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THE PRIME NECESSITY DOCTRINE AND SECTION 36 OF THE COMMERCE ACT 1986

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ABSTRACT

The object of this paper is to analyse section 36 in the light of the Privy Council decision in *Telecom* v *Clear*. Section 36 will then be compared with the doctrine of prime necessity. The comparison notes the different elements, purpose and origins of section 36 and the doctrine. The paper contains a case study in which the facts of *Telecom* v *Clear* are applied to the doctrine. The paper concludes with the view that the doctrine of prime necessity is a viable alternative to applying section 36 to natural monopolies.

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 15,000 words.

CONTENTS

INTRODUCTION

The Privy Council's treatment of section 36 of the Commerce Act 1986 (section 36) in *Telecom Corporation of New Zealand Limited* v *Clear Communications Limited* [1] (*Telecom* v *Clear*) has cast doubt on the effectiveness of section 36 as a mechanism for promoting competition in vertically integrated natural monopolies. In the absence of any industry specific regulatory body to control the conduct of natural monopolies the Courts have used section 36 as a mechanism to control anti-competitive conduct by firms in a dominant position. It is this paper's view that the *Telecom v Clear*[2] decision has narrowed the test in section 36 to such an extent that it is no longer an effective tool capable of ensuring access to distribution networks and facilities that are natural monopolies. The failure of section 36 to allow Clear access to Telecom's telecommunications network has effectively prevented competition in the local fixed telephone market since negotiations commenced between the parties in 1990.

The purpose of this paper is to discuss and compare the common law prime necessity doctrine with section 36, in order to ascertain whether it is a viable mechanism for ensuring access to markets that are natural monopolies. With this purpose in mind, the paper is divided into the following principal parts:

(a) Section 36; its elements,
(b) The doctrine; its origins, purpose and elements,
(c) Section 36 and *Telecom v Clear*,
(d) Alternatives to section 36,
(e) Section 36 and the doctrine; a comparison,

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[1] [1995] 1 NZLR 385

[2] Above n 1

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(f) Section 36 and the doctrine applied to the facts of *Telecom v Clear*.

The paper will discuss the Privy Council's single test for 'use' and its restrictive interpretation of the purpose of section 36 and how this has the practical effect of excluding anti-competitive conduct previously caught by the section.

After a survey of the case law concerning the doctrine it will be concluded that the doctrine and section 36 are equally capable of being applied to a situation where access is being denied to a vertically integrated natural monopoly. The principal differences between section 36 and the doctrine are those of sophistication and the reliance they each place on a Court to regulate a fair and reasonable price. Given the importance of the regulatory component of the doctrine the paper will consider the role and ability of the Court's to set a price for access to a natural monopoly.

The paper concludes with an analysis of the facts of *Telecom v Clear* [3] as applied to the doctrine. The analysis will show that the doctrine is sufficiently flexible to be a workable alternative to the application of section 36 to vertically integrated natural monopolies.

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[3] Above n, 1

II MONOPOLY POWER

Monopolies occur when "[T]he competitive forces which usually prevent stagnation, compel efficiency and stimulate progress are not operative..."[4] The economic effects of monopoly power have been divided into three categories. Allocative inefficiency involves the waste of society's resources (and a diminution in society's wealth) by monopolies, who, because of the lack of competition, use the resources for less valuable purposes.[5] Secondly, monopoly pricing transfers wealth from the consumer to the monopolist. This transfer is a further example of society's wealth being diminished by the actions of a monopolist.[6] The third category defines a firm's desire to remain competitive by developing and improving a product. While a firm strives to obtain monopoly profits it competes energetically and in so doing reduces its costs and improves the quality of its product. Once monopoly profits are reached (or a profit very close to it) the monopoly will, now being shielded from competition, adopt the "quiet life" and cease to maintain the drive needed to keep costs down and improve the product by research.[7]

A monopoly may be created by historical accident, exceptional business acumen and competitive practices.[8] Natural monopolies occur because

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[4]Sir Arnold Plant, "Monopolies and Restrictive Practices", Lloyds Bank Review, October 1948, p7 cited in Alan Ransom & Warren Pengilley. *Restrictive Trade Practices: Judgments Materials and Policy* (Legal Books Pty Ltd, 1985) 24.

[5]Robert H Lande, "Wealth Transfers as the Original and Primary Concern of Anti-Trust: The Efficiency Interpretation Challenged" (1982) 34 Hastings Law Journal 65, 72.

[6]Above n 5, 74-77.

[7]Above n 5, 77-79.

[8]JGM Shirtcliffe "Access to Essential Facilities in Electricity Supply" in M Copeland and W Haddrell (eds) *Competition Review: Current Issues in New Zealand Competition and Consumer Law* Vol 5 May 1993 (Wellington, Commerce Commission, 1993) 2, 6.

of factors central to or at the heart of the industry involved. They are often identified as industries that have "[H]igh sunk costs and/or a high degree of technical coordination".[9] The more commonly listed examples are electricity networks (the physical means by which the generators of electricity convey their electricity to the wholesaler), gas pipelines, telecommunications and ports.

Telecom's local fixed phone network is an example of a vertically-integrated natural monopoly. Telecom operates the network (a natural monopoly) and also competes in a downstream market, being the provision of local telephone services. In the electricity industry, the electricity distribution line businesses are natural monopolies. These businesses can constitute a vertically integrated natural monopoly when they compete in the downstream market of electricity retailing. The detrimental economic effects of monopoly power will be experienced when the monopolist restricts access to the natural monopoly in order to restrict or prevent competition in the downstream market.

III SECTION 36 - ITS ELEMENTS

Section 36 provides:

> **36. Use of dominant position in a market** - (1) 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 in any other market; or
>
> (c) Eliminating any person from that or any other market.

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[9]Above n 8, 5.

Its object is to prevent dominant firms using their market power for anti-competitive purposes. Ahdar, in the context of the deregulated telecommunications industry, has described it as being the "[L]ynchpin of light-handed regulation...".[10]

The paper will now examine the elements of section 36.

A Market

It is necessary to define the market in order to assess whether there has been a reduction in competition;[11] the market also provides an environment in which the concept of dominance can be assessed. Section 3(1A) of the Commerce Act 1986 states that every reference to the term market, "[I]s a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them." A market has been defined as having four dimensions, namely: product, functional, geographic and time. The product market[12] involves discovering how many goods are substitutable for those that are in issue. The more goods that are substitutable the wider the market is. The greater the substitutability, the less likely it is that the behaviour in respect of the goods, has substantially reduced competition. The functional market is defined horizontally and exists because those

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[10]R Ahdar, "The Privy Council and 'Light-handed' Regulation" (1995) 3. Law Quarterly Review, 217, 219

[11]See *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR, 352, 358

[12]*Re The Proposed Takeover by LD Nathan & Co Ltd of McKenzies (NZ) Ltd* (1981) 2 NZAR 321, para 120. See also Yvonne van Roy *Guidebook to New Zealand Competition Laws* (2 ed CCH New Zealand Limited, Auckland 1991) 61-65

involved in a trade practice may deal in the same goods and services.[13] The geographic market is that area in which buyers can substitute one product for another, an example of a small geographic market would be that of the hairdressing trade, in that it is unlikely that customers would travel long distances to have their hair cut.[14] The final dimension is that of time. The Courts will be concerned with the time period in which to assess the amount of product or service substitution. It is likely that a Court would be more concerned with promoting the objective of the Commerce Act 1986 (the promotion of competition) in long run (permanent) markets rather than those of a short run (transitory) nature. As McGechan J said, "[M]arkets are objective facts. The exist, like the weather. They are not abstract concepts to be tailored, as to boundaries, so as to facilitate some desired ultimate outcome".[15]

B Dominant Position

Until the Court of Appeal decision in *Telecom Corporation NZ Limited v Commerce Commission*[16] the Commerce Commission and the High Court had adopted an economic definition of the word "dominant". Relying on the Article 86 of the Treaty of Rome[17] origin of the words

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[13]See van Roy above n 12, 62 and *Telecom Corporation of NZ Ltd v Commerce Commission & Others* (1991) 3 NZBLC, 99-239

[14]See van Roy above n 12, 63 and *Re The New Zealand Council of Registered Hairdressers (Inc)* [1961] NZLR 161

[15]*The Commerce Commission v Port Nelson Limited* (1995) 5 NZBLC 102 340, 102, 358

[16][1992] 3 NZLR 429

[17]Article 86 states:

> Any abuse by one or more undertakings of a dominant position within the commission market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between member states

"dominant purpose", the Commission in *News Limited/ Independent Newspapers Limited*, adopted an economic approach when it said a business was dominant when it was, "[A]ble to make significant business decisions, particularly those relating to price and supply, without regard to the competitors, suppliers, or customers of that person".[18]

In *Re Broadcast Communications Limited* the Commission redefined the meaning of dominance when it stated it[19]:

> [E]xists when a person is in a position of economic strength such that it can behave to a large extent independently of that person's competitors. A person in a dominant position will be able to effect an appreciable change in the price and or other aspects of supply of his goods and services and maintain this change for an appreciable length of time without suffering serious adverse impact on profitability.

The Commission used the *Broadcast Communications Limited*[20] test in *Telecom Corporation of New Zealand Limited/The Crown*[21]. The decision proceeded to the Court of Appeal[22] where the economic approach to dominance was rejected. All five judges adopted a non-technical, dictionary based meaning of the word dominant. Richardson J delivered the leading judgment. He criticised[23] the *Broadcast Communications Limited* decision which said "large" and "appreciable"

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[18](1987) 1NZBLC (Com) 99-500; 104, 054. An economic analysis of Article 86 is contained in *Re Continental Can Co Inc* (1972) CMLR DII

[19](1990) 2 NZBLC (Com) 99-526

[20]Above n 19

[21]Decision 254, 17 October 1990. This decision involved Telecom seeking clearance from the Commerce Commission (under section 66(3) of the Commerce Act 1986) for the purchase of a cellular frequency called AMPS-A

[22]*Telecom Corporation NZ Limited v Commerce Commission* [1992] 3 NZLR 429

[23]Above n 22, 442

were synonymous with "dominant". He stated:[24]

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

In *Commerce Commission v Port Nelson Limited*[25] (*Port Nelson* 1995) the Court, it appears reluctantly,[26] followed the Court of Appeal's dictionary (non-economic) definition of dominant. McGechan J's discussion of the definition noted the following points:[27]

(a) Although the definition of dominance was not a matter of economic theory it could not be separated from the competitive nature of the Commerce Act 1986 on which economic concepts would inevitably have an input.

(b) Dominance does not mean absolute control, there need not be

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[24]Above n 22, 442. For a critical appraisal of the Court of Appeal's decision see, Ross H Patterson "The Rise and Fall of a Dominant Position in New Zealand's Competition Law: From Economic Concept to Latin Derivation" (1993) 15 NZULR 265. Patterson argues that the application of the dictionary meaning to "dominant", "[T]o a greater or lesser extent turned the established jurisprudence on its head." (see p280). The consequence of which is to place, "[T]he market power threshold far higher than had been intended by the framers of the legislation". (see p267). For a less pessimistic view see J A Farmer, "Deregulation and Competition: is the Commerce Act working?" [1993] NZ Recent Law Review, 14

[25]Above n 15

[26]McGechan J was a member of the Court of Appeal, that confirmed the economic approach to dominance, in *ECNZ v Geotherm Energy Limited* (1992) 2 NZLR 641. At page 49 of *Commerce Commission v Port Nelson Limited* (Above n 15, 103788) McGechan J said, "[I] have no choice..." but to follow the Court of Appeal decision. "If that standard is too divorced from the requirements of modern competition law, legislative action may be warranted".

[27]Above n 15, 103 787-103 788

a monopoly

(c) The dominant firm must be able to operate commercially without significant competitive restraints, and

(d) While operating must be able to dictate an increase in prices without fear of competitive restraint, or reduce prices knowing that its competitors would have to follow

(e) The ability to dictate must be sustainable and that the concept of dominance sets a very high standard.

Consistent with his reluctance to follow the Court of Appeal, McGechan J appears to have read down the dictionary definition. His view that the definition could not be separated from an essentially economic/competition orientated statute, that absolute control was not necessary and that the control must be sustainable are all indicative of a lower threshold test than that envisaged in the Court of Appeal.

Once having defined the meaning of dominance it is necessary to look for its existence. Section 3(8) of the Commerce Act 1986 directs the Court to look for a firm in a position to exercise a dominant influence not the actual exercise of a dominance influence. Section 3(8)(a), (b) and (c) set out non-exhaustive factors[28] that may indicate dominance. Structural factors such as market share, access to capital and materials, technical knowledge and barriers to entry are noted in section 3(8)(a). Sections 3(8)(b) and (c) ask the Court to have regard to the extent to which the person is constrained by the conduct of competitors or potential competitors, and suppliers or acquirers of the goods or services. The Court of Appeal in *Telecom Corporation NZ Limited v Commerce Commission*[29] did not share the High Court's view[30] that

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[28]In *News Limited/Independent Newspapers Limited* above n 18, the Commission set out an expanded list of factors that could be used in determining dominance

[29]Above n 16

in determining the existence of dominance market structure was the primary determinant of market power or dominance. This approach emphasised the section 3(8)(a) factor over the market conduct (behavioural) factors in sections 3(8)(b) and (c). Richardson J in stressing the case by case nature of the enquiry said:[31]

> Section 3(8) does not allow any theoretical or intuitive ranking applicable in all cases. It proceeds on the premise that the weighting must vary according to the particular facts. *It calls for a pragmatic assessment in the particular circumstances* of one's ability to exercise a dominant influence in one or more aspects of the relevant market.

C *Use* (of a Dominant Position)

It will be recalled that section 36(1) relates to persons who use their dominance in the market for anti-competitive purposes. *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd*[32] considered the meaning of "take advantage of"[33] which is the Australian

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[30]See *Telecom Corporation New Zealand Ltd v Commerce Commission* (1991) 3 NZBLC 102, 340, 102 367

[31]Above n 22, 444

[32](1989) ATPR 40, 925. The case involved a large steel manufacturer's (BHP) refusal to supply a steel Y-bar to Queensland Wire. Queensland Wire wanted to produce fence posts (of which the Y-bar was a component) in competition to BHP's wholly owned subsidiary.

[33]Section 46(1) of the Trade Practices Act states:

> **46**(1) A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
> (b) preventing the entry of a power on in to that or any other market; or
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market

equivalent of "use" in section 36. The High Court of Australia held that the words were to be equated with the neutral word "use".[34] Van Roy[35] notes that the test for use in *Queensland Wire* has been summarised in the following ways:[36]

(a) Is the conduct made possible only by the absence of competitive conditions?

(b) Is the conduct something that only a firm with substantial market power [dominant firm] can do?

(c) Could the conduct be done if the market was vigorously competitive?

In *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Pty Ltd*[37] the Court stated that the role of "use" was to provide a causal connection between the acts complained of and the degree of power in the market. Use was not to be viewed in isolation but in conjunction with the prohibited purposes set out in sections 46(1)(a), (b) and (c), (sections 36(1)(a), (b) and (c) of the Commerce Act 1986). Wilson J (in *Queensland Wire*) said "It is these purpose provisions which define what uses of market power constitute misuses"[38]. In a case that was decided before any New Zealand decisions[39] that considered 'use' as

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[34]Above n 32, 50, 012

[35]Yvonne van Roy "The Privy Council decision in *Telecom v Clear*: Narrowing the application of s36 of the Commerce Act 1986" [1995] NZLJ 54

[36]Above n 35, 57

[37](1992) ATPR 41 - 196, p40, 644

[38]Above n 32, 50, 010

[39]See *Union Shipping New Zealand Ltd v Port Nelson Ltd* below n 43, *ECNZ v Geotherm Energy Ltd* above n 26 and *Telecom Corporation New Zealand Ltd v Clear Communications Ltd* above n 1

a separate element, Tipping J, in *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd*,[40] (*Magic Millions*) emphasised the importance of the prohibited purposes in subsections 36(1)(a), (b) and (c). In contrast to the Privy Council decision in *Telecom v Clear*[41] Tipping J considered that proof of one of anti-competitive purposes almost certainly meant that there had been a use of a dominant firm's position in the market; he said[42],

> It seems to me that the key question is not so much whether a dominant party has used its dominant position but rather whether or not its conduct is proved to have been for one or more of the proscribed purposes...

In *Union Shipping New Zealand Ltd v Port Nelson Ltd*[43] the Court emphasised "use" over purpose. McGechan J stated, "If a person simply acts in a normal competitive fashion, as he would whether dominant or not, that person can hardly be said to be "using dominance".[44]

The different approaches to the significance of "use" in *Magic Millions*[45] and *Union Shipping New Zealand Ltd v Port Nelson Ltd*[46] was resolved

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[40][1990] 1 NZLR, 731

[41][1995] 1 NZLR, 385, 402 Where the Privy Council said it was "[D]angerous to argue... that because the anti-competitive purpose was present, there was use of a dominant position."

[42]Above n 39, 761

[43][1990] 2 NZLR 662

[44]Above n 43, 706

[45]Above n 40

[46]Above n 43

by the Court of Appeal in *ECNZ v Geotherm Energy Ltd*[47]. Gault J confirmed that use and purpose were separate concepts, that required proof in order to show contravention of section 36. He stated:[48]

> The conduct prohibited by the section is the use of the dominant market position for the proscribed purposes. There will be circumstances in which the use of the market position and the purpose are not easily separated but the two requirements must be kept in mind.

In the High Court determination of *Telecom Corporation New Zealand Ltd v Clear Communications Ltd*[49] the word "use" was given little judicial time. The Court concentrated its analysis of Telecom's activities on the requirement to prove purpose. It held that Telecom's pricing model for interconnection to its network was likely to improve competition and because of this, it was not possible to imply an anti-competitive purpose on the part of Telecom.

The Court of Appeal[50] considered that the "use" and "purpose" elements had been proved and that Telecom's reliance on its pricing model constituted a breach of section 36. After noting the dangers of substituting synonyms for the statutory words, Gault J said that in questioning whether or not a natural monopolist (or a firm that controls an essential facility) has used its position in the market, a Court could

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[47]Above n 26

[48]Above n 43, 646-647

[49]1992 5 (TCLR) 166 The Court considered that the Baumol/Willig rule was more likely than the alternatives to foster competition and because of this, use of the rule could not amount to Telecom using its dominance to deter Clear from competing. This analysis of use appears to concentrate on the effect of the conduct, rather than the conduct itself. It is difficult to see how the Court effectively separated 'use' from 'purpose', because it also used the effect of the rule to establish purpose (see p217).

[50](1993) 4 NZBLC 103, 340

enquire as to "[W]hether the firm has acted reasonably or with justification."[51] In the circumstances of a natural monopoly he considered that a separate enquiry into Telecom's purpose was unnecessary, as it could, "[B]e inferred from the inevitability of the consequences of refusing to deal except on terms that lead to a competitive advantage."[52] The Court considered that Telecom's use of the pricing rule (which preserved Telecom's monopoly profits) was unjustified and something that only a monopolist could do. Accordingly, reliance on the rule amounted to use of a dominant position.

It has been recognised that the *Queensland Wire*[53] and *Union Shipping New Zealand Limited* v *Port Nelson Limited*[54] tests are best "[U]sed as guides rather than absolute benchmarks."[55]Van Roy noted that the *Queensland Wire*[56] test of, "is the conduct made possible because of the market dominance"? difficult to apply because it does not take into account the fact that the same conduct (for example, price cutting) might be engaged in by dominant and non-dominant firms alike. A dominant firm may cut its prices below marginal cost in an attempt to destroy a competitor while a non-dominant firm might do the same to secure a foothold in a market. In the example given, the type of conduct is the same but the effect in the former example is anti-competitive and in the latter, pro-competitive.[57] Van Roy noted that the *Union Shipping*

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[51]Above n 50, 103, 354

[52]Above n 50, 103, 360

[53]Above n 30

[54]Above n 43

[55]See van Roy above n 12, 152

[56]Above 30

[57]See van Roy above n 12, 152

New Zealand Ltd v Port Nelson Ltd[58], "is the firm acting in a normal competitive fashion, as it would whether dominant or not..."?, test would involve the Court embarking on an analysis of normal competitive behaviour in any particular industry.[59] Such a criticism was echoed by the Court of Appeal in *Telecom Corporation NZ Ltd v Clear Communications Ltd*[60] when Telecom argued that its pricing model did not constitute a breach of section 36 because it only reflected what a non-dominant firm in a competitive market would do. Gault J noted that this argument attracted, "[T]he construction of theoretical economic models..."[61] on which economists were unlikely to agree. In conclusion van Roy suggests[62] that the difficulty of formulating one test for use is such that the search for use should be carried out in conjunction with that for the section 36(1)(a), (b) and (c) search for purpose.

D Purpose

Under section (2) (5) (b) of the Commerce Act 1986 a person will be deemed to have been engaged in conduct for a particular purpose if that purpose was the substantial[63] purpose. A dominant firm will contravene section 36 when it has used its market power for the purpose of achieving one of the results listed in section 36(1)(a), (b) and (c). It is not necessary to actually achieve the result. As Hampton

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[58]Above n 43

[59]See van Roy above n 12, 152

[60]Above n 50

[61]Above n 50, 103, 354

[62]See van Roy above n 12, 153

[63]"Substantial" is defined in s2(1A) of the Commerce Act 1986 as being "real or of substance"

states:[64]

> [T]he fact that certain acts or practices engaged in by dominant firms achieve or attain the consequences set forth in s36(1)(a)-(c) is not of itself sufficient to make the section applicable to those acts or practices. Before liability can arise, a plaintiff must prove that the impugned acts or practices constitute the use of a dominant position for one or more of the proscribed purposes.

In *Port Nelson 1995*[65] McGechan J noted that, "There is rampant uncertainty within New Zealand Courts whether "purpose" in s27 and s36 is to be ascertained objectively or subjectively, or under both heads".[66] The Court went on to survey[67] Australasian authority on the topic. The Court concluded that there was no authoritative decision favouring one approach over the other, and adopted both a subjective and objective test to the existence of purpose. Such a solution was arrived at with reference to the likelihood that the Plaintiff in proof of its

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[64]J Farrar & Borrowdale (eds) *Butterworths Commercial Law in New Zealand* (2 ed, Butterworths, Wellington, 1992) 756-757

[65]Above n 15

[66]Above n 15, 103, 773

[67]Above n 15, 103 773 - 103 776. *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647, (ARA), favoured an objective test, *Magic Millions* (above n 40) a subjective test, *Union Shipping New Zealand Limited v Port Nelson Limited* (above n 43, 709) favoured an objective test, but left the issue open. McGechan J considered that *Tui Foods v NZ Milk Corporation* ((1993) 4 NZBLC 103, 335, 103, 338) (a case that dealt with section 29 of the Commerce Act 1986) suggested that an objective approach would be sufficient, but where evidence is lacking, a subjective approach may suffice, and *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR, 385 as favouring a mixed objective/subjective approach. McGechan J's survey missed the High Court decision in *Apple Fields Ltd v New Zealand Apple and Pear Marketing Board* (1989) 2 NZLBC 103, 564 which favoured a subjective test. The Court of Appeal later overturned the High Court decision but not specifically on the correct test (see [1989] 3 NZLR 158) but on the issue of section 43 of the Commerce Act 1986, statutory authorisation. A decision which was later overturned by the Privy Council (see [1991] 1 NZLR 257). The Court noted the differing Australian approaches on the same issue and was unable to discern one particular approach in the ascendancy.

claim was just as likely to adduce evidence that tended to prove purpose subjectively as well as objectively. McGechan J stated:[68]

> [A] plaintiff may establish anti competitive purpose objectively, in the sense of inviting the inference from actions and circumstances. That will be the more ordinary approach. Alternatively, a plaintiff may establish anti competitive purpose subjectively, in the sense of evidence otherwise of actual thinking... Where a plaintiff has both objective and subjective evidence, a plaintiff may - and doubtless will - present both. Any other approach is artificial. It will not ordinarily impose an unfair additional burden on the plaintiff to lead evidence of subjective intention (if held) as well as objective, and to cross examine in the area , if subjective intention is raised by the defendant.

Having looked at the basic components of section 36, it is important to note that section 36 has been used in a variety of circumstances. In *Magic Millions*[69] it was used to prevent the anti competitive scheduling of horse auctions. In the *ARA*[70] case the section was used to enable rival car rental firms to have their applications for a rental car concession considered, in *Union Shipping New Zealand Ltd v Port Nelson Limited*[71] and *Port Nelson 1995 Limited*[72] it was used to stop Port Nelson Limited refusing to deal with stevedores and maritime pilots on terms that were designed to prevent competition.

The discussion of section 36 has set out the complexity and ongoing development of the meaning of the elements of, the comparatively new, section 36. In contrast, the prime necessity doctrine will now be considered.

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[68]Above n 15, 103, 777

[69]Above n 40

[70]Above n 67

[71]Above n 43

[72]Above n 15

IV THE PRIME NECESSITY DOCTRINE

A Origins

The doctrine has its origin in a late seventeenth century private essay of the Lord Chief Justice of the Kings Bench, Lord Hale. In *De Portibus Maris*[73] Lord Hale stated:[74]

> If the king or subject have a publick wharf, unto which all persons that come to that port must come and unlade or lade their goods as for the purpose, because they are the wharfs only licensed by the queen, or because there is no other wharf in that port, ... in that case there cannot be taken arbitrary and excessive duties for cranage, wharfage, ... but the duties must be reasonable and moderate ... For now the wharf and crane and other conveniences are affected with a publick interest, and they cease to be *juris privati* only; ... it is now no longer bare private interest, but it is affected with a publick interest.

Lord Hale postulated that there were three major divisions of the law: the rights and powers of the King, the rights of the person and the rights of things. The latter category was divided into juris publici[75] and juris privati[76]. Lord Hale considered that things that were juris privati could become juris publici if the activity took on, as a consequence of external

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[73]Reproduced in F Hargrave, *Collection of Tracts Relative to the Law of England* (1787), Vol 2 Part 2, Chapter 3, 77, cited in B P McAllister "Lord Hale and Business Affected with a Public Interest" (1929 -1930) 43 Harv L. Rev 759.

[74]See Hargrave above n 73, 77

[75]See B P McAllister, above n 73, 761. Things that are juris publici are those common to the public, examples are common bridges, rivers and ports

[76]See B P McAllister, above n 73, 761. Things that are juris privati are those that arise by contract an example, in the case of a 17th century port, would be the franchise the Monarch has granted to an individual to run and charge for port services

factors,[77] a public function. It was in this context that Lord Hale, in *De Portibus Maris*,[78] considered that the private rights of an individual to operate a wharf were subject to the rights of persons to use that wharf (once it had become subject to the public interest), for a reasonable fee. Lord Hale defines juris publici in terms of the regulation of trade and commerce and more particularly the control of prices. He specifically noted that the rights and powers of the King included the power to regulate commerce, weights, coinage and prices[79]. Although, at a practical level, it could be argued that the effect of Lord Hale's doctrine is to regulate commerce it is equally true that the delineation of the rights of things has just as much to do with a description of the competing demands on, and conflicting rights over, property. Lord Hale chose the interests of the public as the rights that should prevail[80].

Thirteen years after the first publication of *De Portibus Maris, Bold v Stennett*[81] became the first English case to apply Lord Hale's doctrine. It was held that the owner of a licensed wharf must allow the public to use the crane positioned on the wharf on reasonable terms.

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[77]An Act of Parliament, allowing private property to be used for a specific purpose (eg customs collection). Lord Hale gave the example of an operator of a ferry being required to charge a reasonable fee when the ferry became the only means of crossing a river because of the destruction of a nearby bridge, see B P McAllister, above n 73 762

[78]Above n 73

[79]See B P McAllister above n 73, 761

[80]See also P P Craig *Administrative Law* (2 ed, Sweet & Maxwell, London, 1989) 155 - 159, who believes that the doctrine is related to the "Common Calling" cases that evolved at times of social/economic hardship. He cites the period after the Black Death when surviving tradespeople were obliged to provide their services at reasonable rates, so as to prevent charging whatever they pleased. Craig is cited in J Land "The Prime Necessities Doctrine: Where Does It Fit?" a paper prepared for the sixth workshop of the Competition Law and Policy Institute of New Zealand, Wellington 4 - 6 August 1995

[81](1800) 8 T.R. 606

Ten years later Ellenborough C J, in *Allnutt and Another v Inglis*[82] (*Allnutt*), cited Lord Hale's doctrine. The defendant was the treasurer of a company that operated the London Dock warehouses. The company was subsequently certified by the General Warehousing Act [83], as being a warehouse where importers could secure their "[4]0 pipes of wine..."[84] for the period before they were obliged to pay duty.

The plaintiff sought a declaration that the company could only impose a rental that was reasonable as to price and its terms. Lord Ellenborough held that the company owned the only premises in which importers could secure their goods in terms of the General Warehousing Act and as such enjoyed a monopoly of a public privilege. Because of the monopoly the company was obliged to charge a reasonable rental.

Judicial acceptance of Lord Hale's doctrine had an inauspicious start in New Zealand. In *Wellington Gas Company v Patten*[85] the company appealed the decision of the Magistrates Court that held that the company could not refuse to supply gas to Patten until such time as he had paid the arrears owed by a former tenant of the hotel he was now resident in. The Court upheld the obligation of the company "[T]o supply the inhabitants of Wellington with gas so long as they paid reasonable prices for it."[86]

After considering *Allnutt*[87] Williams J, in the Court of Appeal, stated

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[82](1810) 12 East 527 and 104 ER 206, 211.

[83]43 G.3, c.132.

[84]104 ER 206, 209.

[85](1885) 2 NZLR 205 (the date of decision was 8 December 1881)

[86]Above n 85, 205

[87]Above n 82

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that it was incumbent on the individual seeking to use the services of a monopoly to prove the existence of a right to use them. On perusal of the empowering legislation (The Wellington Gas Company Act 1870) the majority found the company was under no obligation to supply everyone with gas at a reasonable rate and that the company was at liberty to enter such contracts as they please. The legislation was so general it did not afford Patten the right to demand gas from the company. Accordingly the company was within its rights to refuse to deal with Patten on the terms it did and that *Allnutt*[88] was of no application. This perverse decision has not been followed (or cited) in any subsequent New Zealand decisions.

B Purpose

In *Minister of Justice for the Dominion of Canada v City of Levis*[89] (*Levis*) the Privy Council considered the Levis Council's obligation to supply water to a building owned by the Canadian Government. A dispute had arisen between the Council and the Government about the cost that the Council could charge for the supply of water to the Government's building. When negotiations broke down the Council cut off the Government buildings water supply. It was held that although the Government was not liable to pay the taxes levied on the property for payment of the construction of the waterworks and the water itself, there was an obligation on the Government to pay a fair and reasonable

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[88]Above n 82

[89][1919] AC 505. See also *Chastain v British Columbia Hydro & Power Authority* (1972) 32 DLR (3d) 443, which concerned the supply electricity. The Court affirmed the prime necessity doctrine with the following (see p 454) comment:

> The obligation of a public utility or other body having a practical monopoly on the supply of a particular commodity or service of fundamental importance to the public has long been clear. It is to supply its product to all who seek it for a reasonable price and without unreasonable discrimination between those who are similarly situated or who fall into one class of consumers.

payment to the Council for the supply of water. While acknowledging that the Council did not have a monopoly[90], Parmoor LJ said:[91]

> [I]t must be recognised, however, that water is a matter of prime necessity, and that, where waterworks have been established to give a supply of water within a given area for domestic and sanitary purposes, it would be highly inconvenient to exclude from the advantages of such supply Government buildings, on the ground that these buildings are not liable to water taxation. The respondents are dealers in water on whom there has been conferred by statute a position of great and special advantage, ... Their Lordships are therefore of opinion that there is an implied obligation on the respondents to give a water supply to the Government building provided that, and so long as, the Government of Canada is willing, in consideration of the supply, to make a fair and reasonable payment.

In contrast to section 36, the doctrine has been used for many purposes, in most cases the prevention of anti-competitive behaviour has not been an issue that needed to be addressed. In *Levis*[92] no mention was made of the promotion of commerce or trade. The Court held that the special position the City of Levis found itself in conferred on it, a public interest or social obligation to supply water. The City of Levis, being a supplier of water, held, "[A] position of great and special advantage..."[93] that prevented it from cutting off supply if it obtained a fair and reasonable payment. In the search for a means of defining the relationship between the Government (that was not liable to pay for the water, it being charged as a tax) and the City of Levis (that had cut off

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[90]Above n 89, 512.

[91]Above n 89, 513.

[92]Above n 89

[93]Above n 89, 513

the supply of water) the Court imposed an obligation to supply when the supplier did not have a monopoly.[94] A wider definition of "prime necessity" was introduced and in so doing the social or public duties were extended to those who were not monopolies.

In *Mayor, etc, of Auckland v The King*[95] (*Mayor of Auckland*) the *Levis* principles were applied to a dispute about the payment of rubbish collection charges. The Court agreed that the Post Office department wasn't liable to pay the charges as they were levied pursuant to an Act that did not bind the Crown. After holding that the collection of rubbish was a prime necessity Stringer J went on to say that to hold the Crown not liable to pay a fair and reasonable fee would mean that a greater fee would have to be levied on the taxpayers to make good the shortfall.

The usefulness of the prime necessity doctrine is apparent in the *State Advances Superintendent v Auckland City Corporation and The One Tree Hill Borough*[96]decision (*State Advances*). The local city Corporation and Borough had failed to agree over the terms of the supply of water to the Crown(acting through its powers contained in the State Advances Act 1913). *State Advances* was not about competition, commerce or trade, it was principally an exercise in the statutory construction of section 86 of the Municipal Corporations Act 1920[97] which set out the power of the Corporation and the Borough to withhold the supply of water where there was non-payment by the person liable.

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[94]Above n 89, 512

[95][1924] GLR 415

[96][1932] NZLR 1709

[97]Section 86 states:

> If any person refuses or fails to pay any water rate for which he is liable, the Council may, without prejudice to any other remedy for the recovery of such rate, stop, in such manner as the Council thinks fit, the supply of water to the premises in respect of which such rate is payable, and may recover from such person the whole expense incurred in stopping such supply.

Levis was cited as a statement of general principle that stood outside the statutory framework and was consequently available as an aid to the construction of the section.[98] The Court held that the Corporation and Borough only had the power to cease supplying a person who is liable and in actual possession of the property. In the present case, State Advances had rented the premises (using its mortgagee power; it was not in physical possession) and accordingly the tenants' premises had to be supplied with water in return for a fair and reasonable fee.

The Wairoa Electric Power Board v Wairoa Borough[99] (*Wairoa*) and *South Taranaki Electric Power Board v Patea Borough*[100] (*South Taranaki*) decisions involved disputes between monopoly suppliers of electricity and the local boroughs. In both cases the existing commercial relationships had broken down and the issue of price for the continued supply remained at large. In both cases the prime necessity doctrine was held to apply and imposed as a means of resolving a dispute between a purchaser and a seller.

The *Hutt Golf Course Estate Company Limited v Hutt City Corporation*[101] (*Hutt Golf Course*) decision is perhaps the most obvious example of the utilitarian nature of the prime necessity doctrine. The Hutt Golf Course Estate Company sued the Hutt City Corporation for £720.00 being the cost of sewage and water connections installed on the Corporation's instructions. The Corporation had not paid because the Crown (the purchaser of the allotments in which the connections were installed) was not liable to pay for building permits. It was a term

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[98]Above n 96, 1715 (Myers CJ), 1723 (Herdman J) and 1725 (Kennedy J)

[99][1937] NZLR 211

[100][1955] NZLR 954

[101][1945] NZLR 56

of the agreement between the Hutt Golf Course Estate Company and the Hutt City Corporation, that the Corporation would not pay the company until the building permit had been paid.[102] At first instance and on appeal it was argued that the prime necessity doctrine went as far as obliging the Crown to pay fair and reasonable water and sewage connection (in addition to supply) fees,. After Blair J's acceptance of this proposition, the majority of the Court of Appeal rejected this argument and held that such an extension of the prime necessity doctrine was not contemplated by the *Levis*.[103] decision. What is more significant than the ultimate rejection of the broadening of the prime necessity doctrine is the fact that both the Supreme Court and the Court of Appeal did not question the proposition that the doctrine could be imposed on a non-party (the Crown) to the proceeding as a means of resolving a land development/construction dispute between the Hutt City Corporation and the Hutt Golf Course Estate Company. The prime necessity doctrine was not being considered in the context of a dispute between purchaser and seller, but in a situation where one party to a dispute was seeking to enforce payment of a debt. The application of the doctrine to the facts is a long way from Lord Hale's analysis of a person's private interest in property being subject to the public's interest. There was no suggestion that the prime necessity doctrine was being used for a social or public purpose, nor was it envisaged that the Crown was going to be deprived of a water supply to its allotments.

After the *South Taranaki*[104] case the doctrine appears to have fallen into disuse until its re-emergence in *Auckland Electric Power Board v*

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[102]Above n 101, 73

[103]Above n 89

[104]Above n 100

Electricity Corporation of New Zealand Limited (Auckland Electric)[105]. In facts not dissimilar to those in *Wairoa*[106] Barker J, in an interlocutory decision, confirmed the existence of the proposition, "[T]hat a monopoly supplier of an essential commodity has a duty to supply and charge a fair and reasonable price with a corresponding duty on the recipient to pay a reasonable price."[107] On appeal[108] the Court of Appeal upheld Barker J's interlocutory decision. Richardson J[109] cited the *Allnut*[110], *State Advances*[111], *Wairoa*[112] and *South Taranaki*[113] decisions and confirmed the prime necessity doctrine.

In *New Zealand Rail Limited v Port Marlborough New Zealand Limited*[114] the Court of Appeal dealt with an interlocutory appeal concerning the discovery of documents and their relevance to the

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[105][1993] 3 NZLR 53

[106]Above n 99. IN 1988 ECNZ entered a transition agreement with the Board under which ECNZ would supply electricity while negotiations for a new agreement were continuing. No new agreement had been resolved by March 1993. In the same month ECNZ purported to terminate the transitional agreement. The Board then commenced proceedings seeking a declaration that the transitional agreement was still in force. In *Mercury Energy Limited* (the renamed Auckland Electric Power Board) *v Electricity Corporation of New Zealand Limited* Unreported, 22 May 1995, High Court, Auckland Registry, CP 20/92, Temm J granted a declaration to *Mercury Energy Limited* that the transitional agreement remained in force. The declaration was granted without reference to the doctrine of prime necessity and on the basis that ECNZ had breached the earlier transitional agreement with Mercury.

[107]Above n 105, 60. The cause of action asserting the proposition way struck out because on the facts and given the other causes of action, it was superfluous

[108][1994] 1 NZLR 551

[109]Above n 108, 557

[110]Above n 85

[111]Above n 96

[112]Above n 99

[113]Above n 100

[114][1993] 2 NZLR, 641

calculation of a reasonable fee. Such a question had arisen in the context of New Zealand Rail Limited's causes of action, one of which relied on the prime necessity doctrine.

The most recent decision to affirm the existence of the doctrine is that of the High Court in *Airways Corporation of NZ Limited v Geyserland Airways Limited*.[115] The dispute concerned whether or not Geyserland had to pay a fee ($7.00 per takeoff) for air traffic control services at Rotorua airport. The High Court upheld the District Court decision that there was no contract between the Corporation and Geyserland stipulating payment of the fee. The High Court noted the Corporation's concession that it had a practical monopoly in the provision of air traffic control services and a duly to provide them for a reasonable fee.

It is clear from the survey of the cases that the doctrine remains alive and that it has not been rendered redundant by the passing of increasingly more sophisticated competition legislation. In contrast to the specific purpose of section 36 the doctrine has been used in a variety of circumstances and for a variety of purposes. The paper will now discuss the elements of the doctrine.

C The Elements

The prime necessity doctrine, as enunciated in *Levis*,[116] has three components: a prime necessity, (a supplier in) a position of great and special advantage and a fair and reasonable payment.

1 Prime necessity

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[115]Unreported, 30 June 1995, High Court, Rotorua Registry, AP 127 and 128/94.

[116]Above n 89

The *Bolt v Stennett*[117] and *Allnutt* [118] decisions adhered to Lord Hale's formulation of a person's private rights in property being subject to the public interest to use that property in return for payment of a fair and reasonable fee. In *Levis*[119] the prime necessity was the supply of water. The supply of rubbish collection services[120] and electricity[121] have been confirmed as a prime necessity. More recently the prime necessity doctrine has been asserted as applying to a right of access to port facilities[122]. The activities, defined as prime necessities, are by their nature, enterprises that lend themselves to industries that are monopolistic.

2 A position of great and special advantage - (The concept of monopoly)

The supplier of the prime necessity must be in the position of a monopoly. Lord Hale did not use the word monopoly, but he referred to an analogous circumstance when he described the public's need to use a wharf when it was, "[O]nly licenced by the Queen...",[123] or

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[117]Above n 81

[118]Above n 84

[119]Above n 89

[120]See *Mayor of Auckland* above n 95

[121]See the *Wairoa, South Taranaki and Auckland Electric* cases, above n 99, n 100 and n 105. See also *New Zealand Private Hospitals Association - Auckland Branch (Inc) et al v Northern Regional Health Authority* Unreported (Interlocutory decision) 7 December 1994, High Court, Auckland Registry, CP 440/94, where (at page 30) Blanchard J noted (without enthusiasm) the submission that the prime necessity doctrine could place a monopoly purchaser (a source of money) under a duty to contract and pay a fair and reasonable sum for goods and services

[122]See *New Zealand Rail Limited v Port Marlborough New Zealand Ltd* above n 114, 642

[123]See text at above n 74

because there was, "[N]o other wharf in that port...".[124] In *Levis*[125] the Court, taking a narrow view of monopoly, concluded that no monopoly existed as there was nothing to "[P]revent any owner or occupier from providing an independent supply..."[126] In the absence of a monopoly the Court defined the nature of the commodity (a prime necessity) and described the position of the supplier as one which was characterised by a "[G]reat and special advantage..."[127] The *Levis*[128] approach widened Lord Hale's original doctrine; it was now not necessary to establish a monopoly, something less would suffice.

In *State Advances*[129] Myers CJ noted *Levis*[130] as applying to water suppliers who had a practical monopoly.[131]

Ostler J in *Wairoa*[132] cited *Levis*[133] and *State Advances*[134] as being authority for the need to find a practical monopoly. The definition of

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[124]See text at above n 74

[125]Above n 89

[126]Above n 89, 512

[127]Above n 89, 513

[128]Above n 89

[129]Above n 96

[130]Above n 89

[131]Above n 96, 1715

[132]Above n 99, 215

[133]Above n 89

[134]Above n 96

monopoly was not at issue in *Hutt Golf Course,*[135]at issue was definition of supply in the *Levis* decision. In contrast the *South Taranaki*[136] decision provides the only factual analysis of what might constitute a practical monopoly. Hutchison J believed that the *State Advances*[137]practical monopoly was synonymous with a position of great and special advantage.[138] He noted that the South Taranaki Electric Power Board's empowering regulations did not give the board an exclusive right to supply electricity in the Patea Borough and that, accordingly it did not have a monopoly. In deciding that the board enjoyed a practical monopoly the Court considered the:[139]

(a) Impracticability of the Borough embarking on capital expenditure on a generating plant of its own,
(b) Refusal of the Crown to directly supply the Borough, and
(c) The unwillingness and unlikelihood of a neighbouring board to supply the Borough.

The recent cases have not defined practical monopoly, although the Electricity Corporation in *Auckland Electric*[140] conceded that they were bound to supply electricity at a fair and reasonable price. This may be a concession that it had, at the very least, a practical monopoly. With perhaps the exception of *South Taranaki*[141] the cases have had largely simple factual situations, the issue of whether or not a monopoly exists

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[135]Above n 101

[136]Above n 100

[137]Above n 96

[138]Above n 96, 962

[139]Above n 96, 962-964

[140]Above n 105

[141]Above n 100

was easily resolved by reference to legislation or by acknowledging that the particular industry (water and/or electricity) did not, by its nature, promote and create an abundance of suppliers.

3 A fair and reasonable payment

The payment of a fair and reasonable fee has remained constant throughout the development of the prime necessity doctrine. The moderate nature of the reimbursement is indicative of the original belief that the advantages of monopolistic private rights should be balanced by the public's interest. The Courts have not been troubled by a definition of a fair and reasonable price (as it rarely was an issue). In *Allnutt*[142] it was conceded that the amount offered by Allnutt to the London Dock Company was reasonable; what remained was whether or not the London Dock Company was obligated to accept the reasonable sum as rental. In *Levis*[143] the Privy Council noted that the Court at first instance had decided that $300.00 was a fair amount for the supply of water. In *Mayor of Auckland*[144] and *Wairoa*[145] it was admitted that the envisaged charges were reasonable. In *State Advances*[146] the Court of Appeal was asked specifically to set out the principles on which a fair and reasonable price could be fixed. Myers CJ stated, "[T]hat (without saying necessarily that it is the sole test) the charge made to other persons is at least a test and probably the best test of what is fair and reasonable."[147] After noting the difficulty of

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[142]Above n 82

[143]Above n 89

[144]Above n 95

[145]Above n 99

[146]Above n 96

[147]Above n 96, 1718

fixing a reasonable price he said, "there seems to be no reason why the Crown should pay more than the ordinary payer of rates is required to pay, plus the cost of connecting up with the system."[148]

In *South Taranaki*[149] Hutchison J was asked to declare which of two alternatives were reasonable charges for the supply of electricity. It was also intimated by the Borough's counsel that the Court would be asked to rule on elements of the proposed charges including replacement costs and of transmission charges.[150] Because of the lack of hearing time it was agreed that the issue of reasonableness should be referred to the Registrar of the Court and an accountant as referees.[151]

The doctrine is old. This largely explains the relatively simple (when compared with section 36) concepts and purpose embodied in the doctrine. The doctrine grew up at a time when competition law had yet to evolve and consequently it is not imbued with any pro-competition purpose. It (being of a utilitarian nature) has been called to assist in a variety of circumstances, but essentially those involving contractual disputes.

Before the doctrine and section 36 are compared, the impact of the Privy Council decision on section 36 will be discussed.

V SECTION 36 AND *TELECOM* v *CLEAR*

It has been argued that section 36 has been seriously weakened as a

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[148]Above n 96, 1724

[149]Above n 100

[150]Above n 100, 956

[151]Above n 100, 958

mechanism to control the abuse of a firm's dominant position in a market. The most recent criticism involves the Privy Council's interpretation of "use" in *Telecom v Clear*[152]. The case involved a dispute about the cost that Clear was to pay Telecom for interconnection to the Public Service Telecommunications Network (PSTN) operated by Telecom. Interconnection was (and is) essential and has been described as being a "[S]ine qua non to competition..."[153] between Clear and Telecom. At the heart of the litigation was Telecom's pricing model which came to be known as the Baumol/Willig[154] rule. The most controversial element of the rule states:[155]

> Third, the competitive market standard requires that when one firm provides facilities or some other inputs to another firm, and this process entails some sacrifice of profit by the supplier firm (as when it thereby gives up some capacity that it would otherwise have used itself), then the supplier firm must be permitted to price the article in question at a level sufficient to compensate it for the profit it is forced to sacrifice because of its supply to the other firm. Economists refer to the sacrifice of profit unavoidably entailed in an activity as the opportunity cost of that activity.

In essence the rule allows Telecom (a company in a dominant position) to include in its price[156] for an intermediate product (interconnection

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[152]Above n 1

[153]Above n 10, 218

[154]After Telecom's expert American witnesses, economists, Professors Baumol and Willig. Dr Kahn (another American economist) was also called by Telecom

[155]Above n 1, 405

[156]The three principles on which a telecommunications company prices it product are:

(i) Access (the cost of providing the network/infrastructure by which a caller makes a call, these costs exist whether or not a call is made) and usage (the additional costs incurred when someone makes a call) should be charged separately.

to the PSTN) to Clear (a firm which wishes to compete with it) a component which represents the amount of profit it will lose: the private opportunity cost. The rationale behind the rule is simply that the rule reflects what would happen in a fully contestable or competitive market.

A Use

The Privy Council said that use of the Baumol/Willig rule could not amount to use of its dominant position because all Telecom was doing was what a firm in a competitive market would do. Van Roy has criticised this approach as being artificial because of its failure to recognise the use of the Baumol/Willig rule (the conduct) in the proper market context.[157] Proper analysis of the nature of the conduct with reference to the market context would differentiate a refusal to supply goods by a firm in a dominant position from the same act by non-dominant firm doing so because of the customer's poor history of payments. Although the purpose of the withholding supplies is highly relevant, the market context of a dominant incumbent and a fledgling new entrant will define whether or not refusal to supply amounts to a use

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(ii) The price must include the average incidental costs, that is the average cost of meeting the next increment of demand. The more usual requirement that a price covers the marginal cost (the cost of making the next unit of production) is not used because the next telecommunication unit can be very small (eg an extra telephone line or loop) or very large (eg a new exchange).

(iii) The need to recover common costs i.e costs not incurred directly by the production of a particular unit, costs that remain even though the unit was no longer being made.

See Terence Arnold, "The Courts, The Commerce Act and the Pricing of Access to Essential Facilities: Law & Economics at Work? A paper delivered to the LEANZ Group 5 December 1994 and W Pengilley "Determining Interconnection Prices in Telecommunications: New Zealand Lessons on the Role of a Regulator" (1993-1994) 1 CCLJ 147, 153

[157]Above n 35, 59

of a dominant position.[158] Van Roy notes[159] that the Court of Appeal viewed Telecom's use of the pricing rule, which incorporated monopoly rents, as being one that could only be imposed on Clear because Telecom's dominant position. The Privy Council viewed the same conduct narrowly when it stated:[160]

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

Or, put another way, Telecom could not be using its dominance when it was relying on a rule that firms in a competitive market would rely on; as Ahdar says: [161]

> With respect, this approach to causation seems extremely artificial and prone to mislead. There is an air of unreality in asking how a non-dominant firm in a competitive market would have priced its essential facility. The very question strikes one as odd, as a sort of antitrust oxymoron. It is like asking how fast fish could run if they had legs. In a competitive market firms do not control essential facilities nor is their provision a sine qua non to effective competition flourishing at all. Likewise, how Telecom would have acted in another setting, a competitive market (one where its source of dominance, network control, would ex hypothesi not be present), is neither knowable nor is it the issue.

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[158]Above n 35, 58

[159]Above n 35, 59

[160]Above n 1, 403. The word "unless" appears to be a mistake. As van Roy notes, (above n 35, 56) the word "if" should be inserted in substitution for "unless". See also *Port Nelson 1995* (above n 15, 103790.) where McGechan J said, "The 'unless' in the fourth to last line appears to be a reversal of an intended 'if'....".

[161]Rex J Ahdar "Battles in New Zealand's Deregulated Telecommunications Industry", (1995) 23 Australian Business Law Review 77, 103

A further criticism of the Privy Council's approach to the treatment of use is that it is emphasised over the need to prove one of the purposes in section 36(1)(a)(b) and (c). The Privy Council said:[162]

> Although it is legitimate to infer "purpose" from use of a dominant position producing an anti-competitive effect, it may be dangerous to argue the converse ie that because the anti-competitive purpose was present, therefore there was use of a dominant position.

Van Roy considers this passage [163] to be indicative of the Privy Council's view that the test for use should be strict enough to determine which conduct will or will not be contrary to section 36. Such an approach ignores the requirement of proof of purpose in order to determine whether or not the use of the dominant position has contravened section 36 [164]. The Privy Council acknowledged [165] that Telecom had an anti-competitive purpose but failed to view this in conjunction with Telecom's reliance on the Baumol/Willig pricing rule. The judgment was thus decided by defining use in the absence of purpose or market context. Van Roy concludes that the ambit of section 36 has been narrowed by the failure of the Privy Council to accept that conduct in one market situation might be benign while the

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[162]Above n 1, 402

[163]See van Roy above n 35, 60. In support of her view the author also quoted the following passage from page 406 of the Privy Council decision:

> 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 the production of an anti-competitive 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. Therefore, as the Court of Appeal in the present case accepted, use and purpose, though separate requirements, will not be easily separated.

[164]See *ECNZ v Geotherm Energy Limited* above n 26 and the Court of Appeal decision in *Clear Communications Limited v Telecom Corporation of New Zealand Limited* above n 50

[165]Above n 1, 403

same conduct in another market situation might amount to the use of a dominant position. The test, "[H]as the potential to be very narrow in scope, and to exclude from the ambit of section 36 a good deal of conduct which has in earlier cases been held to be contraventions of that section". [166]

Farmer's view is in contrast to that of van Roy. He argues that the Privy Council decision, "[A]ccepted the Court of Appeal's position that use and purpose, though separate requirements, will not be easily separated." [167] It is correct that the Privy Council cited Court of Appeal authority [168] for the proposition but it is difficult to accept that the Privy Council followed the authority. The fact that the Privy Council ignored Telecom's anti-competitive purpose had the inevitable result of separating it from the use element.

In *Port Nelson 1995* [169] McGechan J utilised the Privy Council's test for 'use' in a way that will please the test's detractors. Port Nelson Limited was dominant in the market for tug services. It had refused the make its tugs available unless its pilots were used; the question was whether this refusal (the tug tie) amounted to "use" of a dominant position. McGechan J applied the Privy Council approach and asked himself whether a firm, faced with competition, would have refused to make its tugs available unless its pilots were also engaged? In answering no to

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[166]Above n 35, 60

[167]James Farmer "New Zealand Competition Law arrives in London" [1994] NZ Recent Law 365, 370. T Arnold is also of the view that the Privy Council adopted, "[A]n orthodox formulation of the test to be applied under section 36..." Although he considered that the Privy Council's approach to purpose suggests that, "[W]here there is a use of dominance a general purpose to beat the new entrant...." will suffice. See above n 156, 23

[168]*ECNZ v Geotherm Energy Limited* (above n 26) and *Union Shipping NZ Limited v Port Nelson Limited*, (above n 43)

[169]Above n 15

the question, (and finding that Port Nelson Limited had used its dominant position for an anti-competitive purpose) McGechan J said:"[O]ne must look at the commercial circumstances and steps taken at the time as pointing both to the course which a non-dominant firm would have taken in relation to a tie and onward to actual purpose."[170]

In contrast to the Privy Council's approach McGechan J was prepared to view the conduct taken in the context of the market at the time, in order to ascertain what a non-dominant firm would have done. This signals a broader more expansive approach to the test, one in which purpose and effect might feature. [171]

B The Role of Section 36

In addition to the narrowing of the definition of use the Privy Council has also taken a restrictive view of the role and ambit of section 36. The proscribed purposes at section 36(1)(a) and (b) of the Act have been misconstrued. The Privy Council said, "[I]n considering whether Telecom's monopoly profits (if any) will produce so high a price to Clear that Clear would be *prevented from entering* the market *at all*."[172] In dealing with the evidence the Board:[173]

> [N]oted that it has not been established by Clear (nor can it be regarded as a serious risk) that Telecom's charges will be so high that Clear will be unable to enter the CBD market at all. Surprisingly, Clear did not produce any of its figures to the Court. As a result Clear could

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[170]Above n 15, 103, 824

[171]Van Roy also noted the possibility of a Court taking a broad view of the conduct at issue and the market context, see above n 35, 60

[172]Above n 1, 404. Emphasis added

[173]Above n 1, 407. Emphasis added

> not make any factual case that it would be altogether prevented by the level of Telecom's charges from entering the market at all.

It was not necessary for Clear to prove that its entry had been totally restricted, as Gault J said in the Court of Appeal, "s 36 is not confined to wholly preventing or denying competitive conduct as seems to have been assumed by Dr Kahn...".[174] This is consistent with the wording of section 36(1)(a) and (b) which requires the purpose of, "Restricting the entry...," or, "Preventing or deterring any person...". Contravention of section 36 will also occur when the proscribed purpose is present but that purpose has not been achieved. This is consistent with Gault J's view that the total prevention of competitive conduct need not be proved in order to show a breach of section 36. Ahdar is of the view that the Privy Council's "all or nothing" approach to section 36 makes, "[T]he Plaintiff's burden even more formidable than it already is."[175]

Inherent in the Board's judgment is a failure to appreciate section 36's pivotal role in promoting competition in those markets where an incumbent is in a dominant position. It is this paper's view that McGechan J correctly identified the role of section 36 and the Commerce Act 1986 when he said: [176]

> A firm may have a dominant position in a market. That is not unlawful. The firm, in that dominant position, may trade in competitive fashion. That is now unlawful. Indeed, the purpose of the *Commerce Act* is to encourage competition, including vigorous competition on the part of all firms, including dominant firms. It is only when the dominant firm oversteps that mark, and "uses" its dominant position for anti-competitive purposes (specified in s 36(1)(a)(b)(c)), that the law steps

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[174]Above n 50, 103358

[175]Above n 161, 104

[176]See *Port Nelson* 1995 above n 15 103, 789

in.

The concern the Board had for Telecom is indicative of the Privy Council's predilection for viewing section 36 in terms that were benign, to a monopolist. Although the Board was correct when it said that a monopolist is entitled to compete with other competitors,[177] it failed to note the pro-competition role of section 36 when it said that if a monopolist was not allowed to compete, to do so, "[W]ould be holding an umbrella over inefficient competitors."[178] As Ahdar states:[179]

> The plain fact is that in a natural monopoly situation the monopolist must hold the umbrella out at least enough to enable competition to spring into life but - and this is the crux - thereafter no further.

In the context of a natural monopoly, Ahdar's view reflects the very purpose of section 36.

The dismissal of Justice Gault's "has the defendant acted reasonably or justifiably"[180] test (in determining use of a dominant position) because of its uncertainty led the Board to conclude that, "[S] 36 must be construed in such a way as to enable the monopolist, before he enters upon a line of conduct, to know with some certainty whether or not it is lawful."[181] The Privy Council highlighted the "quasi-criminal"[182]

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[177]Above n 1, 402

[178]Above n 1, 402

[179]Above n 161, 104

[180]Above n 50, 103, 354

[181]Above n 1, 403

[182]Above n 1, 403. See also Valentine Korah "Charges for Inter-Connection to a Telecommunications Network" (1994-1995)2 CCLJ, 213 at 227. Korah, in an effusive article about the Privy Council decision in *Telecom v Clear*, notes that the prospect of a Court, after the event, finding that a firm's prices were excessive (and because of

penalties as justification for its view. It also explains the subsequent single test for use formulation. The Privy Council's quest for certainty has, by the imposition of a single test to activities that change with circumstance and time, hampered the role of section 36.

It is also exaggerated to suggest that a firm's liability under section 36 turns exclusively on a definition of use (although this was the practical effect in *Telecom v Clear*). Proof of a dominant position, a market and the proscribed purpose are also required. Indeed if Gault J's, "acted reasonably" test[183] is failed it does not necessarily follow that the firm has the proscribed purpose. This would be particularly so where the dominant firm thought it's conduct was reasonable at the time. Section 80(2)(a) and (c) also allow a Court to take into account the nature, extent and circumstances of the conduct. This affords a firm an opportunity to highlight its properly held belief that it acted justifiably and reasonably when it carried out the impugned conduct.

The importance of section 36 to competition in the telecommunications industry (given the New Zealand Government's adherence to a light-handed regulation of the industry) was overlooked by the Board. The Court of Appeal acknowledged this fact[184] and viewed the Part IV of the Commerce Act 1986 machinery (which empowered the Government to regulate to prevent monopoly prices) as being redundant. In the light of this reality it is understandable why the Court of Appeal considered the monopoly element within the Baumol/Willig pricing rule as contributing to a price that had the effect of substantially reducing

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that, amounted to an unreasonable act) and awarding penalties would be unfair and inefficient.

[183]Gault J only envisaged using this test when the firm was dominant in a market, because of its control of a facility to which access was essential if a competitor was to enter a downstream market, see above n 50, 103, 354

[184]Above n 50, 103 359

competition. While acknowledging the potential for monopoly rents within Telecom's price the Board did not accept that the Baumol/Willig rule would prevent competition, as it provided, "[A] proper model for demonstrating what would be charged by the hypothetical supplier in a perfectly contestable market. "[185] The risk of profits was unproven and if they were present they could either be competed out or regulated against by the use of the Part IV machinery. The fact that the New Zealand Government's policy was not to use Part IV was of, "[N]o concern of the Courts."[186] The Board viewed the Court of Appeal's emphasis on the monopoly component of the Baumol/Willig rule, and its subsequent rejection of the rule as amounting to a quasi-regulatory activity, something (and on this point the Board agreed with the Court of Appeal) that was not the preserve of the Courts.

Given the narrowing of the definition of use and the Privy Council's restrictive construction of section 36 are there alternative means of ensuring access to a natural monopoly?

VI ALTERNATIVES TO SECTION 36

Van Roy [187] suggests amending section 36 in order that the role of 'use' is set out, and the ways in which it will be determined are clearly, but not exhaustively, listed.

Van Roy envisages a clear statutory statement that 'use' is to be determined as the causal link between the conduct complained of and

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[185]Above n 1, 407

[186]Above n 1, 408

[187]Above n 35, 60

the dominant position [188], and that it is, "[T]he purpose of the conduct that determines which uses contravene the Act". [189] Van Roy states that the following should be noted as the way in which "use" might be determined: [190]

(i) Conduct which would only be done by a firm with market power, or which would not be done by a firm in a competitive market situation; and

(ii) Conduct which only has an anti-competitive effect when carried out by a firm with market power; and

(iii) Any other method that the Court thinks best describes the causal connection between use and dominance in the particular case, taking into account the market context of the conduct.

Further reform that contemplates the continued use of the Commerce Act 1986 has been mooted by a paper prepared by the Ministry of Commerce and The Treasury. [191] The paper acknowledged the difficulties associated with the Privy Council decision in *Telecom v Clear* [192] and the failure of both companies to resolve the interconnection dispute after four years of litigation. The paper proposes that there are four institutions capable of resolving an access price dispute such as that in *Telecom* v *Clear*, [193] they are[194]: direct Governmental intervention, an industry specific regulatory agency, mandatory

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[188]Above n 35, 60

[191] "Regulation of Access to Vertically Integrated Natural Monopolies a Discussion Paper" Ministry of Commerce and The Treasury (Wellington, New Zealand, August 1995)

[192]Above n 1

[193]Above n 1

[194]Above n 191, 89 - 97

[195]Above n 191, 89 - 97

arbitration and the existing Courts. The paper doesn't contemplate the use of any common law doctrines, it envisages any dispute being resolved [195] with reference to the Commerce Act 1986 (in its present form), the Act plus general legislative regulatory principles and the Act plus industry specific access pricing principles. The proposals put forward await public submissions and further Governmental action. The suggestions for reform have been born of the same criticisms that have regenerated an interest in the doctrine. A comparison of section 36 and the doctrine is necessary.

VII SECTION 36 AND THE PRIME NECESSITY DOCTRINE - A COMPARISON

A Purpose

The pro-competitive thrust of section 36 needs no further discussion. As drafted section 36 is a sophisticated tool that defines when otherwise normal competitive behaviour becomes anti-competitive. It's creation was largely as a consequence of there being either no specific statutory control of monopolistic activities or ineffective amendments to earlier trade practices legislation[196]. In contrast, the doctrine is a utilitarian vehicle for ensuring access to (and payment for) a prime necessity. The purpose of the doctrine is founded in the notion that the Courts have the power to exert, "[C]ontrols in the public interest over activities

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[195]Above n 191, 89 - 97

[196]See the Commerce Amendment Act 1976 and a further amendment in 1983. The Trade Practices Act 1958 stated that any complete or partial monopoly of supply of goods was an examinable trade practice

that might loosely be described as utility services."[197] One commentator[198] has analysed the doctrine in terms of the "[B]asic social obligations"[199] of a monopoly public service supplier of an essential commodity. More particularly he said the doctrine sets out a reciprocal public obligation (to supply, at a fair and reasonable price) on public utilities whose character is derived from there use of public facilities (eg telephone poles, cables and pipes under streets). Ahdar[200] suggests that the renewed interest in the prime necessity doctrine is because people believe that the deregulation, corporatisation and privatisation of 1980's and 1990's has resulted in a lack of accountability. The doctrine and its use as a means of controlling state owned enterprises is discussed by M Taggart[201] in an article about the interaction between public law and state owned enterprises. Given the comments of Galbraith, Ahdar and the doctrine's origins (that is, the belief that certain private property rights are subject to the rights of the public) it is hard not to associate the doctrine with public law rather than competition law. However, to do so would be to ignore the fact that the doctrine has been confined to contractual and statutory disputes between a supplier and a purchaser. It has been a convenient means of imposing a solution in the absence of any other common law or statutory remedy.

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[197]A Galbraith QC. "Deregulation, Privatisation and Corporatisation of Crown Activity: How will the Law Respond?", a paper presented at the New Zealand Law Conference, Wellington 2-5 March 1993, reproduced in *Conference Papers* Volume 1 p226-240, 236

[198]Above n 197, 237, A Galbraith QC cites the *Wairoa & South Taranaki* decisions (see text at n 99 and 100) and calls what has been referred to as the prime necessity doctrine, the "essential services doctrine"

[199]Above n 197, 231

[200]Above n 161, 112

[201]M Taggart "State Owned Enterprises and Social Responsibility, A Contradiction in Terms?" [1993] NZ Recent Law 343, 362

B Dominance

The doctrine's 'equivalent' to section 36's dominance is the notion that a firm enjoys a position of great and special advantage. This was later defined[202] in terms of a firm having a practical monopoly in the supply of the particular services or goods. It is not sufficient that a firm's business is that which can be described as a prime necessity, the firm must have a practical monopoly in that business. The fact that most of the cases have dealt with the water and electricity supply industries[203] has meant that there has been no in-depth analysis of what a practical monopoly is. However, *South Taranaki*[204] approached the concept with market related matters in mind such as the whether or not the Borough could find an alternative supply and the fact that potential alternative suppliers were not prepared to supply.

Overall, economic analysis was something that did not trouble the Courts in the early decisions. Such a state of affairs rests easily with the non-economic approach to dominance adopted by the Court of Appeal in *Telecom Corporation of New Zealand Limited* v *Commerce Commission*.[205] The Court of Appeal acknowledged that in the course of investigating whether or not dominance existed the application of section 3(8) of the Commerce Act 1986 was to be on a case by case basis and that the structural and behavioural factors of the particular market should be looked at pragmatically. Although the early decisions on the doctrine were never expressed in terms of market considerations they did involve practical and uncomplicated decisions on the existence

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[202]See text at n 131

[203]See *Levis* (text at n 89) *State Advances* (text at n 96) *Wairoa Electric* (text at n 99) and *South Taranaki* (text at n 100)

[204]See text at n 100

[205]See text at above n 31

of a practical monopoly. The concept (of practical monopoly) was never given a meaning, it was more a description that the Courts attached to the facts before them.

Despite the similarity of the case by case nature enquiries into dominance/practical monopoly, it is submitted that the doctrine's practical monopoly threshold will be more easily reached than the section 36 dominance threshold.

The view that the doctrine's practical monopoly threshold is more easily reached than section 36 dominance threshold may well be of little practical significance. The existence of a prime necessity almost certainly predicates the existence of a practical monopoly or section 36 dominance. A prime necessity has been defined broadly as applying to the collection of rubbish[206], the supply of water[207], the supply of electricity[208], the provision of warehouse space[209] and access to maritime port services[210]. In none of the above was there any challenge to the fact that the non-supplier was not, in fact, in a practical monopoly situation. The non-suppliers were invariably municipal and maritime authorities or organisations that had statutory power that enabled them to supply warehouse space or electricity exclusively. Those prime necessities that involved water, electricity and access to a port all had high sunk costs which gravitated strongly against there

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[206] *Mayor of Auckland* see text at n 95

[207] *Levis* and *State Advances* see text at n 89 and n 96

[208] *Wairoa Electric, South Taranaki & Auckland Electric Power Board* see text at n 99, n 100 and n 105

[209] Allnutt, see text at n 82

[210] *De Portibus Maris* and *New Zealand Rail Limited v Port Marlborough New Zealand Limited* see text n 74 and n 114

being any rival supplier. In *Telecom v Clear*[211] it was conceded that Telecom was in a dominant position in the fixed local telephone market because of its control of the PSTN. In terms of the prime necessity doctrine there is no reason why the public service telecommunications network would not be viewed as a prime necessity: Access to the network by Clear would certainly be required by Barker J's formulation of the doctrine, viz, "[A] monopoly supplier of an essential commodity has a duty to supply..."[212].

C Fair and Reasonable Price

Monopoly profits per se are not contrary to section 36 . This was noted by the Privy Council in *Telecom* when it said:[213]

> The Court of Appeal took the view that s 36 had the wider purpose, beyond producing fair competition, of eliminating monopoly profits currently obtained by the person in the dominant market position. Their Lordships do not agree.

However, monopoly profits may be a reason why there has been contravention of section 36. In the Court of Appeal Gault J noted[214] Telecom's insistence on an access code, its intention to charge its subscribers an additional amount (based on Clear's own charge for terminating calls in its own network) and its refusal to give interim connection to enable Clear to meet its Justice Department obligations, (in addition to the monopoly profits) all amounted to the use of a

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[211]Above n 1

[212]*Auckland Electric Power Board v Electricity Corporation of New Zealand Limited* above n 105

[213]Above n 1, 407

[214]Above n 50, 103, 360

dominant position.

The issue of price lies at the heart of the doctrine. It does, however, remain largely undefined.[215] Land[216] says the *State Advances*[217] fair and reasonable price test (being the price chargeable to other persons) is problematic. He notes that it would be unlikely for a Court to accept that a monopolist's prices are fair and reasonable because they are the same as charged to other persons. Recent cases provide some guidance on how a Court may define fair and reasonable.

In *Union Shipping NZ Limited v Port Nelson Limited*[218] the Court was asked to decided whether Port Nelson's charges were (pursuant to section 49 of the Waterfront Industry Commission Act 1976) commercially reasonable. The Court defined a commercially reasonable price as being one that allowed the recovery of daily running costs, a contribution towards capital costs and a reasonable margin for profit.[219] In *Air New Zealand Limited v Wellington International Airport Limited*[220] Air New Zealand brought a judicial review claim challenging the Airport Company's setting of landing fees. The Court held that the Airport Company was entitled to recover the costs of providing the service along with a reasonable commercial return. In *New Zealand Rail Limited v Port Marlborough New Zealand Limited*[221] the Court of Appeal considered what documents were relevant to the issue of what

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[215]See text above n 142 - n 145

[216]Above n 80, 11

[217]See text above n 146 - 148

[218]Above n 43

[219]Above n 43, 694

[220]Unreported, 15 October 1993, High Court, Wellington Registry, CP 829/92

[221]Above n 114

was a reasonable fee. Richardson J noted that New Zealand Rail Limited's own profitability was not relevant. He went on to say, "[T]he inquiry necessary focuses on the assets employed and the costs incurred by an efficient provider of terminal services in a notionally competitive market."[222]

The use of the words "fair and reasonable" reveal the doctrine's common law, as opposed to economic, background. The common law approach of the Court of Appeal in *Clear v Telecom* and its rejection of the economic Baumol/Willig rule is certainly more aligned to the doctrine than an economic approach to the provisions of the Commerce Act 1986. Having spurned the Baumol/Willig rule Gault J said, "[I]t 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."[223] Cooke P said, "[T]hat Telecom is entitled to a fair commercial return..."[224] for Clear's use of the PSTN and the charge is to be, "[F]ixed on the basis of what a network owner not in competition for the custom of subscribers could reasonably charge for use of its facilities.[225] The re-emergence of these common law concepts was to be shortlived. The Privy Council said[226] that Gault J's belief that use might be determined by the reasonableness of the firm's actions was too uncertain a test for a monopolist firm to be able to understand and apply to its affairs. Nonetheless, Land[227] considers that in ascertaining a fair and reasonable price the Court would have regard to

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[222]Above n 114, 644

[223]Above n 50, 103, 354

[224]Above n 50, 103, 344

[225]Above n 50, 103, 344

[226]Above n 1, 403

[227]Above n 80, 13

the value of the assets, the appropriate rate of return and the efficiency of operation.

D The Role of the Court

Perhaps the most significant difference between the doctrine and section 36 is the role of the Court in determining what a fair and reasonable price is. The cases since *Levis*[228] have not been troubled by the concept as the price has generally been agreed upon or been easily referable to external factors or an external agency. The possibility of the Court being involved in an economic analysis of what constituted a fair and reasonable price was never contemplated until *State Advances*[229] and *South Taranaki*[230]. In the context of Commerce Act litigation the Courts[231], at all levels, have made it clear that they have no desire to be involved in fixing a price.

If the doctrine is to be workable the Courts must be prepared to fix a price. The Courts' views to date have been discouraging.

E Can the Court Regulate?

Rule has cited four reasons why Courts are not able to properly regulate

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[228]Above n 89

[229]See text at n 96

[230]See text at n 100

[231]See the comments of Cooke P in *Clear v Telecom* at text n 221 and n 222. The Privy Council in *Telecom v Clear* (above n 1, 408) said (after noting the difficult considerations inherent in the concept of a reasonable price), "They are the daily diet of a regulatory body," and Blanchard J in *New Zealand Private Hospitals Association - Auckland Branch (INC)* above n 121) "Happily, no one wants the Court to get into the business of price fixing"

prices. They are: [232]

(a) Courts are deprived of an industry wide view when they are called upon to determine a specific matter between injured parties.

(b) Courts lack the specialised economic/accounting skills to determine a particular price.

(c) Courts are not structured in a manner that allows for ongoing monitoring and reappraisal of a particular price.

(d) The process of fixing a price is a political task, which a Court should have nothing to do with.

The first three reasons have also been noted by Pengilley,[233] in the context of the High Court decision in *Clear v Telecom,* who doubted whether a Court had the accounting and auditing expertise to secure the raw data from Clear and Telecom to enable it to calculate marginal, average incremental, common and opportunity costs and any return on assets necessary for the implementation of the Baumol/Willig rule.[234]

The political nature of judicial decision making is hardly a new phenomenon for the Courts and it has not, to date, prevented a Court

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[232]C Rule "Antitrust and Bottleneck Monopolies: The Lessons of the AT & T Decree" Remarks before the Brookings Institution, Washington DC, October 1988, cited in JGM Shirtcliffe "Access to Essential Facilities in Electricity Supply" in M Copeland and W Haddrell (eds) *Competition Review: Current Issues in New Zealand Competition and Consumer Law* Vol 5 May 1993 (Wellington Commerce Commission 1993) 2, 42. See also the Discussion Paper (above n, 190) for a comparison of the Courts, Arbitrators, regulatory bodies and Governmental intervention as regulatory institutions.

[233]W Pengilley "Determining Interconnection Prices in Telecommunications: New Zealand Lessons on the Role of a Regulator" (1993-1994) 1 CCLJ 147, 158

[234]Rule 324 of the High Court Rules enables the Court to appoint an expert witness to enquire into a question of fact. Sections 14 and 15 of the Arbitration Act 1908 allow for the referral of the dispute to a special referee or arbitrator

from making a decision. Proponents[235] of judicial regulation have drawn on the role the American Courts have had in defining what a "reasonable" fee is in the essential facilities doctrine [236]. Shirtcliffe[237] has noted that the American Courts have expressed a reluctance to regulate and where they have, they have either done so in broad terms and then referred the detail to a regulatory body[238] or made a decision on the price with detailed reference to earlier negotiations between the parties[239] or the price paid for the facility by a party who is not in competition with the supplier in a downstream market.[240]

In *Queensland Wire Industries Ltd v The BHP Co Ltd*[241] the High Court of Australia held that there had been a misuse of market power by Queensland Wire when it offered to supply Y bar to BHP at prices that were "excessively high",[242] and were not "competitive".[243] The High

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[235]See Galbraith above n 197, 238

[236]For examples see below n 238, 239 and 240

[237]Above n 8, 44-46

[238]See *Consolidated Gas Co of Florida v City Gas Co of Florida* 665 F Supp 1493 and *Otter Tail Power Co v United States* 410 US 366 (1973) where the Court ordered City Gas to sell at a "reasonable price" and that Otter Tail should not be forced to supply electricity at rates that were not compensatory. In both cases the exact details of the price were referred to the regulatory agency in Florida and the Federal Power Commission

[239]See *Aspen Skiing Co v Aspen Highlands Skiing Co* 472 US 585 (1985) and *Byars v Bluff City News* 609 F.2d 843 (1979) where no regulatory body was in existence but there was a history of earlier dealings between the parties

[240]See *US v Terminal Railroad Association* 224 US 383 (1912) and *Associated Press v US* 326 US 1 (1945) where a facility (a railway bridge and a wire service) was held collectively by a group which sought to exclude a new entrant. The terms on which the facility was held by the existing group members could be used to ascertain a reasonable price to be charged to the new entrant

[241](1988) ATPR 40, 841 (Federal Court)

[242](1989) 83 ALR 577, 594

[243]Above n 242, 577, 604

Court remitted the case back to the trial judge for the fixing of the terms of the injunction which would have involved the fixing of a reasonable price.[244] In *Pont Data Australia Pty Ltd v ASX Operations Pty Ltd*[245] the Federal Court of Australia found that ASX had misused its market power in insisting on a price and terms (for the supply of electronic stock exchange information) that could only be insisted on because of it's monopolistic position. The Court ordered that supply be granted on "commercially reasonable"[246] terms, additionally Wilcox J made a specific order that the supply be fixed at a "cost plus" supply price.[247] On appeal the full Federal Court rejected the "cost plus" pricing but did not reject the idea of judicial price fixing, when a monopoly price might amount to a firm taking advantage of its power for an anti-competitive purpose.[248]

The outcome of the *Pont Data* full Federal Court decision is an example of the potential for vagueness and uncertainty in judicial price fixing which would make it particularly difficult for any firm to forecast what a reasonable price is. Although the United States and the Australian cases show a willingness (albeit reluctant) to regulate, the background of the United States cases is different to the prime necessity cases and *Telecom v Clear*. The principle difference is that in New Zealand there is a lack of prior dealing between or with natural monopolies and there are no telecommunications or electricity industry regulatory bodies which a Court might refer to for the detail of a pricing order. In the United States there has been a long history of private ownership of those

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[244]The parties settled; the trial judge (Pincus J) was never asked to fix the price

[245](1990) ATPR 41, 007

[246]Above n 245, 41 132

[247]Above n 245, 41 068

[248]*ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* (1991) ATPR 41109

industries (railways, electricity generation and supply and telecommunications) which have been owned by the State in New Zealand. This different economic history accounts, to a large degree, for the United States judicial pricing case law.

In the context of section 36, it is submitted that there is always going to be an element of price regulation by the Courts. In *Clear v Telecom*[249] the Court of Appeal effectively regulated against a rule that had allowed the incumbent to potentially recover monopoly rents from the new entrant. Although the Court noted that it had no interest in fixing prices it did re-introduce the concept of a fair and reasonable fee. The Privy Council[250] said the Court was not a regulatory body yet implemented the Baumol/Willig rule which was a quasi-regulatory act.[251] The Baumol/Willig rule is regulatory in its nature, in so far as it calls for an assessment of Telecom's:

(a) marginal costs
(b) average incremental costs
(c) common costs
(d) opportunity costs

The calculation of the above would be complex and require full disclosure by the market incumbent, who would probably be less than eager to reveal its inner most financial secrets. The Privy Council, despite eschewing the role of judicial regulation, has by the adoption of an economic model given itself the role. The Court has now left open the possibility of litigants arguing about whether or not the calculations

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[249] Above n 50

[250] Above n 1, 408

[251] Above n 233, 157 and 158

required by the rule are correct. As the High Court in *Clear v Telecom* noted:[252]

> [T]here would be a need for careful design of the administrative system. Regular reviews would be necessary to adjust for shifting prices and costs. It would be important to design an arm's length mechanism that would minimise the possibility of collusion. There is another point in which some regulatory presence may be needed. It would be important for the reviews not to take place at too frequent intervals, for that would reveal sensitive market information; the adjustments should be backdated, with interest covering the time value of money.

The "[R]egulatory presence [that] may be needed...", be it in the form of Part IV intervention, or in an industry specific regulatory body is not in existence. With a Government that has shown no signs of using its Part IV powers (to eliminate monopoly rents) or re-regulating at least a part of the telecommunications industry the only available forum (of last resort) is the Court. Although there are difficulties with the judicial fixing of price they are not insurmountable. In the absence of any other entity the Courts must accept the responsibility.

The discussion in this part has emphasised the sophisticated nature of section 36 and the "unsophisticated", general and utilitarian nature of the doctrine. Both section 36 and the doctrine are capable of being applied to the same set of facts, in the situation of a natural monopoly, is the outcome likely to be different?

VIII A TEST - SECTION 36 AND THE DOCTRINE APPLIED TO THE FACTS OF *TELECOM* v *CLEAR*

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[252]Above n 49, 170

A *Facts*

It will be recalled that Telecom was dominant in the local fixed telephone call market. Telecom owned and operated the PSTN; [253] interconnection to which was essential if Clear was to compete in the local fixed telephone call market. Telecom wished to charge Clear an interconnection price that allowed them to recoup monopoly profits.

B *Elements of Section 36 and the Doctrine*

Section 36 requires proof of a market, dominance (within that market) and use of the dominance for one of the proscribed (anti-competitive) purposes at section 36(1) (a), (b) and (c).

The doctrine requires proof of a prime necessity, the supplier (of the prime necessity) holding a practical monopoly and a fair and reasonable payment.

1 Market

The definition the market was not in issue in *Telecom* v *Clear*.[254] The relevant market (fixed local telephone call business) was easily identified and thus proved. The doctrine does not have an equivalent.

2 Prime necessity

Proof of a particular kind of business is not required by section 36. The doctrine requires a prime necessity or an essential commodity.[255] As

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[253]See text at n 152

[254]Above n 1

[255]See text above n 105

already mentioned a prime necessity has been defined broadly; the electricity and water supply industries have been identified in New Zealand as being a prime necessity. The earlier survey of the cases revealed that the prime necessities were often in the form of a natural monopoly. It is this paper's view that Telecom's ownership of the PSTN would be defined as a prime necessity.

3 Dominance and practical monopoly

The fact of Telecom's dominance in the market was conceded. Given this paper's view that the practical monopoly threshold is lower than the existing section 36 dominance threshold, it is submitted that the doctrine would consider Telecom to be in the position if a practical monopolist in the operation of the PSTN and in the provision of local fixed telephone call services.

4 Use and purpose

Proof of both is required. Although Telecom had an anti-competitive purpose the Privy Council considered that it had not used its position because it did nothing that a firm in a competitive market would not have done. The doctrine does not require proof of purpose or use.

5 A fair and reasonable charge

Given the doctrine's common law origins and the sense of fairness, equity and even-handedness inherent in the expression, "fair and reasonable" it is particularly difficult to envisage the doctrine allowing Telecom to insist on an interconnection price that contained or allowed monopoly profits.

If the doctrine is applied to *Telecom v Clear*[256] it is submitted that Telecom would have been required to interconnect Clear to the PSTN for a reasonable price. The Baumol/Willig rule would not have been sanctioned as a means of calculating the price. In many ways this outcome is similar to that in the Court of Appeal [257]. Importantly, Clear's job would have been made easier by the need to prove the fewer, and conceptually simpler, components of the doctrine.

V CONCLUSION

The Privy Council's restrictive treatment of section 36 in *Telecom* v *Clear* [258] is evidenced by a test for use that disregards the market context in which the impugned conduct took place, and the need to prove the purposive element. The effect of such a test is to ignore the fact that otherwise normal competitive behaviour in a fully contestable market could amount to anti-competitive behaviour in a monopolistic market; put simply the test failed to compare 'like with like'. Additionally, the Privy Council failed to note the pivotal pro-competition role of section 36 in ensuring access to vertically integrated natural monopolies. The lack of any industry specific regulatory body to control the telecommunications industry and the unwillingness of the New Zealand Government to use the Part IV machinery was of no concern to the Board.

The disabling effect of the decision has prompted trenchant criticism, a call for the amendment of the section, a Ministry of Commerce/Treasury discussion paper (seeking submissions on the future of section 36 and its role in the regulation of access to natural monopolies) and further

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[256]Above n 1

[257]Above n 50

[258]Above n 1

interest in the doctrine.

The paper's survey of section 36 and the doctrine reveals a sophisticated statutory instrument and unsophisticated utilitarian doctrine. Section 36 is part of a wider statutory scheme designed to promote competition while the doctrine has no specific competition law focus, it has, at its heart, public law concepts of mutual social obligations and fairness. The doctrine provides a workable alternative to section 36 as its pragmatism and common law origins have led to it being framed in terms that are easier to prove than the elements of section 36.

The Baumol/Willig rule has the potential to restrict the entry of new entrants if the monopoly rent component of the price rule is sufficiently high. The High Court and Privy Council acknowledged, that if the monopoly profits did constitute a barrier to entry, the Part IV machinery existed to remove such a barrier. The rule must work with Governmental regulation, which is unlikely to occur. There exists the real possibility that a dominant firm in a market can now, with immunity, charge a price that it could not in a competitive market before it allows access to a product or service to a potential competitor. The prospect of Governmental intervention is so remote as to constitute little in the way of a deterrent to firms that can prevent entry by the imposition of a price that contains monopoly rents.

The doctrine is a workable alternative to section 36 if the Courts are prepared to regulate a fair and reasonable price. In the absence of a regulatory body or direct Governmental intervention the Courts remain the only forum for resolving access difficulties. Although there are problems with the judicial fixing of a reasonable price they are not insurmountable. In the absence of any other entity the Courts must accept the responsibility.

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