Jersey Breeders Assn Inc* 2/5/98, Penlington J, HC Hamilton CP17/96.

Breeders Assn. The plaintiff alleged that the *Jersey Breeders Assn.* had engaged in conduct designed to restrict, prevent, deter and eliminate the *Purebred Jersey Breed Soc.* from competing.

Significantly, Penlington J, in addressing section 36 stated:⁷⁸

...in my view I am bound to apply the test as laid down by the Privy Council. I consider that I have no option. I shall therefore proceed on that basis.

Penlington J concludes that a hypothetical competitor in the relevant market, but not in a dominant position, would have acted in the same way as the *Jersey Breeders Assn.*⁷⁹

Penlington J then proceeds to discuss the 'purpose' of the conduct, concluding that the conduct in question was merely a 'reasonable' response in the circumstances, as opposed to being, "aggressive conduct aimed at stifling competition."⁸⁰

As evident, in determining whether the *Jersey Breeders Assn.* had misused its market power, Penlington J has applied the precedent laid down by McGechan in *Commerce Commission v Port Nelson Ltd.* That being, in the first instance, to apply the Privy Council's hypothetical test for 'use of dominance', and if satisfied, then proceed to examine whether the alleged anticompetitive conduct could be 'justified' as 'reasonable in the circumstances'.

Clear Communications v Telecom (1997)⁸¹

Clear Communications alleged that *Telecom* had breached section 36 of the Commerce Act by pursuing a deliberate policy of deactivating *Clear Communications'* subscribers for the purpose of preventing *Clear Communications* from engaging in competition.

⁷⁸ *Purebred Jersey Breed Soc (NZ) Inc v Jersey Breeders Assn Inc* 2/5/98, Penlington J, HC Hamilton CP17/96, page 137.

⁷⁹ *Purebred Jersey Breed Soc (NZ) Inc v Jersey Breeders Assn Inc* 2/5/98, Penlington J, HC Hamilton CP17/96, page 148-149.

⁸⁰ *Purebred Jersey Breed Soc (NZ) Inc v Jersey Breeders Assn Inc* 2/5/98, Penlington J, HC Hamilton CP17/96. Page 151.

⁸¹ *Clear Communications Ltd v Telecom Corp of NZ Ltd* 4/4/97, Smellie J, HC Auckland CL54/96.

Smellie J discussed the Privy Council's test for 'use', which his Honour referred to as the 'commercial reality test', and concluded that *Telecom* would not operate as it had done, if it was operating in an openly competitive market. Smellie J stated that:⁸²

...Telecom would not have deactivated *whenever possible* in an openly competitive market because there would have been no advantage in doing so, indeed, a loss of revenue would have resulted.

It is suggested that Smellie J's reference to deactivated 'whenever possible' (refer line 1 of preceding quotation) implies an assessment of *Telecom's* 'purpose'.⁸³ (An approach entirely consistent with McGechan J in *Commerce Commission v Port Nelson Ltd*).

*Commerce Commission v Carter Holt Harvey*⁸⁴

New Wool Products ("NWP") manufactured and sold a woollen insulation product ("Wool Bloc") in the Nelson region. Insulation New Zealand Co. ("INZCO") (formerly Carter Holt Harvey) sold insulation products throughout the whole of New Zealand. In response to the success of Wool Bloc, INZCO developed a wool and polyester insulation product ("Wool Line"). INZCO commenced to supply Wool Line to outlets in the Nelson/Marlborough region on a two-for-one basis.

The Commission alleged that in doing so, INZCO had breached sections 27 and 36 of the Commerce Act. The Court concluded that INZCO was selling its product at below-cost.

After quoting the Privy Council's test for 'use of dominance', Williams J, rather innocuously, refers to the Court of Appeal's comments in *Port Nelson v Commerce Commission*, where Gault J questioned as to why 'use' of dominance could not be determined simply as a question of fact.⁸⁵

⁸² *Clear Communications Ltd v Telecom Corp of NZ Ltd* 4/4/97, Smellie J, HC Auckland CL54/96, pages 12-13.

⁸³ *Gault on Commercial Law*, Brookers Ltd (database version), CA36.11A.

⁸⁴ *Commerce Commission v Carter Holt Harvey Building Products* (Unreported), HC Auckland, CL27/95, 18 April 2000, Williams J and Professor R Lattimore.

⁸⁵ *Commerce Commission v Carter Holt Harvey*, above n 34, para 28.

Interestingly, Williams J then proceeded to carry out an analysis of 'use of dominance' and 'anticompetitive purpose' together.⁸⁶ Heeding the comments of the Court of Appeal,⁸⁷ Williams J conducts an in-depth examination of the circumstances and facts pertaining to *INZCO's* '2 for 1' offer. His Honour concludes:⁸⁸

...[W]hether the exercise is undertaken subjectively or objectively, in all the circumstances and in particular in instituting and maintaining the "2 for 1" *INZCO* used its dominant position in the South Island insulation market for the purpose - i.e. the object or aim - of preventing or deterring New Wool Products from engaging in competitive conduct in the market or eliminating it from the market.

Based on his examination of the material circumstances, Williams J concluded that *INZCO* had used market power for an anticompetitive purpose. Interestingly, in carrying out this analysis, Williams J appears to make only a passing reference to the Privy Council's hypothetical test, when he states:⁸⁹

The Court *also* finds that Messrs Trevena-Brown and Peters knew *INZCO's* actions were not merely matching Wool Bloc on price - which might well be setting a price no higher than a hypothetical firm would charge in a perfectly contestable market - but were undertaken in the knowledge that the "2 for 1" would substantially undermine Wool Bloc sales.

With regard to section 27 of the Act, Williams J held that the *Commerce Commission* had not made out its case against *INZCO*. Williams J considered the dynamic nature of the relevant market, noting inter alia that despite *INZCO's* '2 for 1' offer, intense competition had prevailed in the market, and that there had also been a history of new entrants actually entering the market. Consequently, Williams J concluded that by engaging in the 'predatory pricing', *INZCO* had not entered into any contract(s), arrangement(s) or understanding(s), that had either the purpose, effect, or likely effect, of substantially lessening competition in any 'market'.⁹⁰

⁸⁶ *Commerce Commission v Carter Holt Harvey*, above n 84, para 248-265.

⁸⁷ *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLT 217, 242, "...not easy to see why use of a dominant position should not be determined simply as a question of fact."

⁸⁸ *Commerce Commission v Carter Holt Harvey*, above n 84, para 272.

⁸⁹ *Commerce Commission v Carter Holt Harvey*, above n 84, para 264.

⁹⁰ *Commerce Commission v Carter Holt Harvey*, above n 84, para 280-292.

Commentary

The *Commerce Commission/Port Nelson Ltd* litigation is perhaps notable in itself for three significant reasons. First, that section 27 of the Act is extended to capture 'ostensibly' unilateral misuse of market power. Second, that the notion of a defendant 'justifying' its conduct appears to have been cast, in effect, as a defence to allegations under section 36 of the Act. And third, that the Court of Appeal expressed misgivings about the appropriateness of the Privy Council's hypothetical test.

Given the relative volatility associated with 36 of the Commerce Act, it is perhaps surprising to note a degree of consistency in the line of cases dating from the High Court's decision in *Commerce Commission v Port Nelson Ltd*. That being to decide matters by applying the Privy Council's hypothetical test, and then to conduct an examination of a defendant's 'purpose'. This is despite the Privy Council holding that anticompetitive purpose could be inferred from a finding that market power had been 'used'.

This recent line of New Zealand cases also appear to rejuvenate the relevance of notions such as 'justification of business conduct', and 'commercial reasonableness', despite the Privy Council's view that such concepts are inappropriate for determining matters under section 36 of the Act.

Where however, does Williams J's decision in *Commerce Commission v Carter Holt Harvey* fit into this continuum? In what seems a divergence from precedent, Williams J, taking his lead from the Court of Appeal, appears to circumvent the significance that had been previously attributed to the Privy Council's hypothetical test. Indeed, in the face of the Privy Council's protestations, Williams J seems to affirm that a 'rule of reason' approach has an essential role to play in determining matters under section 36 of the Act.

III. Analysis of New Zealand's approach to dealing with Unilateral Misuse of Market Power

The underlying object of section 36 of the Commerce Act is to encourage economic efficiency and enhance consumer welfare. The provision is designed to prevent and deter anticompetitive conduct, while at the same time, not discouraging legitimate competitive conduct. Consequently, while it is important that the courts are able to identify and prevent firms from using their market power to subvert competition, it is equally important that section 36 of the Act does not serve to unduly restrict aggressive, but ultimately efficient, competitive conduct.

This is the fine line that the Courts must identify in interpreting and applying the provision. The issue that faces the Government, and the Judiciary, is how to formulate and apply a test, that, as well as being able to work in the courtroom, will also work in the boardroom. After all, it is the commercial decision-makers that must face the impact of section 36 of the Commerce Act. Ideally, what is required is an approach that is economically sound, practical, certain, and consistent.

A. Where is the Line Drawn to Distinguish Anticompetitive Conduct?

The New Zealand Parliament initially intended the distinction between competitive and anti-competitive conduct to be determined by reference to the purpose of the conduct.⁹¹ In accordance with this intention, the courts chose to determine the legitimacy of trading conduct based on an examination of a defendant's purpose. Gault J, as referred to earlier, perhaps typified this approach in *Electricity Corp Ltd v Geotherm Energy Ltd*:⁹²

⁹¹ As discussed earlier, Parliament's initial introduction of clause 36 of the Commerce Bill invoked a two-limbed test for determining unilateral misuse of market power. Demonstrating a breach required proving that a person held a dominant position in a market, and then also proving that they had conducted themselves with one of the proscribed purposes (restricting, preventing, deterring or eliminating competition). The Select Committee, when explaining why a breach of the provision did not require proving 'abuse' of a dominant position stated, "An action taken with the purpose of attaining any of the specified ends is prohibited, and in itself amounts to an unlawful 'use' of that dominant position." [Select Committee submissions]

⁹² *Electricity Corp Ltd v Geotherm Energy Ltd* [1992] 2 NZLR 64, 649.

The distinction between vigorous legitimate competition by a corporation with substantial market power and conduct that contravenes the section is in the purpose of the conduct. Market power can be exercised legitimately, or illegitimately.

Accordingly, having a purpose to restrict, prevent, deter or eliminate competition, was deemed anticompetitive (if the person held a dominant market position). However, signs of pending change were apparent as a result of the observations of the Australian High Court in *Queensland Wire v Broken Hill*, where it was considered that the issue of whether market power had in fact been 'used' was conceivably a more appropriate determinant for a breach of section 46 of the Australian Trade Practices Act. (the Australian parallel to section 36 of the Commerce Act.) However, it was not until some five years later that this shift in thinking actually manifested into New Zealand law. In delivering its judgement in *Clear Communications v Telecom*,⁹³ the New Zealand Court of Appeal signalled to businesses that the crucial determinant of the legitimacy of a firm's conduct was not a defendant's 'purpose' for its conduct, but whether or not the firm had 'used' its market power. The Privy Council affirmed this view. The line demarcating between competitive and anticompetitive conduct had been redrawn.

There is certainly a degree of common sense to the conclusion that 'use' of dominance is a more sensible tool than an examination of 'purpose' for distinguishing competitive from anticompetitive conduct. For example, in respect to the proscribed purposes in section 36, it is perhaps very rarely that firms would engage in competition without considering its competitors. And, naturally, in respect to its competitors, a firm would not engage in conduct to assist them, but to the contrary, would engage in conduct with a view to deter and restrict them. As Williams J noted in *Commerce Commission v Carter Holt Harvey*:⁹⁴

Every commercial organisation wants to block its competitors in the sense of putting obstacles in the way of their commercial success and making it harder for them to be profitable. This is the normal interplay of commerce. There is nothing sinister or untoward in such manoeuvres.

Consequently, given the construction of section 36, there is a real danger, that if the purpose of one's conduct was the crucial determinant of anticompetitive conduct, that

⁹³ *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* (1994) 6 TCLR 138.

⁹⁴ *Commerce Commission v Carter Holt Harvey*, above n 84, para 271.

engaging in the 'normal interplay of commerce' could conceivably constitute a breach of section 36. Surely Parliament did not intend such an outcome.

Accordingly, there is considerable merit to a conclusion that 'use of market power' may be a more appropriate test. Certainly, if the object is to prevent firms from utilising their power to 'subvert the competitive process', whilst permitting firms to utilise legitimate competitive advantages when engaging in rivalry, then an examination as to how a firm 'uses' its market power appears very suitable. This is, in essence, the view of the Privy Council in *Telecom v Clear*.⁹⁵

However, breach of section 36 also requires an anticompetitive 'purpose'. Parliament did not intend a company to be liable merely because its activities may have had an effect, or likely effect, to restrict prevent, deter or eliminate competition. This would undesirably expose companies to liability under section 36 for engaging in what might be efficient competitive behaviour. Parliament required that a culpable party also entertained an anticompetitive 'purpose'. However, as evident from the examination of New Zealand cases, determining between aggressive competitive 'purpose' and an anticompetitive 'purpose' is often a difficult, and arguably arbitrary exercise.

Where is the line drawn today to delineate permissible competitive conduct from illegitimate and anticompetitive conduct? It is perhaps the judgement of McGechan J in *Commerce Commission v Port Nelson* that has had the most significant influence on this question. In delivering his decision, McGechan J established an approach that still appears to endure today, suggesting that the matter of 'use of dominance', although indicative of anticompetitive conduct, was not necessarily conclusive, and that a defendant's 'purpose' was equally relevant in determining matters under section 36.

In essence, McGechan J, although suggesting that the Privy Council's test for 'use' of market power demonstrated a likely breach, established as an appendage to this question, and perhaps arguably taking up a position akin to a safety valve, a further

⁹⁵ *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* (1995) 1 NZLR 385; (1994) 6 TCLR 138.

necessary inquiry, asking whether a person had also acted for one of the proscribed 'purposes'. In effect, what has evolved is a two limbed test for determining when conduct may be distinguished as anticompetitive, examining both, whether market power had been 'used', and the 'purpose' of the conduct.

B. How do the Courts Determine when the Line has been Crossed?

What then are the methods that the Judiciary employ to determine whether a firm's conduct has crossed the line? In particular, how do the courts decide when a firm has 'used' market power? And when a firm has acted for a proscribed 'purpose'?

As previously alluded to, early decisions under section 36 of the Act appeared to afford a great amount of judicial discretion, with a finding of a breach seemingly dependent on whether the courts concluded that the alleged anticompetitive conduct could be justified as commercially reasonable, or not. For example, the Court in *Magic Millions v Wrightson*⁹⁶ concluded that *Wrightson's* conduct seemed hard to 'justify' in economic terms unless it had an anticompetitive purpose, while in *Union Shipping v Port Nelson*,⁹⁷ McGechan J spoke of a 'commercially reasonable' levy.

Such an approach necessitated the courts to act as a barometer of the market place, and allowed the judiciary a great degree of latitude in determining questions of material fact. Arguably, such an approach is especially well suited to proceedings under the Commerce Act. For instance, decisions made under the Act are expected to reflect the evolving trends and concerns in the market place, and the Act must be flexible enough to adapt to these changing concerns. Such judicial latitude is perhaps even more appropriate given the court's authority to enlist the assistance of an economist to the bench.

The Privy Council however dismissed an approach based on examining whether the alleged anticompetitive conduct could be commercially 'justified', or was 'reasonable'

⁹⁶ Recall that *NZ Magic Millions* sought an injunction to restrain *Wrightson Bloodstock* from holding auction sales of thoroughbred yearlings on dates which clashed with its own sale dates.

⁹⁷ Recall that *Port Nelson Ltd* had imposed a requirement that the shipping company and the stevedore company must use port company forklifts and drivers.

in the circumstances. The Privy Council stated that such an approach placed too much uncertainty on persons who hold dominant market positions, as businesses would have little idea as to what a court may find reasonable or justifiable in the future.⁹⁸ (Certainly a valid concern, given that the object of the Commerce Act is to promote competition, not to discourage it.)

Their Lordships chose to frame a hypothetical test, holding that a firm in a dominant market position does not breach section 36 of the Act if it conducts itself in a way that a firm not in a dominant position but otherwise in the same circumstances would have acted. At the outset, one must acknowledge that the Privy Council's test does provide a plausible means for distinguishing conduct dependant on 'market power' from conduct not dependant on 'market power'. For instance, if a firm without market power (not in possession of a dominant market position) would not choose to engage in the alleged anticompetitive conduct, then it would certainly suggest that engaging in the conduct would be dependant on possession (and use) of 'market power'. However, does establishing the Privy Council's hypothetical test necessarily indicate inefficient and anticompetitive conduct designed to subvert the competitive process?

The New Zealand courts obviously thought not when McGechan J and the Court of Appeal decided to reintroduce an examination of 'purpose'. In fact, the Privy Council's test has been subjected to much criticism directed at its perceived inadequacies in determining anticompetitive conduct.⁹⁹ Arguably, however, it is the

⁹⁸ *Telecom Corporation of New Zealand v Clear Communications Ltd* (1994) 6 FCLR 138, 155.

⁹⁹ For example, can the test accommodate for legitimate competitive advantages resulting from market dominance (i.e. such firms may have superior resources, business structures or experience that permit more daring, aggressive, or nonconformist strategic and operational decisions. - others, without dominance might not choose to hypothetically embark on the same conduct). Alternatively, there may be occasions where non-dominant firms would hypothetically choose to engage in the same conduct, although it is clearly designed to subvert competition (i.e. product ties, aggressive pricing, or perhaps a comparative advertising campaign - others, in a competitive market, might hypothetically (and legitimately) choose to engage in the conduct, and without market power it is unlikely to have any anticompetitive purpose (or effect).

Further criticism targets the test's restrictive nature, and its dependency on conjuring up hypothetical market scenarios and business decisions.

test's perceived inflexibility that is perhaps its greatest flaw, especially given the unlimited spectrum of conduct that could theoretically constitute anticompetitive and inefficient conduct

Despite this criticism, and the Court of Appeal's expressed dissatisfaction with the Privy Council's test, it has generally been recognised as binding in law.¹⁰⁰ However, *Gault on Commercial Law*¹⁰¹ notes that the New Zealand courts have sought to find workable ways of living with the Privy Council's test. For example, McGechan J in *Commerce Commission v Port Nelson* chose to examine *Port Nelson's* actual purpose for engaging in the alleged anticompetitive conduct, Smellie J has referred to the Privy Council's test as the "commercial reality" test¹⁰², and Penlington J chose to carry out an examination of anticompetitive purpose within the context of the Privy Council's, "... otherwise in the same circumstances." Through these subtle changes in the test's application, the courts have been able to circumvent some of its perceived inadequacies. Significantly, the reintroduction of the 'rule of reason' approach to determining the purpose of the alleged anticompetitive conduct has perhaps had the greatest effect on improving the acceptability of decisions made pursuant to section 36 of the Act. However, this line of inquiry is generally considered to be merely an adjunct to the application of the Privy Council's hypothetical test

Notably, the greatest tension at the moment appears to be the New Zealand domiciled courts' attempt to circumvent the application of the Privy Council's test altogether. Note the prior caution of Gault J in *Clear Communications v Telecom*:¹⁰³

It is perhaps timely to caution against substituting a test helpful in applying the statutory rule for the rule itself. To focus upon what the firm in question, or any participant in the relevant market, might do in a fully competitive situation with all the variables which might or might not occur may merely complicate rather than solve the problem.

¹⁰⁰ *Clear Communications Ltd v Telecom Corp of NZ Ltd* 4/4/97, Smellie J, HC Auckland CL54/96, pages 12-13.

¹⁰¹ *Gault on Commercial Law*, Brookers Ltd (Database), at 36.11A.

¹⁰² *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* 4/4/97, Smellie J, HC Auckland CL54/96, pages 12-13.

¹⁰³ *Telecom Corp of NZ Ltd v Clear Communications Ltd* [1995] 1 NZLR 385; (1994) 6 TCLR 138; 5 NZBLC 103,522, 103,534.

Recall also the Court of Appeal's dissatisfaction with the Privy Council's test.¹⁰⁴ In response, Williams J in *Commerce Commission v Carter Holt Harvey* seems to have taken up the gauntlet and attempted to rejuvenate a pure 'rule of reason' based approach to determining whether market power had been used for anticompetitive reasons.

Given the turbulent history underlying the approaches taken to determining matters under section 36 it is difficult to predict with too much certainty exactly what course will be taken in the future. Are the courts legally bound to follow the Privy Council's hypothetical test? Or is a pure 'rule of reason' approach a more appropriate method of determining when the line has been crossed? Smellie J perhaps summed up the present situation quite aptly when he stated:¹⁰⁵

It seems to me that the vexed question of 'use' in respect to which section 36 gives no guidance, is still in a state of evolution.

C. Comparing the approach adopted in New Zealand with the approach adopted in the United States

How does the approach to unilateral misuse of market power adopted in New Zealand compare to the approach adopted in the United States? At the outset, it is apparent that both regimes do share some similarities. For example, both the United States and New Zealand provisions appear to adopt a three-limbed approach to determining anticompetitive misuse of market power, with both regimes requiring an examination of the existence of market power, the exercising (using) of market power, and the purpose for the use of market power.

It is, of course, no accident that similarities exist between the approaches adopted. Indeed, an examination of New Zealand case law would lay open the fact that the New Zealand courts have regularly sought assistance from United States, Australian and European courts in determining matters under the Commerce Act. However, despite this willingness to refer to overseas jurisdictions, the weight given to foreign

¹⁰⁴ *Port Nelson v Commerce Commission* (1996) 7 TCLT 217, 242.

¹⁰⁵ *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* 4/4/97, Smellie J, HC Auckland CL54/96, page 12.

precedent is tempered by cautions that New Zealand decisions must be guided by its own brand of competition laws, and its relatively unique economy.¹⁰⁶

In comparing the United States and New Zealand provisions, one of the more obvious similarities is that both jurisdictions have a threshold test that must be established before the respective provisions may apply. In New Zealand, a person must hold a dominant position in a market. The threshold in the United States is possession of monopoly power. In both jurisdictions, satisfying the threshold is a matter of fact to be determined by the court. And in both jurisdictions, the courts consider similar characteristics as relevant to proving that the threshold has been satisfied. (These may include, for example, market share, substitutability, and barriers to entry).

There is also some similarity between the approaches adopted to determine whether market power has been abused. The crucial determinant of anticompetitive conduct in New Zealand, that being, "has a person 'used' a dominant market position?", is perhaps arguably similar in nature to the question asked in the United States, that being, "has the defendant 'exercised' market power?". In essence, in conducting their respective inquiries, both jurisdictions attempt to determine whether a firm had exceeded what could be considered conventional (and acceptable) means when engaging in rivalry.

Perhaps greater similarity exists with regard to the third limb in the United States and New Zealand tests. The United States defence of 'legitimate business justification' may be directly paralleled to the approach adopted by the New Zealand courts in determining the question of anticompetitive 'purpose'. Indeed, as with the approach in the United States, the New Zealand courts also appear to be developing this area of inquiry along the lines of a 'defence' to allegations of anticompetitive conduct, asking whether the conduct could be 'justified' in the commercial sense.

There is however an obvious divergence in approach between the New Zealand and United States courts in determining the second limb of their respective tests for

¹⁰⁶ *Clear Communications v Telecom Corp of NZ Ltd* (1993) 5 TCLR 413, 430; 4 NZBLC 103,340,103,354.

misuse of market power. In the United States, to determine whether a person has exercised their market power, the courts have adopted a pure 'rule of reason' approach. The courts base their decision on an examination of the relevant conduct and its effect on competition, in terms of 'reason'. In contrast to this, the prevailing New Zealand approach is to apply a hypothetical test, confining the analysis to the matter of whether the hypothetical test has been satisfied, or not.

The hypothetical approach adopted in New Zealand may arguably provide a greater degree of assurance to business decision-makers, in contrast to the 'rule of reason' approach, however, an approach based on the 'rule of reason' does arguably lend itself to more logical and reliable judicial decisions. If only because it allows a more pragmatic approach, enabling the courts to consider the wider relevant issues.

A further significant point of difference between the United States and New Zealand regimes is the development in the United States of a number of specific antitrust common law doctrines (supplementary rules). Predatory pricing, exclusive dealing, and essential facilities, are all areas where United States courts have developed specific rules for dealing with alleged antitrust breaches. In determining matters under section 36, the New Zealand courts have often referred to these doctrines, but have generally been quite reticent about importing them into New Zealand law. Preferring, instead, to confine determination to a literal application of the Commerce Act.

Arguably, there are two distinct advantages to using such supplementary rules. First, such rules assist the courts with making timely, reliable and consistent decisions. For instance, in determining 'predatory pricing' allegations, the United States courts are able to rely on the wealth of previous decisions and experience, and are directed to the particular rules and facts that have evolved as material in previous decisions. In addition to assisting the judiciary, these supplementary rules also assist businesses by signalling to decision-makers what is, and what is not, considered acceptable legitimate conduct. The rules arguably send a clearer and more definite signal to the boardroom about what actually constitutes misusing market power, in contrast to the direction offered by both section 2 of the Sherman Act, and section 36 of the Commerce Act. Given the apparent advantages of developing and using such rules, it

is perhaps surprising that the New Zealand courts have chosen not to embrace this notion. Although, that may be in some part due to the short time span that New Zealand has actually had an effective competition statute, and also to the relative dearth of section 36 proceedings coming before the courts.

D. Section 27 and 36 tension

Section 27 of the Act is typically targeted at capturing collusion between competitors. It prohibits persons from entering into contracts, arrangements, or understandings, that have the purpose, effect or likely effect, of substantially lessening competition in a market. Obvious examples are where competitors carve up a market among themselves, or enter into a price fixing agreement.

McGechan J in *Commerce Commission v Port Nelson* however purported to extend the scope of section 27 of the Act to capture what appears to be 'typical' unilateral misuse of market power ('predatory pricing'). Dealing with this behaviour had previously been the almost exclusive domain of section 36 of the Act.¹⁰⁷ In *Commerce Commission v Port Nelson*, McGechan J ruled that section 27 of the Act applied to a situation where only one party had actually entertained the purpose of substantially lessening competition, and where, in practical terms, the conduct of only one party could have had the effect, or likely effect, of substantially lessening competition. (The Court of Appeal chose not to disturb McGechan J's findings.)

Have the New Zealand courts perhaps pursued this course as a means of addressing perceived deficiencies with the application of section 36 of the Act? Notably, the case was 'hot on the heels' of the Privy Council's decision in *Telecom v Clear Communications*. And in regard to the conduct that was held to breach section 27 of the Act (the \$100 minimum pilotage charge and the 5 % discount), McGechan J had been unable to satisfy the Privy Council's 'use' test, despite unequivocally concluding that the conduct was targeted at deterring and eliminating TBMPA from the pilotage market. In addition, the Court of Appeal, in upholding McGechan J's findings, openly chose to express its dissatisfaction with the Privy Council's test. Conveniently, in holding that section 27 applied to curb what ostensibly appears to be

¹⁰⁷ Section 37 of the Act prohibits 'resale price maintenance' - typically unilateral conduct.

unilateral misconduct, McGechan J circumvented the need to prove that a defendant held a dominant market position, and that a defendant had also 'used' that dominant market position.

Given that *Port Nelson Ltd* was, by most accounts, directing a conceivably unhealthy amount of attention to eliminating TBMPA from the market, the frustrating conclusion in regard to section 36 perhaps demonstrates, to some degree, the case put forward by critics of the Privy Council's test, who reason that the test is overly restrictive, and that it removes from the ambit of section 36 much of the conduct that parliament intended to be caught by the provision.

There are however some serious concerns with this seemingly judicial attempt to redress the deficiencies with section 36 of Act.

For one, the extended interpretation given to section 27 potentially creates an anticompetitive 'purpose' test for all firms, irrespective of their market power, and whether the firms actually possess the ability to effect any significant economic harm. All firms, if they choose to engage in aggressive competition with a purpose to deter competitors ('normal commercial interplay?'), may possibly be liable under section 27 of the Act for having a purpose to substantially lessen competition (ie drive out competitors). The very reason that section 36 of the Act contains a threshold test is so the prohibition does not unduly restrict firms that do not possess the power to bring about an inefficient market structure. That protection does not exist with the extended interpretation of section 27 of the Act.

An even more concerning legacy of the extended section 27 is that it creates an 'effects' test for ostensibly unilateral conduct. A consequence that has the propensity to stifle business through creating uncertainty for those in the boardrooms making decisions. For instance, with a unilateral behaviour 'effects' test, a firm that takes advantage of economies of scale, or economies of scope, may, if it causes competitors to exit the market, be in breach of the provision. This may be despite the best intentions of the firm alleged to have breached the provision, and also despite the fact that the conduct may (arguably) be efficiency enhancing. Businesses, wary of being the target of allegations of anticompetitive conduct, might choose against engaging in

aggressive competition, for fear that if competitors are deterred from competing, they might be held liable for effecting a 'substantial lessening of competition'. This is hardly a desirable consequence, and has the potential to curtail business initiatives, as well as open up litigation floodgates.

However, such a disconcerting conclusion can possibly be tempered by the fact that *McGechan J* does appear to limit the application of the precedent he established:¹⁰⁸

"...it is not a breach of s 27 simply to price competitively. A firm which through efficiency, or willingness to contain profit margins, undercuts rivals or potential entrants may have the elimination of competition as one of its purposes. (Despite ritualistic public pronouncements welcoming competition, most firms would much prefer a clear field.) Such efficiencies and profit containment nevertheless are regarded as in the public interest. Such scenarios are competition in action; to be promoted by the Act, not prevented by it. If less efficient or more rapacious competitors are killed off, so be it.

For breach of s 27 to occur, pricing must go rather further. Pricing must be below cost."

In addition to the concerns identified above, there are further reasons why an extension of section 27 of the Act is perhaps an inferior substitute for dealing with the deficiencies with section 36. For instance, section 27 only takes effect when there is a contract arrangement or understanding. If a firm did engage in (unilateral) anticompetitive conduct, but it did not involve a contract, arrangement or understanding, then section 27 would have no application. Given the perceived unlimited variety of anticompetitive conduct possible, the protection afforded by section 27 is consequently going to be somewhat arbitrary from the outset. Also, section 27 only focuses on competition in the market as a whole. It will not necessarily protect a specific firm that is being eliminated from a market. Analysis under section 27 requires an assessment as to whether the purpose, effect or likely 'effect of substantially lessening competition in the market' is present. If other market participants remain in the market, then section 27 might not protect a firm that is being deterred or eliminated from the market. Further, it is arguable whether section 27 could actually provide any comfort at all to potential new entrants that are being prevented ('restricted') from actually engaging in competition.

¹⁰⁸ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 538.

The conclusion submitted is that if the scope of section 36 of the Act has been unduly narrowed, then an extension of section 27 of the Act is a poor substitute. Fittingly, the Government's current proposed amendments to section 36 of the Act (discussed below) are intended to restore the efficacy of the section - proposing amendments to address both the threshold test and the Privy Council's test for 'use' of dominance. If the proposed amendments do restore section 36 to its intended strength, then it will be interesting to follow the course the courts take with section 27 and unilateral misuse of market power. Certainly, in the interests of encouraging businesses to engage in aggressive competition, there would be no need for the extended interpretation given to section 27 of the Act.

E. The Government's Proposed Amendments to section 36 of the Act

The former National Government planned to implement changes to the Commerce Act but was voted out of Office before enacting these. Having general agreement regarding the need to amend the Commerce Act, the present Labour Government has undertaken to introduce a package of amendments. With regard to section 36 of the Act, the Government's concern is that it needs to be strengthened. (This is perhaps particularly necessary given the Government's view that section 47 of the Act (as it presently stands) has been unable to adequately deal with accumulations of market power).¹⁰⁹

Interestingly, the amendments as proposed will serve to align section 36 with its Australian parallel, section 46 of the Trade Practices Act. This is perhaps particularly beneficial given the continued development of a global economy and the fact that a move to align with the Australian provision will obviously serve to reduce the costs and uncertainty for those operating in both jurisdictions.

Dominance

In its April 1999 discussion document on the proposed review of the thresholds in the Commerce Act, the Ministry of Economic Development (formerly the Ministry of Commerce) suggested that judicial interpretation of the term 'dominance' had

¹⁰⁹ Backgrounder on the Commerce Act Reforms, Ministry of Economic Development 22/06/2000 (www.med.govt.nz/gbl/bus_pol/comref/backgrounder)

narrowed the scope of section 36. The discussion paper suggested that this had reduced the section's effectiveness in prohibiting and deterring unilateral misuse of market power. In response, the Government intends to broaden the range of firms that are subject to the section 36 prohibition by amending the section's threshold to 'substantial degree of power in a market'.

An obvious example of the present threshold's deficiencies is that the prevailing 'dictionary' approach to dominance appears to limit the application of section 36 to the possibility of 'single firm' market dominance, ignoring the reality, that, (in economic parlance), 'more than one firm may have the market power to behave to an appreciable extent in a discretionary manner'. If a firm were able to conduct itself as such, without suffering detrimental effects in the relevant market, then such a firm would possess a substantial degree of (economic) market power, but may not meet the current 'dictionary' definition of dominance, (ie. commanding, or ruling.) Interestingly, the Ministry has specifically indicated that one of the intentions with the amendment of the threshold is to ensure that the prohibition will also apply to major participants in oligopolistic markets.¹¹⁰

Obviously such an amendment will have a significant effect on the provision's reach. And the early uncertainty as to which businesses may actually be caught by the threshold, and thereby be subject to the behavioural restrictions, may possibly have an unsettling effect on the business community. It would be undesirable if businesses curtailed aggressive competitive strategies on a mistaken belief that its activities were subject to the section 36 prohibition. On the other hand however, the amendment to the threshold will hopefully provide the Commerce Commission and aggrieved market participants with the ability to tackle firms that engage in inefficient anticompetitive conduct, (but that because of the current narrow interpretation given to dominance are presently able to escape redress.)

In essence, a change in the threshold is going to result in some degree of uncertainty in the business community, however, that needs to be balanced by the resultant enhancement of the section's efficacy. In tempering the uncertainty however, some

¹¹⁰ above at n 109, page 3.

guidance may be gleaned from the approach the Australian Courts have adopted to the comparable Australian provision, section 46 of the Trade Practices Act 1974. The Australian provision uses the same threshold as proposed for the New Zealand provision, "substantial degree of market power", and may provide companies, and the courts, with some insight and indication for the future application of section 36.

'Use' - 'take advantage of'

The Government also intends replacing the word 'use' in section 36 with the phrase 'take advantage of'. This is also the wording used in the equivalent Australian provision. Ironically, the Australian Courts have actually equated 'take advantage of' with the word 'use'.¹¹¹

Significantly however, unlike in New Zealand, the Australian courts have not rigidly applied hypothetical tests for determining whether market power had been utilised. In contrast, the Australian courts have tended to examine the market structure and relevant circumstances, before forming a pragmatic view as to whether a defendant had 'taken advantage of' market power.¹¹²

Accordingly, the New Zealand Government, in adopting the wording 'take advantage of' could be considered as registering its dissatisfaction with the Privy Council's hypothetical test as a means for determining when market power had been used.¹¹³ Given the Court of Appeal's dissatisfaction with the test, and now that the Government has provided the courts with the opportunity to diverge from the Privy Council's hypothetical test, it is submitted that the New Zealand courts will perhaps tend to align themselves closer to the line adopted by the Australian courts, and move more towards applying a pure 'rule of reason' approach, as opposed to a hypothetical test.

¹¹¹ *Queensland Wire Industries Pty Ltd v BHP Co Ltd* (1989) 167 CLR 177.

¹¹² *Australian Competition & Consumer Commission v Boral Ltd* [1999] FCA 1318. *Melway Publishing Pty Ltd v Robert Hicks Pty. Ltd* [1999] FCA 614.

¹¹³ See Ministry of Commerce *Review of thresholds in the Commerce Act 1986 and related issues* A discussion document April 1999.

Proof of anticompetitive purpose

The Government also sought comment on two proposals designed to address the evidential problems in proving anticompetitive purpose under section 36. The first proposal involved reversing the burden of proof where the Commerce Commission is the applicant. The Government has since retracted this proposal. The second proposal concerns enacting a provision that provides for the court to infer a proscribed purpose from relevant conduct and circumstances. It is submitted that such a proposal is perhaps unlikely to have much effect on the application of section 36 of the Act, as it appears to merely codify the stance already adopted by the courts in determining purpose.

F. CONCLUSION

Competition laws are essentially a set of rules by which business strategies are directed to produce an efficient allocation of resources.¹¹⁴ In line with this view, section 36 of the Commerce Act is designed to prohibit conduct likely to impose efficiency losses, while contemporaneously working not to deter efficient and competitive conduct.

Analogous to a school bully who may wield his/her power to rule the playground, the central concern addressed by section 36 is that companies with market power, if left unchecked, may similarly choose to wield their (market) power to rule and control a market. The problem is, however, how are we to distinguish unilateral misuse of market power (bullying) from legitimate, efficient and competitive conduct.

Given the potentially limitless range of unilateral business behaviour that may in fact constitute anticompetitive conduct, it is no surprise that Parliament enacted such a general rule to deal with this issue. Indeed, a prescriptive code for unilateral misuse of market power would probably run into many pages, be very complicated to adhere to, and apply, and yet still be inadequate. However, Parliament, in enacting such a

¹¹⁴ Philip L. Williams, "Why Regulate for Competition?", in Michael James (ed), *Regulating for Competition? Trade Practices in a Changing Economy*, Published by the Centre for Independent Studies Limited (1989).

general provision, has passed a significant degree of discretion in determining matters under section 36 to the courts.

In fostering competitive markets it is crucial that business decision-makers are given sufficient guidance as to the application and reach of section 36. However, a consequence of relying on such a general prohibition is the difficulties faced by the courts in disentangling, and signalling, illegitimate conduct from legitimate conduct. The *Clear Communications* and *Telecom Corporation* access litigation perhaps provides the best example of this, where, although the same provision was applied to identical facts, three widely contrasting and distinct conclusions were drawn by each of the courts called upon to determine the issue. This is obviously not an ideal situation - if the courts are unable to follow a consistent line of reasoning and approach, then those in business are also not being provided with any clear signals as to what constitutes anticompetitive conduct.

In conclusion, there are a number of specific matters that perhaps require some further comment.

First, it appears that there is little genuine concern that the questions raised by section 36 are inappropriate. Indeed, section 36 raises similar issues to the accepted approaches in both the United States and Australia. Further to this, an examination as to whether market power has been 'used', and whether an anticompetitive 'purpose' exists, does seem a very logical approach to determining unilateral misuse of market power.

The second point concerns the tension between the application of the Privy Council's speculative hypothetical test, versus applying a pure 'rule of reason' approach, as adopted in both the United States and Australia.¹¹⁵ Although the Privy Council suggest such a pragmatic 'rule of reason' approach may provide little guidance to those that hold dominant market positions, such an approach unquestionably enables more credible, logical and rigorous decision making, if only because it provides the courts a wider discretion as to the material considerations. Interestingly, Williams J

¹¹⁵ *Australian Competition & Consumer Commission v Boral Ltd* [1999] FCA 1318.

in *Commerce Commission v Carter Holt Harvey* did not appear to give weight to the Privy Council's hypothetical test in concluding INZCO had breached section 36 of the Act. It is submitted that the Government's proposal to replace the word 'use' with 'take advantage of' will provide the courts with the opportunity to expressly challenge the binding authority of the test, an approach previously advocated by the Court of Appeal.¹¹⁶

The third point I would like to raise concerns the approach of the courts in determining 'purpose'. The New Zealand courts appear to be fashioning the examination of purpose as a defence to allegations of misuse of market power, similar in approach to the 'justification' test formulated by the United States Supreme Court. In terms of providing guidance to those in business, such an approach may arguably provide a degree of assurance as to when a person may not be in breach of section 36. For instance, if a person could legitimately justify their conduct on commercial terms, then they are unlikely to be in breach of section 36.

Fourth, the extension of section 27 to capture what ostensibly appears to be unilateral misuse of market power does raise some grounds for concern. This is especially so given the dangerous precedent set with regard to establishing a potential 'effects' test for 'all' businesses. It will be interesting to observe which direction the courts take with regard to section 27 of the Act and unilateral conduct.

Finally, it is interesting to note that the New Zealand courts have not chosen to develop or adopt supplementary rules as the courts in the United States have done. Their reticence is perhaps surprising given the arguments in favour of adopting such rules, in particular the direction such rules could provide to the business community.

As evident, the application of section 36 of the Act has followed a somewhat disorderly and turbulent path since its enactment. Given the unlimited permutations of conduct that may be caught by section 36, it is perhaps inevitable that there will be difficulties in determining a breach at the provision's margins, but there is conceivably no reason for the present relatively nebulous state of affairs with regard

¹¹⁶ *Port Nelson Ltd v Commerce Commission* (1996) 7 TCLR 217.

to dealing with unilateral misuse of market power. The proposed amendments to section 36 may perhaps go some way to improving the suitability of the framework for dealing with such issues, but as when first enacted, it will be up to the courts to develop a credible and consistent approach to determine unilateral misuse of market power. We await to see which path the courts choose to take.

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