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The Supreme Court and Regulating Competition

In this paper I discuss how the Supreme Court has dealt with regulating competition. In particular I look at two areas – competition law and regulated industries. In both areas of law Parliament’s aim is low prices for consumers while providing producers sufficient incentives to invest and innovate. The different areas achieve these aims in different ways. Competition law lets the market achieve those aims and only intervenes when market participants block or impede the market functioning. Regulation conversely directly controls the prices firms can charge or the revenue firms receive. Both areas have (or should have) a focus on economics. Thus, economic analysis is (or should be) important. I deal with each area in turn.

**Competition Law**

While the Supreme Court has been established for ten years it has heard only three cases involving the Commerce Act 1986 on competition law.\(^1\) Of these only one involved substantive traditional competition law. It is a monopolisation case.\(^2\) (“0867”) Of the other two, one involved the Act’s extraterritorial effect\(^3\), while the second was a statutory interpretation issue on the Commerce Commission’s investigative powers.\(^4\) Thus, I am going to use just the one traditional case to discuss how the Supreme Court deals with substantive competition law. While a scientist might be reluctant to conclude on such a small sample, this is no problem for a lawyer. As the old saying goes “to a lawyer, the plural of anecdote is data”. Despite engaging in anecdotage I use the case to conclude the following:

1. the Supreme Court is a black letter law court when analysing competition law. The case is a prime example of bottom-up reasoning - rather than top-down. It is a narrow decision.
2. the Supreme Court has downplayed the use of economic analysis. It has almost declared it irrelevant. This harms competition law analysis.
3. the Supreme Court has very little discussion of international authorities – apart from Australia. It is a parochial decision.

In these three aspects the Supreme Court contrasts with other final appellate courts – in particular the High Court of Australia.

To that end, the next part of the paper will deal with the 0867 case. The first section of this part will outline the background and facts of 0867. The next section discusses how the decision is a black letter, legalistic analysis. I have previously disagreed with its analysis\(^5\) and this part expands on that criticism.

I then discuss how the case has a dearth of economic analysis and contrast this with other final appellate courts. This part argues that the Supreme Court’s downplaying of economic

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5 Paul G Scott “Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act” (2011) 17 NZBLQ 260.
analysis harms New Zealand competition law. The final section of this part discusses how parochial the decision is. Again this contrasts with other final appellate courts. It argues that ignoring overseas authority is also a backward step for New Zealand competition law.

0867 Facts

In 0867 the Commerce Commission (“the Commission”) alleged Telecom had breached s36 of the Commerce Act (New Zealand’s monopolisation provision) in the way it introduced a dial-up internet package called 0867. In 1996, Clear and Telecom signed an interconnection agreement. One part of the agreement dealt with the payment of termination charges. When a customer of one provider made a call to the other provider’s network, the network of origin had to pay a per minute charge to the network on which the call terminated. Under the agreement, Clear paid Telecom more than Telecom paid Clear. This was partly due to the charges Clear paid Telecom being higher. It was mainly due to most voice calls terminating on Telecom’s much larger network. Then dial-up internet became popular. Telecom customers started making lengthy calls to Internet Service Providers (“ISPs”). Internet calls lasted much longer than voice calls. If the ISP was on Clear’s network and the residential consumer on Telecom’s, then Telecom had to pay termination charges to Clear. The calls were all one way. Consumers called ISPs. ISPs did not call consumers. Clear took advantage of this by keeping ISPs’ charges low or free to attract ISPs to its network. It also agreed to share the termination charges that Telecom paid with ISPs. Telecom ended up paying large termination charges to Clear. Its network also became increasingly congested. Telecom responded by introducing the 0867 package. The package’s purpose was to encourage residential customers and ISPs on Clear’s network to migrate away from it. Telecom would not charge residential customers and ISPs who used a 0867 prefix for their calls. Telecom charged customers who did not use 0867 two cents per minute (unless their ISP was Telecom’s ISP, Xtra) beyond 10 hours of internet use. This meant customers and ISPs had a substantial incentive to use the 0867 package.

The main issue was whether the 0867 introduction was a use of a dominant position. Both the High Court and Court of Appeal quite rightly applied the counterfactual test.

The Counterfactual Test

This comes from a majority of judges in Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd. The High Court held that BHP took advantage of its substantial market power by absolutely and constructively refusing to supply an input to a rival, Queensland Wire. Mason CJ and Wilson J said:7

“In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power – in other words, if it were operating in a competitive market – it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor.”

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6 Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd (1989) 167 CLR 177.
7 Ibid, at 192.
Dawson J also said:  

“For the reasons given by Deane J, I am of the view that the words “take advantage of” do not have moral overtones in the context of s46. That being so, there can be no real doubt that BHP took advantage of its market power in this case. It used that power in a manner made possible only by the absence of competitive conditions.”

Toohey J observed:  

“The only reason why BHP is able to withhold Y-bar (while at the same time supplying all the other products from its rolling mill) is that it has no other competitor in the steel product market who can supply Y-bar. It has dominant power in the steel products market due to the absence of constraint. It is exercising the power which it has when it refuses to supply QWI with Y-bar at competitive prices; it is doing so to prevent the entry of QWI into the star picket market; and it has been successful in that attempt.”

This test found favour in New Zealand. In *Clear Communications Ltd v Telecom Corp of NZ Ltd* Gault J observed:  

“To determine whether particular conduct involves use of a dominant position in a market for any of the purposes specified in s36 has been said to require consideration of whether the conduct would have been open if the party were not in a dominant position— if it were in a fully competitive market. Such a test reflects the underlying purpose of the section which is to promote competition.”

The Privy Council applied a similar counterfactual test (although it came to a different result). It phrased the test as:  

“It cannot be said that a person in a dominant market position uses” that position for the purposes of s36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.”

Subsequently, Gault J was not a friend of the counterfactual test. He was not alone in critiquing the test. However, the Privy Council endorsed it in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission*. It said:

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9 Ibid, at 216.  
10 *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* [1993] 5 TCLR 413 (CA) at 429.  
11 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at 403.  
“It is, as the Board said in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* at p 403, both legitimate and necessary when giving effect to s36 to apply the counterfactual test to determine whether the defendant has used its position of dominance.”

**Legitimate Business Rationale**

A variant or version of the counterfactual test was the legitimate business rationale test.\(^{16}\) If a firm has legitimate reasons for its conduct, then a firm with substantial market power would engage in the same conduct in a competitive market. This test derives from the United States Supreme Court.\(^{17}\) Heerey J introduced it to Australian jurisprudence in *Melway Publishing Pty Limited v Robert Hicks Pty Limited*\(^ {18}\) and then *Australian Competition and Consumer Commission v Boral Besser Masonry Limited*.\(^ {19}\) The High Court of Australia picked it up in *Boral*\(^ {20}\) and the Privy Council endorsed it in *Carter Holt Harvey*.\(^ {21}\)

**Deane J Purpose Test**

An alternate or different test comes from Deane J in *Queensland Wire*.\(^ {22}\) There Deane J observed:\(^ {23}\)

“[BHP’s] refusal to supply Y-bar to QWI otherwise than at an unrealistic price was for the purpose of preventing QWI from becoming a manufacturer or wholesaler of star pickets. That purpose could only be, and has only been, achieved by such a refusal of supply by virtue of BHP’s substantial power in all sections of the Australian steel market as the dominant supplier of steel and steel products. In refusing supply in order to achieve that purpose, BHP has clearly taken advantage of that substantial power in that market.”

Thus, Deane J said a court could infer a taking advantage of market power from a firm’s substantial market power and purpose. If a firm could only achieve an anticompetitive purpose because of its market power, then there would be a taking advantage. The *Melway* High Court majority approved this test describing it as “different” from the *Queensland Wire* majority’s reasoning.\(^ {24}\) It said the test illustrated the United States Supreme Court case of

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\(^{15}\) Ibid, at [60].


\(^{19}\) *Australian Competition & Consumer Commission v Boral Ltd* [1999] 166 ALR 410.


\(^{21}\) *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145, at [54].

\(^{22}\) *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177.

\(^{23}\) Ibid, at 197-198.

\(^{24}\) *Melway Publishing Pty Ltd v Robert Hicks Ltd* [2001] HCA 13, (2001) 205 CLR at [48].
Eastman Kodak Co v Image Technical Services Inc. There Scalia J said that conduct that may be of no concern or procompetitive in a competitive market may be anticompetitive or exclusionary if a monopolist engaged in it. The High Court majority also favourably referred to and applied Deane J’s analysis in NT Power Generation Pty Ltd v Power and Water Authority. It noted without comment that Finkelstein J in the “Full Federal Court called it an alternative approach” to the test of the majority in Queensland Wire.

Material Facilitation

Another test comes from the majority in Melway. This is the material facilitation test. The High Court majority were of the view that a firm might breach s46 if its market power made it easier to act for proscribed purposes than otherwise would be the case. In other words, a firm may take advantage of market power where it does something that is materially facilitated by the substantial market power, even though it may not have been impossible without the power.

Question of Fact

A final alternate test comes from the New Zealand Court of Appeal in Port Nelson Ltd v Commerce Commission. There Gault J, having lost all enthusiasm for counterfactual analysis preferred determining “use” as a question of fact without the need for postulating hypothetical counterfactuals or any test at all. Arguably, the Privy Council minority in Carter Holt Harvey tepidly supported such an approach. Some commentators suggest Tipping J in the High Court in New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd had also treated “use” as a question of fact and judgment without any formal test.

The Supreme Court Decision

Blanchard and Tipping JJ gave the Supreme Court’s decision. The Court first held that the concepts of “use” and “take advantage” involve the same inquiry. “Use” implicitly means advantageous use. Thus, Australian law was directly relevant. The Court held that the primary issue before it was: how does one determine whether a dominant firm has made use

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30 Ibid, at [51].
32 Ibid, at 577.
34 New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd [1990] 1 NZLR 731.
of its dominant position? In deciding this, the Court reaffirmed the Privy Council’s decisions in Telecom and Carter Holt Harvey.

It rejected the Commission’s argument that the Australian authorities represented permissible alternatives to “use” that were divorced from and independent of comparing the actual market and a hypothetical competitive market.

It noted that it was important that Australian and New Zealand law on restrictive trade practices be broadly similar. It said of the Commission’s argument “Having a range of tests, all potentially applying, depending on the circumstances and whether a comparative approach can ‘cogently’ be adopted, would not assist predictability of outcome”. It held such an approach was not consistent with the Australian cases when they are appropriately analysed. After discussing the Australian cases it concluded that both Deane J’s purpose test and Melway’s material facilitation test involved comparing the actual and hypothetical markets. Thus, there is only one test – the counterfactual test, although the Court renamed it the comparative exercise.

The Court appeared to endorse Melway’s material facilitation approach. It said this involved a comparative exercise as it involves an express comparison between the actual and hypothetical market. It said similar things about Deane J’s purpose test and that it too involved comparing the actual and hypothetical market. The Court also endorsed Heerey J’s business rationale test that the Boral High Court and Privy Council endorsed. It said the test captured the essence of the comparative exercise. It stressed that New Zealand’s and Australia’s interpretation of ss36 and 46 should be broadly the same.

The Court formulated the following test:

“A firm with a substantial degree of market power has the potential to use that power for a proscribed purpose. To breach s36 it must actually use that power in seeking to achieve the proscribed purpose. Anyone asserting a breach of s36 must establish there has been the necessary actual use (taking advantage) of market power. To do so it must be shown, on the balance of probabilities, that the firm in question would not have acted as it did in a workably competitive market; that is, if it had not been dominant.”

It showed how to carry out the comparative exercise. First, the necessary comparison requires only a sufficient level of competition to deny dominance to any competitor in the market. Second, the Court stressed that the question of what a non-dominant firm “would” do in the hypothetically competitive market is a matter of practical business or commercial judgment,

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38 Ibid, at [30].
39 Ibid, at [31].
40 Ibid, at [30].
41 Ibid.
42 Ibid, at [17] and [21].
43 Ibid, at [21].
44 Ibid, at [17].
46 Ibid, at [26].
47 Ibid.
48 Ibid, at [31].
49 Ibid, at [34].
50 Ibid, at [22].
not necessarily a matter of economic analysis. Third, in determining the hypothetical market, a court must strip away all aspects of a firm’s dominance.

The Court then undertook the comparative exercise. It found the Commission failed to show that in a hypothetical competitive market Telecom would not have introduced the 0867 package.

**Bottom up not Top down Reasoning**

A noticeable feature of the Supreme Court’s decision is how legalistic it is. It starts and ends with previous Australian and New Zealand case law. It treats the cases as the universe. As a black box to which nothing else intrudes – neither United States nor European authorities and most definitely no economic analysis nor academic or practitioner articles. As such, the Supreme Court’s approach is restricted and is a prime example of bottom up reasoning. Richard Posner divides legal reasoning into two categories – top down and bottom up. With top down, a court has a theory about an area of law and uses it to organise, criticise, accept or reject or distinguish the decided cases to make them consistent with the theory. The theory generates an outcome in each new case, which is consistent with the theory. Should a case or group of cases be inconsistent with the theory, the court will regard them as a deviant branch of the law and ignore them.

Conversely with bottom up reasoning, the court starts with the statute or group of authoritative cases and moves from there. The court uses traditional techniques such as syllogistic reasoning and reasoning by analogy or plain meaning of the statute. However, the court does not move very far from the source material.

Competition law has, in the United States at least, been a prime example of top down reasoning. Courts start with the principle of wealth maximisation or consumer welfare or attaining economic efficiency and interpret the statutes to achieve these goals. Necessarily economic analysis plays an important part.

This was not the case with 0867. The Supreme Court treated the case as a straight forward reasoning problem ie as a matter of reading and interpreting cases.

The Supreme Court has acted the same way in other areas of law. *Peterson Portable Sawing Systems Ltd v Lucas* is the Supreme Court’s only substantive patent case. It dealt with obviousness. The Court noted that the principles and test for obviousness were well known and established. The Court applied those principles. It does not discuss the purpose of patent law nor why obviousness is in the Patents Act. It differs from other final appellate courts. At roughly the same time the United States Supreme Court dealt with obviousness in

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50 Ibid, at [23].
51 Ibid, at [36].
52 Ibid, at [49].
54 Ibid.
55 Ibid.
56 Ibid.
57 Ibid, at 172-173.
59 Ibid, at [54].
KSR International Co v Teleflex Inc. There the Court fully discussed why obviousness is a ground for revoking patents. Its decision is anything but mechanically applying a rule.

Similarly, the High Court of Australia dealt with obviousness in Lockwood Security Products Pty Ltd v Doric Products Pty Ltd (No 2). There the High Court extensively discussed the purpose of obviousness and how and why it came to be in various Patent Acts. Again, the High Court did not mechanically apply the Act.

With 0867 the Supreme Court has very little on the purpose of the laws against monopolisation and on the purpose of competition law. The case does not mention any top down principle that could guide interpretation.

It only refers to purpose when it cites the High Court of Australia in Boral that s 46 (and presumably s36) was designed to prevent damage to the competitive process rather than to individual competitors. It says “only uses of market power that damage competition rather than competitors per se are caught by the section”. But that is the extent of any purposive approach to competition law. The Court mentions neither efficiency nor consumer welfare.

This contrasts to the High Court of Australia in competition cases. In Queensland Wire Mason CJ and Wilson J say:

“But the object of s 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless.”

In Melway and Boral the High Court notes: “section 46 aims to promote competition, not the private interests of particular persons or corporations”.

It may be that the Supreme Court regards itself as having adopted Australian law – but it should have discussed the purpose of the law given that 0867 was its first substantive competition law decision.

As mentioned above the decision is legalistic. The problem is that one needs a purposive approach as literally applying the Supreme Court’s rule may capture procompetitive behaviour. A firm with substantial market power may be able to take advantage of economies of scale. These economies may only kick in with a large market share. Such economies result in lower prices to consumers. On a literal wording of the Supreme Court test these economies are not achievable in a workably competitive market. A firm would not be able to achieve them in a competitive market. Thus, a firm that achieves and uses economies of scale has used its dominant position or taken advantage of substantial market power. This meets the Supreme Court’s test yet cannot be right. Consumers are better off. Hence the need for a purposive approach. Another example may be that a firm with substantial market power uses its monopoly profits to innovate and invents a new product.

61 Ibid.
64 Ibid.
This product leads the firm to eliminate its rivals. Arguably, without a purposive approach this is “use” or “taking advantage”. The only way the firm could innovate successfully was by using its monopoly profits. Yet these profits by definition are unavailable in a competitive market.

The Supreme Court’s Analysis

An issue arises as whether the Supreme Court’s legalistic approach was correct. In particular whether the Supreme Court was correct in its reading of Australian law and in its claim that Australian law does not have more than one approach to taking advantage of substantial market power. In short, that whether following 0867, Australian and New Zealand monopolisation law is the same and in harmony. The Commerce Commission did not, and does not agree with this.\(^67\) Conversely Telecom and some law firms appear to agree with the Supreme Court.\(^68\) I have previously set out why I disagree\(^69\) – so I briefly restate my reasons.

As mentioned above the Supreme Court noted it was important that Australian and New Zealand law be broadly similar.\(^70\) This is ironic as Tipping J in the Court of Appeal in *Giltrap City Ltd v Commerce Commission* dealt with the meaning of “arrangement” and “understanding” in s27 of the Commerce Act.\(^71\) The same words are in the Australian Act. Tipping J ignored Australian case law on the topic when he formulated a test for “arrangement” and “understanding”. A leading Australian commentator has noted that Australian and New Zealand law on these terms now differs.\(^72\)

One of the reasons the Supreme Court gave for having and saying one test was that a range of tests would not assist predictability of outcome. That one test leads to certainty for market participants.\(^73\) The need for certainty has concerned final appellate courts in monopolisation cases.\(^74\) However, the notion that one test (the counterfactual or comparative exercise) leads to increased certainty rests on wobbly empirical foundations.

In New Zealand and Australia eight monopolisation (ss36/46) cases have had two levels of appeal. The only case in which every judge has agreed on “use of a dominant position” or “take advantage of substantial market power” has been 0867. Some cases have had marked differences on the issue. Not even the legitimate business rationale test leads to agreement. In *Rural Press Ltd v Australian Competition and Consumer Commission* Kirby J dissented.

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\(^{67}\) Mark N Berry “New Zealand Antitrust: Some Reflections on the First Twenty-Five Years” (2013) 10 Loyola University Chicago International Law Review 125; Professor Andrew Gavil has appeared at a conference arguing this but I have not seen this paper.


\(^{69}\) Paul G Scott “Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act” (2011) 17 NZBLQ 260.


\(^{71}\) *Giltrap City Ltd v Commerce Commission* [2004] 1NZLR 608 (CA).

\(^{72}\) Warren Pengilley “What is Required to Prove a Contract Arrangement or Understanding?” (2006) 13 CCLJ 241 at 263.


\(^{74}\) See for example the Privy Council in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145.
saying the defendant lacked a legitimate business rationale. Academic commentary also shows this lack of certainty. Ahdar has written that *Carter Holt Harvey* was a straightforward and easy case of predatory pricing. Conversely I argued there was no breach. The only case where all courts have agreed on whether there has been a breach or not is 0867. Certainty and predictability is in the eye of the beholder.

The Supreme Court said that the Australian cases all involve comparing the actual and hypothetically competitive markets. This meant that rather than alternate tests, the counterfactual, the Deane J purpose test and material facilitation all represent just one test. They are not alternate tests. If this is so, applying each “test” to the one set of facts must lead to the same result. This is dubious.

Dealing with the counterfactual test first. As the Supreme Court notes substantial market power or dominance must cause the conduct. There must be a causal connection between substantial market power and the conduct. That is what counterfactual analysis seeks to establish. Anytime we say that X caused Y, we are implicitly asserting that in the absence of X, Y would not have occurred. To assess such claims it is helpful to consider what the world would look like in the absence of X. That is counterfactual analysis. With monopolisation, X is dominance or substantial market power. Y is the conduct. In the counterfactual (ie a market without dominance or substantial market power) if the defendant would still have engaged in the conduct in issue then the dominance or substantial market power did not cause the conduct. The requisite causal connection is missing. The majority judgments of Mason CJ and Wilson J, Dawson J and Toohey J are classic counterfactual causation reasoning. Without substantial market power BHP would not have been able to refuse to supply. No substantial market power, no refusal to supply.

With that in mind it is difficult to see how material facilitation is the same as counterfactual reasoning. The High Court in *Melway* said:33

“...in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.”

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78 See generally for a discussion of certainty in the New Zealand regulatory context: Daniel Kalderinis, Chris Nixon and Tim Smith “Certainty and Discretion in New Zealand Regulation” in Susy Frankel and John Yeabsley “Framing the Commons: Cross-cutting Issues in Regulation” (VUP, Wellington; 2014).
80 Ibid, at [14], [25], [28], [31], [32] and [34].
81 Ibid.
The Supreme Court said:84

“It is evident from this approach that the concept of facilitation employed by their Honours was comparative; that is, facilitation as against the position that would have obtained in a competitive market. Hence their qualification of the word “facilitated” by the word “materially” to make it clear that their approach was not departing from the comparative exercise undertaken in Queensland Wire. This implicitly comparative approach is made more express in the equivalent idea that the dominant firm’s market power made it easier-than would otherwise be the case for it to act for a proscribed purpose. That way of framing the matter involves an express comparison between actual and hypothetical markets.”

That something (say X) makes conduct easier does not mean that X caused the conduct. Just because market power made the conduct easier does not mean that the conduct would not have occurred in the absence of market power. Logically the conduct could well have occurred. As such material facilitation does not pass the counterfactual test.

Furthermore in Melway the High Court did not try to apply the material facilitation test. The ACCC had introduced it when it intervened in the High Court. The High Court said:85

“That [material facilitation] was not the case that was made below and the findings of fact necessary to support such an argument were not sought or made. The case should be disposed of on the basis on which it was argued by the parties in the Federal Court...”

Under the Supreme Court’s comparative exercise test the defendant in Melway could never be liable as it had acted in the same way in a competitive market. It passed the counterfactual test. If the counterfactual and material facilitation tests were the same there could not be any findings of fact that could change the result. This suggests the High Court regarded the tests as different.

Deane J’s Purpose Test

The same is true of Deane J’s purpose approach. The Supreme Court regarded it as part of the comparative exercise as it involves comparing the actual and a hypothetical market.86

The High Court of Australia conversely does not view it as the same as the counterfactual test four High Court judges used in Queensland Wire”. In Melway the majority said “Deane J’s approach was different.”87 Finkelstein J also regarded Deane J’s approach as different in NT Power.88 The NT Power majority agreed noting:89 “Finkelstein J also adopted what he saw as an alternate approach – that of Deane J (Dawson J concurring) in Queensland Wire”. The High Court majority agreed with Finkelstein J.

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Unless the High Court was using “different” and “alternative approach” in a “special” sense, it did not view Deane J’s approach and the counterfactual test as the same.

When discussing Deane J’s test, the Melway High Court said that Deane J’s approach illustrated Scalia J’s point in Eastman Kodak.90 There Scalia J said:91

“Where a defendant maintains substantial market power, his activities are examined through a special lens. Behaviour that might otherwise not be of concern to the antitrust laws – or that might even be viewed as pro-competitive – can take on exclusionary connotations when practiced by a monopolist.”

When one looks at Scalia J’s statement one can see that the counterfactual test does not capture such conduct. An example of procompetitive conduct is efficiency enhancing behaviour. A firm which is not a monopoly is by definition in a competitive market. Thus, Scalia J is talking about a firm without substantial market power engaging in efficiency enhancing behaviour in a competitive market. Such behaviour must by definition pass the counterfactual or comparative exercise.

Competition law, literature and case law shows a number of such practices.92 These include lease-only practices, minor acquisitions, tying contracts, exclusive dealing contracts and below cost pricing.93 All these can be efficiency enhancing but also anticompetitive when a dominant firm engages in them. This Eastman Kodak scenario is counter to the Supreme Court’s view that Deane J’s approach and the counterfactual test are the same. The Supreme Court deals with the Eastman Kodak scenario by ignoring it. Arguments can be powerful if one pretends there is no counterargument or counterevidence.

The Supreme Court also ignores what some judges did in Boral with predatory pricing. Heerey J in the Federal Court94 and McHugh J in the High Court95 held there would be no “taking advantage” unless the defendant could recoup its losses by subsequently raising price. This like Eastman Kodak focuses on anticompetitive effect. There is no need to engage in a comparative exercise.

Certain passages in the Supreme Court’s decision suggest a lowering of the threshold or a softening of the test for “use” and “take advantage”. This comes when the Supreme Court said:96

“Translating that approach to the circumstances of the present case the Commerce Commission was obliged to show, on the balance of probabilities, that Telecom would not have introduced 0867 in a workably competitive market; in other words, that it would not have done so had it not been dominant in the markets involved. If that is shown, it follows that Telecom used its dominance in that its dominance gave it an advantage which caused, enabled or facilitated its introduction of 0867.”

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91 Ibid, at [48].
92 Phillip Areeda and Donald Turner Antitrust Law (Little Brown and Co, Boston, 1978) at [806e].
93 Ibid.
This suggests that the material facilitation is now part of s36. Thus, a firm takes advantage of its substantial market power if that power caused or enabled or materially facilitated its conduct. The problem with this is that the Supreme Court subsequently framed the test as a question about how the firm would have acted i.e. just like the Privy Council: 97

“the question, as earlier articulated, is whether the Commerce Commission has shown, on the balance or probabilities, that in a hypothetical workably competitive market, so constructed, the non-dominant company X would not as a matter of commercial judgment have introduced the 0867 service as Telecom did…

“Accordingly, the Commission failed to show that in a hypothetical workably competitive market, because of the fear of losing retail customers, company X would not have introduced an 0867 service.”

If “would have acted” is the test, there is no scope for analysing whether market power made the conduct easier. Facilitation does not exclude the possibility that a firm without market power would have acted the same way or engaged in the same conduct. The fact that market power materially facilitated the conduct does not mean a non-dominant firm would not have undertaken the same conduct. Indeed the whole point of the material facilitation test is that a firm without substantial market power would still engage in the conduct. Substantial market power makes the conduct easier. By using “would” language in determining how Telecom was not liable, the Supreme Court has not left room for liability for material facilitation when the conduct passes the traditional counterfactual test. This does not aid predictability. By reaffirming the Privy Council, the Supreme Court has not added anything. It has not lowered the threshold.

Despite these jabs the Supreme Court deserves credit for having a test. It noted how the Privy Council observed that s36’s words provided no explanation as to the distinction between conduct which does and conduct which does not constitute use of a dominant position. 98 So it is up to courts to fashion a test. A test is better than simply saying it is a question of fact and judgment as Gault J suggested in Port Nelson. 99 Interestingly obviousness is a question of fact in patent law. Yet Gault J had no problem in applying “well established” principles and a test in Peterson Portable Sawing Systems Ltd. 100

Downplaying Economic Analysis

A consequence of being legalistic and a bottom up type of decision is that the decision does not contain much economic analysis. Indeed the Supreme Court downplays economic analysis. This is the next distinguishing feature of the Court’s 0867 decision. The Court

97 Ibid, at [42] and [49].
98 Ibid, at [12].
talked of how a dominant firm would have acted as “a matter of commercial judgment.” It continued:

“The necessary assessment must be undertaken on the basis that the otherwise dominant firm will act in a commercially rational way in the hypothetically competitive market . . . The Court is involved in making what is essentially a commercial judgment . . . Economic analysis may be helpful in constructing the hypothetically competitive market and to point to those factors which would influence the firm in that market. But it must always be remembered that the ‘use’ question is a practical one . . .”

This deprecating economics resembles Roberts CJ’s comments in the Healthcare Litigation:

“To an economist, perhaps, there is no difference between activity and inactivity; both have measurable economic effects on commerce. But the distinction between doing something and doing nothing would not have been lost on the Framers, who were “practical statesmen”, not meta-physical philosophers.”

The Supreme Court’s comments are unusual in that competition law involves economic concepts and analysis. This is especially so in New Zealand where the Commerce Act allows for lay member economists to sit with the courts. One commentator has said “that antitrust litigation not only needs economic analysis, antitrust litigation is becoming economic analysis.” At the very least economics informs competition law. The entire law and economics movement started at the University of Chicago when antitrust professor Ed Levi invited economist Aaron Director to sit in and comment on his antitrust class.

United States judges and academics have recognised the importance of economics to antitrust. Judge Posner has said “antitrust law has become a branch of applied economics.” Judge Easterbrook has claimed “antitrust is increasingly a branch of economics” and a branch of industrial organisation. He has said: “Modern antitrust law is a search for economic explanations of problematic conduct.” It is not only a United States notion, but also a European one. There the authorities no longer simply formally assess classes of conduct but engage in a contextual analysis of the conduct’s economic impact. In 2003 the European Commission’s Director General of Competition stated “a credible policy on abusive conduct must be compatible with mainstream economics.” Thus, the Supreme

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102 Ibid, at [35].
110 Ibid.
112 Ibid.
Court’s eschewal of economic analysis in competition law is out of line with the rest of the world.

Most previous New Zealand courts had recognised how important economics and economic analysis is in competition cases. Richardson J for example put efficiency at the heart of the Commerce Act in *TruTone Ltd v Festival Records Retail Marketing Ltd*113 The High Court in *Fisher and Paykel v Commerce Commission*114 extensively discussed the economics of exclusive dealing.

On the other hand Cooke P in *Clear Communications Ltd v Telecom Corp of NZ Ltd*115 asserted that the Baumol-Willig rule would seem obviously anticompetitive and in breach of s36 without bothering to do any economic analysis.116

As mentioned above the Supreme Court noted that it was important that Australian and New Zealand law on restrictive trade practices (on monopolisation) is broadly the same.117 This suggests the Supreme Court has read Australian law as also deprecating economic analysis – or at least in monopolisation cases. However, the Australian cases say no such thing. They recognise how economics can be useful in competition law cases.

In *Queensland Wire* Dawson J noted that the essential notions with which s 46 is concerned and the objective s 46 is designed to achieve are economic and not moral ones.118 In *Melway* Kirby J observed:119

“A further argument supports the approach which this Court took in Queensland Wire to the interpretation of the phrase “take advantage of” in s46 of the Act, an approach which placed economics at the heart of s46 analysis”

He continued120

“... by posing the question “What would the corporation with a dominant market position have done in a competitive market?” this Court offered a practical test. It is one suited to fostering competition in markets as a means of promoting efficiency and consumer welfare.”

Whether conduct promotes efficiency and consumer welfare requires economic analysis even though the test may be practical.

In *Boral* McHugh J stated:121

“The terms of the Act have economic content and their application to the facts of a case combine legal and economic analysis. Their effect can only be understood if economic theory and writings are considered.”

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113 *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA).
114 *Fisher and Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731
115 *Clear Communication Ltd v Telecom Corp of New Zealand Ltd* [1993] 5 TCLR 413 (CA).
116 Ibid, at 416.
118 *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 194.
120 Ibid.
In a non-monopolisation case, Visy Paper Pty Ltd v Australian Competition and Consumer Commission Kirby J emphasised the importance of legal and economic scholarship to competition law cases. The High Court of Australia not only states how important economic analysis is, it also engages in it. For example, in Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd the majority discuss how intrabrand restraints can be procompetitive. McHugh J in Boral has a sophisticated discussion of predatory pricing and the need for recoupment.

As mentioned above both Kirby J in Visy and McHugh J in Boral state that competition courts must consider economic theories and writings. The 0867 decisions shows none of this. (Although to be fair it appears the parties cited little of such writings to the Court). This again contrasts to the High Court of Australia.

The Queensland Wine judgments refer to scholars such as Scherer, Stigler, Landes, Kaysen and Hovenkamp. Boral has even more with the judges referring to Bork, Posner, Areeda and Hovenkamp, Brodley and Hay, Krattenmaker and Salop. The parties, in particular the ACCC, extensively cited to economic literature, including some heavily game theoretic analysis of predatory pricing. This topic may more readily lead to economic citation. However, the Privy Council in its predatory pricing case did not cite any economic literature. This contrasts to the United States Supreme Court predatory pricing decision Brooke Group Ltd v Brown & Williamson Tobacco Co. Lack of economic citation may be a British phenomenon. The 0867 court may be acting in the British tradition whereas the High Court of Australia may be going the United States route.

In one sense the High Court’s use of economic literature is admirable in the sense the decisions are not economically illiterate. Conversely some of the material the Court cites is contradictory. For example Queensland Wire’s definition of barriers to entry using Scherer is contrary to Stigler – yet the Court cites both. Boral cites Bork and Posner yet has a Harvard school approach to barriers to entry. This makes parts of the decisions appear a wishing well in the sense one can find support for any view and economic school of thought in the cases.

The Supreme Court’s decision to stress commercial judgment and practical questions appears to come from Heerey J’s comments in Boral. The Court cites the Privy Council who quoted

123 Ibid, at 25.
124 Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd (1989) 167 CLR 177 at [190].
127 See footnotes 119-121, above.
131 Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd (1989) 167 CLR 177, at [189-190].
132 Ibid, at [201].
134 Ibid, at [295].
135 Berkey Photo Inc v Eastman Kodak Co 603 F2d 263 (2nd Cir 1979).
Heerey J’s comments in *Boral.*136 (The High Court of Australia had also favourably cited it.)137 However, the Supreme Court do not put Heerey J in context. In *Boral* he essentially repeated comments he had made on the topic in the Full Federal Court in *Melway.*138 There, Heerey J did not eschew economic analysis. He linked legitimate business rationale to efficiency.139 He cited two economists who pointed out that “taking advantage of market power” has to be seen in terms of efficiency.140 He also referred to the United States Supreme Court in *Aspen Skiing Company v Aspen Highlands Skiing Corporation* where the Court referred to the lack of valid business purpose in finding monopolisation.141 Heerey J approvingly cited the Supreme Court’s mentioning the defendant’s failure to offer any efficiency justification whatsoever for its pattern of conduct.142 This is not limiting economic analysis.

The 0867 Court’s deprecating of economic analysis can cause problems. The Supreme Court claims taking advantage and use is a matter of rational commercial judgment. However what people consider rational commercial judgment can change. Economic analysis sheds light and understanding on business practices. Well into the twentieth century conventional thought was that practices such as tying and exclusive dealing had monopoly explanations.143 Their purpose was to extend a monopolist’s market power. That these practices were almost always anticompetitive. The advent of the Chicago School led to the view that these practices can have efficiency enhancing purposes and effects. That rather than being anticompetitive these practices were actually procompetitive.144 Post-Chicago theorists have shown in certain circumstances exclusive dealing and tying can be anticompetitive, particularly in the sense of raising rival’s costs.145 These changes have necessarily influenced overseas courts in competition cases. The 0867 Court’s comment arguably prevent that type of influence.

Other examples of economics changing views of practices is with the Baumol-Willig rule or Efficient Component Pricing Rule. At the time of and just after the New Zealand litigation on the issue the predominant view was that the rule was anticompetitive.146 Twenty years later one of the world’s leading post-Chicago economists advocates use of the ECPR (or a close variant of it) to be the guide for refusals to deal and price squeezes.147


139 Ibid, at [22].

140 Ibid, at [22] and [28].

141 Ibid, at [26].

142 Ibid, at [27].


144 Ibid.


Game theory as a branch of economics has also been influential. Chicago School theorists presented a strong case that predatory pricing is irrational and consequently rare. This influenced the United States Supreme Court. Game theory has provided insights that challenge that view. It has shown in certain circumstances predatory pricing can be a rational strategy.

With the Eastman Kodak scenario, mentioned in Melway, of practices that may be procompetitive in a competitive market but anticompetitive in the hands of a monopolist, the focus is on anticompetitive effect (or in Deane J’s framework the attaining of an anticompetitive purpose). To assess whether this effect has happened or is likely one must do economic analysis. This is contrary to confining “use” to a matter of commercial or practical judgment. In stressing the practical over the economic the Supreme Court has ignored Keynes who said:

“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.”

One of the cases Telecom cited in its printed case to the Supreme Court was Town of Concord v Boston Edison Company. This was a price squeeze case and a decision of Judge Breyer when he was on the First Circuit Court of Appeals. In that decision he provided an appendix in which he set out the economics of price squeezes and how they can be anticompetitive. He included a graph. Based on 0867 no one on the Supreme Court of New Zealand will be doing that.

Foreign Authority and Writing

While Telecom cited Town of Concord and other United States authority in its written argument a noticeable feature of the Supreme Court cases is the absence of any foreign authority – apart from the Privy Council and the High Court of Australia. This not only includes foreign judgments but also academic writing. In this the Supreme Court differs from other final appellate courts and in particular the High Court of Australia. In Queensland Wire the judges cited eight United States Supreme Court cases, two Circuit Courts of Appeal, five European cases and eighteen foreign publications. In Melway the number is eight United States Supreme Court cases, six Circuit Courts of Appeal, six European cases and eleven local publications. In Boral there are eleven United States Supreme Court cases, three Circuit Courts of Appeal, three European cases, twenty-two foreign and fourteen local publications.

152 Town of Concord v Boston Edison Company 915 F 2d 17 (1st Cir, 1990).
Even the Privy Council in New Zealand competition cases cited foreign cases. In particular the Privy Council in *Telecom*, following the example of the High Court in *Queensland Wire*, cited the Seventh Circuit Court of Appeals case *Olympia Equipment Leasing Co v Western Union Telegraph Co*. The Privy Council majority in *Carter Holt Harvey* while not mentioning *Olympia* by name gives the principle it stands for. The majority also cited Judge Breyer’s decision for the First Circuit Court of Appeals in *Barry Wright Corporation v ITT Grinnell Corporation*.

The lack of enthusiasm for United States and European authority seems to have become a trait of New Zealand competition law jurisprudence. However, it was not always like this. Barker J in *Auckland Regional Authority v Mutual Rental Cars* was enthusiastic about the United States essential facilities doctrine. The High Court in *Union Shipping NZ Ltd v Port Nelson Ltd* knocked this on the head and was not at all keen about importing the doctrine. It summed up its reasoning:

“At risk of fatuity, it is the task of this Court to interpret and apply the New Zealand Commerce Act 1986. It is not a matter of importing common law doctrine. It is a matter of obeying and applying New Zealand statute law. In that task, our preferred starting point is to look at s36 requirements . . . The American experience may give valuable insights, and assist assessment of potential s36 solutions. While we do not adopt the doctrine as such, nor do we ignore help which it may offer in achieving some sensible resolution.”

The High Court in *Telecom Corp of New Zealand Ltd v Commerce Commission (Data Tails)* only briefly referenced two United States cases. It ignored a United States Supreme Court decision on price squeezes (the subject of Data Tails) that appeared after hearing but before the judgment. With predatory pricing both the *Port Nelson* and *Carter Holt Harvey* Courts of Appeal rejected United States law which said recoupment was a prerequisite for liability for predatory pricing.

Again the High Court of Australia provides the best counterexample. In *Boral Gaudron*, Gummow and Hayne JJ drew three propositions from United States antitrust law.

“The structure of Pt IV of the Act does, despite the considerable textual differences, reflect three propositions found in the United States antitrust decisions. The first is that these laws are concern with ‘the protection of competition, not competitors’ (129). The second, stated in *Brooke Group Ltd v Brown and Williamson Tobacco Corp*...
in that ‘[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or purported to afford remedies for all torts committed by or against persons engaged in interstate commerce’ (131). The third, which appears from *Cargill Inc v Monfort of Colorado Inc* (132), is that it is in the interest of competition to permit firms with substantial degree of power in the market (or, in the United States, a dominant position) to engage in vigorous price competition and that it would be a perverse result to render illegal the cutting of prices in order to maintain or increase the market share.

McHugh J was even more explicit, observing:165

“Even when one allows for the difference between the Australian Act and the United States legislation, no valid reason justifies rejecting the United States jurisprudence as an aid in developing the law relating to “predatory pricing” in this country.”

Given that the Supreme Court claims Australia and New Zealand law should be broadly similar one would expect that New Zealand Courts will follow Australian High Court practice and refer to more overseas authority than they have done previously.

**International Authority May be Helpful**

Overseas cases and writing can be beneficial as they may explain things and be directly relevant. This is what *Olympia* did. One of the benefits of the Baumol-Willig rule is that a new entrant must be at least as efficient as the incumbent access giver.166 *Olympia* with its warning that the purpose of competition law is not to hold an umbrella over inefficient rivals is a graphic example of the Baumol-Willig principle in action.

As previously noted Heerey J derived his legitimate rationale test from the United States Supreme Court in *Aspen*167 and *Eastman Kodak*.168 If it is good enough for the Federal Court and High Court in Australia to refer to United States law for help it should be good enough for New Zealand courts. New Zealand courts should not be waiting for Australian courts to adopt United States concepts and ideas. Why not go direct to the source if it is relevant. European law can also be useful; for example European law has a legitimate justification defence to refusals to supply.169

Overseas case law and authorities can explain things. In *Melway* the High Court outlined how intrabrand restraints can be procompetitive. While this is economic analysis the High Court used two United States cases to illustrate this.170

Another example of the way the High Court usefully invoked United States law is in *Melway* where the majority cited Scalia J’s statement in *Eastman Kodak*.171 It is a graphic example of

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165 Ibid, at [281].
how Deane J’s purpose test captures conduct that the traditional counterfactual test does not. By ignoring United States law the Supreme Court does not have to engage with this example and how it is counter to the notion that Australian law shows only one test.

Along this line, overseas authority may have helped things. The *Eastman Kodak* scenario and the Deane J purpose test (well at least according to the majority of the High Court in *Melway* and *NT Power*) deal with anticompetitive effect. Practices may be anticompetitive and exclusionary when a monopolist undertakes them. Thus they deserve condemnation. The way the Supreme Court articulates its comparative exercise test the effect of conduct is irrelevant. Rather what counts is conduct. Its test focuses only on conduct which may be why the Supreme Court did not discuss *Eastman Kodak*.

However, the Supreme Court quoting Gaudron, Gummow and Hayne JJ in *Boral* pointed out:  

> “[The section] was designed to prevent damage to the competitive process rather than to individual competitors.”

This is a well-established principle of Australian jurisprudence. New Zealand courts have said the same. It is also true of United States law.

In *United States v Microsoft Corp* the DC Circuit Court of Appeals observed:  

> “To be condemned as exclusionary, a monopolist’s act must have an ‘anticompetitive effect.’ That is, it must harm the competitive process and thereby harm consumer. In contract, harm to one or more competitors will not suffice.”

Thus, under both United States and New Zealand law to be liable for monopolisation, the conduct must harm the competitive process. Harm to competitors is not enough. That harm to the competitive process is anticompetitive effect. If only a monopolist can cause that effect only a monopolist’s conduct can be exclusionary then the courts should condemn that conduct. Courts can do so by Deane J’s test. The counterfactual test which only refers to conduct will not condemn such conduct. A firm in a competitive market would engage in such conduct as in those circumstances it is procompetitive. Well at any rate it is an insight and argument that overseas jurisprudence provides.

**Use of International authorities can be inconsistent**

The counter to referring to foreign law and one reason why the Supreme Court did not refer to any is Judge Leventhal’s quip that relying on foreign law is “looking over a crowd and...

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171 Ibid, at [29].
174 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at 403.
176 United States v Microsoft Corp 253 F 3d 34 (DC Cir 2001) at 58.
picking out your friends”. This jibe has an element of truth in competition cases – in particular in the High Court of Australia. McHugh J adopts principles from United States law for predatory pricing in Boral but rejects United States law for refusals to supply in NT Power. There as part of the majority he rejects a Supreme Court case Verizon Communications Inc v Law Offices of Curtis V Trinko LLP saying:“It was not entirely clear whether PAWA was relying on [Verizon] as an aid to the construction of s 46(4)(c) or as an aid to the construction of s46 generally. In either event, it is not an authority which compels or influences the result in this case. Section 46 is in different terms from s2 of the Sherman Act. Section 2 is backed by sanction of imprisonment; s46 is not. Section 2 requires “the wilful acquisition or maintenance” of monopoly power – a test which is entirely different from and stricter than that in s46.”

The United States does not use s 2 criminally and all those reasons would apply to predatory pricing. Another example of picking and choosing is Kirby J. In Visy he claimed that one could gain insights from United States law on whether to characterise agreements as horizontal or vertical. The Visy majority noted that adopting a horizontal or vertical distinction: “… confuses the task of construing the Act’s provisions. It is necessary to pay attention to the text of applicable statutes in preference to judicial or other glosses on that language. Not only does adopting these terms distract attention from the language of the Act, it does so by introducing terms which are, so it seems, intended to convey value or other judgments about the social or economic consequences that are assumed or expected to follow from the making of or giving effect to the arrangement to which one of these descriptions is applied.”

The Court said it was wrong to adopt such terms from the “wholly different statutory context of United States antitrust law”. A court may misread foreign law such as in NT Power. There Kirby J advocated following the Supreme Court case of Verizon on refusals to deal. Yet he has praised Queensland Wire. Verizon and Queensland Wire are incompatible as BHP had never previously supplied Y-bar to anyone. It had used the product for itself. Also BHP and Queensland Wire had never been in a longstanding relationship where BHP supplied Y-bar to Queensland Wire and then stopped. Given this, BHP would never have had a duty to supply Queensland Wire and could not be liable under Verizon.

Some international authority supports 0867

180 Ibid, at 10.
181 Ibid.
Another reason for adopting or at least discussing overseas law is that it may support a decision and its reasoning. Commentators have criticised 0867 and suggested its comparative exercise test is unique. However, the essence of the comparative exercise is that conduct will not be monopolisation if a firm carries it out in a competitive market has support.

The Eight Circuit Court of Appeals in *Trace-X Chemical Inc v Canadian Industries Ltd* has enunciated the difference between acceptable and illegal conduct by a monopolist, in very similar terms to the 0867 test. The case involved a monopolist’s refusal to extend credit or replace defective material. The Court held:

“[A]cts [by a monopolist] which are ordinary business practices typical of those used in a competitive market do not constitute anticompetitive conduct violative of section 2.”

Some competition law scholars have said similar things. Evans and Padilla state:

“Consider a practice in which firms in both competitive and uncompetitive markets engage. We would expect that the practice cuts costs or enhances value to customers — after all, competitive firms cannot survive indefinitely if they do not use the most efficient methods of producing, designing, and distributing products.”

They continue:

“Sources of efficiency remain, regardless of the degree of market power of the firm engaging in the practice.”

Hylton and Salinger agree that the practices have an efficiency reason if a monopolist and competitive firm engage in them. “There is no economic reason to believe these efficiencies become less important as firms acquire market power.”

Epstein puts the argument as follows:

“… there are certain business practices that are routinely allowed by firms that do not possess monopoly power. Since these firms do not have any market power, the appropriate assumption is that these practices offer some efficiencies that improve the gains from trade, even if a reviewing court cannot quite understand exactly why these practices survive or how they work.”

Posner captures the argument:

“If the practice is one employed widely in industries that resemble the monopolist’s but are competitive, there should be a presumption that

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185 *Trace-X Chemical Inc v Canadian Industries Ltd* 738 F2d 261 (8th Civ 1984).

186 Ibid, at 266.


188 Ibid, at 91.


the monopolist is entitled to use it as well. For its widespread use implies that it has significant economizing properties, which implies in turn that to forbid a monopolist to use it will drive up his costs and so his optimum monopoly price”.

While these statements do not quite cover the comparative exercise, they provide economic support for the idea that no liability should attach to a firm that engages in conduct that a firm in a competitive market would carry out. However, the Supreme Court’s reasoning was solely legal and the statements involve economic analysis.

I do not agree with the argument as a practice can have both efficiency justifications and anticompetitive effects if a monopolist undertakes them. The scholars do not make it an inflexible rules as the words “would expect”, “assumption” and “resumption” show. Courts still need to analyse anticompetitive effect as per Eastman Kodak. However, by eschewing economic analysis and foreign authorities and writings, the Supreme Court denied itself support for its decision.

It may be unfair to use one decision to pronounce on the Supreme Court’s use of overseas material. Poynter in the extraterritoriality of the Act uses more than 0867. Other areas show this – in particular copyright and patents. As discussed above, the High Court of Australia cases more have foreign and academic references that the New Zealand Supreme Court equivalents. Based on these cases and 0867 it seems unlikely the Supreme Court will have discussions like the following extracts from High Court of Australia transcripts:

**GUMMOW J:** “There will be a grant of a special leave in this matter. The Court will allow one and a half to two days, I think, and we expect to have the assistance of counsel to deal with this matter thoroughly without any reticence in starting at the bottom, so to speak, and we expect counsel to be familiar with the academic writing in this field. They have already been referred, I think, to an article by Dr Deazley in [2004] Intellectual Property Quarterly 121. There is also what may be a useful article by Professor Sterk in Michigan Law Review for 1996, vol.94, pp 1197 called Rhetoric and Reality Copyright Law. There is a lot of other material out there as well. I hope the arguments will be informed with all of that, at least in a suitable background.”

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192 Paul G Scott “Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act” (2011) 17 NZBLQ 260, at 277-278.
195 *Ice TV Pty Ltd v Nine Network Australia Pty Ltd* [2008] HCA Trans 308, at 11.
Another example is:196

GUMMOW J: “I am not sure whether it was referred to in your written submissions. There is a paper by Professor Jane Ginsburg on this point called “The Concept of Authorship” in 2003 52 DePaul Law Review 1063 which is easily accessible on Hein online, I think, where she deals with the difference between what she says is in the United Kingdom and Australia and the United States and Canada and they are questions sweat of brow and the attempted corporatisation of copyright creation, if I can put it that way.”

The next area I deal with, regulated industries, has less scope for foreign citations and influence as the statutes are particular to New Zealand. However, they have ample scope for and indeed demand economic analysis and scope. The decisions here show the Supreme Court can engage in it.

Regulated Industries

Competition law and regulation can be different sides of the same coin. Depending on the type of regulation, both competition law and regulation aim at lower prices for consumers. Governments regulate for many reasons197 but the main one is because governments believe there are flaws in the operation of competition in a particular market. This is so with a number of markets in New Zealand. Thus, governments have regulated the prices of certain industries198. This legislation aims to limit the aggregate revenue of firms subject to regulation. Some commentators refer to this as rate regulation199. The general aim of rate regulation is to prevent monopoly profits and to ensure that consumers receive fair prices and services. Such regulation has another purpose in that is must be able to ensure that the regulated firm earns enough to stay in business in the sense of earning enough to cover the cost of building and maintaining their assets and also have the incentive to innovate and invest in future assets.

Thus, the goal with rate regulation is to avoid the problems of monopoly of increased prices, decreased output and a wealth transfer from consumers to producers. Regulation should provide a mix of price, output and profits that would occur in a competitive market.

So regulation involves economic concepts and consequently economic analysis. The Supreme Court’s cases have involved the Court reviewing decisions of the regulator – the Commerce Commission. Some cases have involved judicial review but I do not intend to discuss the Supreme Court’s treatment of judicial review. Rather I examine what impacts the Court has had on regulation.

196 Ice TV Pty Ltd v Nine Network Australia Pty Ltd [2008] HCA Trans 356, at 35.
197 See generally “Identifying and Addressing a Regulatory Need or Opportunity” at Regulatory Reform Toolkit, www.regulatorytoolkit.ac.nz
Anyone writing on regulation faces a problem. That problem is with how outside readers regard economic rate regulation cases. Robert Bork, a highly economically sophisticated judge described his time on the DC Circuit Court of Appeals as follows:

“The D.C. Circuit has a docket of a lot of regulatory cases which are not very interesting as law because what you’re doing is second-guessing a prudential decision by some regulator.”

He continued:

“And I am sure nobody ever reads those opinions ever. Maybe the parties, maybe the counsel does.”

He described working on regulation cases as follows:

“… there aren’t any big ideas floating around. But you have to work very hard to get it right, and I used to analogize it to doing a crossword puzzle. Maybe you think you finally get it right, but when you’re all finished, what’ve you got? A completed crossword puzzle that nobody will ever look at.”

With regulation cases, the Supreme Court, apart from one exception, has produced professionally excellent decisions that display a good grasp of the economic concepts. The exception concerns the concept of barriers to entry. This concept impacts regulation and competition law.

Commerce Commission v Southern Cross Medical Care Society was a Court of Appeal merger decision. There, Tipping J discussed barriers to entry. He held:

“Anything is capable of being a barrier to entry or expansion if it amounts to a significant cost or limitation which a person has to face to enter a market or expand in the market and maintain that entry or expansion in the long run, being a cost or limitation that an established incumbent does not face.”

This is a Stiglerian definition of a barrier entry. Stigler defined a barrier to entry as costs that a potential entrant must face at or after entry, which those already in the market did not have to face when they entered. Bain, however, defined it as some factor in a market that allows firms already in the market to earn monopoly profits, while deterring new entrants from entering. As Hovenkamp notes, the difference between the two definitions can be quite substantial.

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201 Ibid.
204 Commerce Commission v Southern Cross Medical Care Society (2001) 10 TCLR 269 (CA).
205 Commerce Commission v Southern Cross Medical Care Society (2001) 10 TCLR 269 (CA), at 73.
206 George J Stigler The Organization of Industry (RD Irwin, Homewood (III), 1968) at 67-70.
207 Ibid.
In *Fonterra Co-operative Group Ltd v The Grate Kiwi Cheese Company Ltd*\(^{210}\) the Supreme Court dealt with regulations under the Dairy Industry Restructuring Act 2001. The Supreme Court held:\(^{211}\)

“To require a new entrant to possess or borrow the capital necessary to establish its own facility would establish a significant barrier to entry.”

The *Fonterra* comment on a barrier to entry is inconsistent with the *Southern Cross* definition\(^ {212}\). Such capital is not a barrier to entry as the incumbent has faced this cost. The author of *Fonterra*: Tipping J.

I shall discuss the Supreme Court’s decision *Vodafone New Zealand Ltd v Telecom New Zealand Ltd*\(^ {213}\) and how it throws up issues for regulation.

**The case**

The case involved four appeals of the Commerce Commission determination under the Telecommunications Act 2001. Part 3 of that Act provided for telecommunications service obligation (TSO) instruments. As of 2001, there was a TSO between the Crown and Telecom. The agreements required Telecom to provide residential telephone connections to commercially non-viable consumers (CNVC’s). In return, Telecom was entitled to recover “net costs” from other telecommunication service providers who use this network.

Section 5 of the Act defines net cost as:

“… [T]he unavoidable net incremental costs to an efficient service provider of providing the service required by the TSO instrument to commercially non-viable customers.”

Vodafone was the largest telecommunication service provider (TSP) and it challenged the Commerce Commission’s determinations. For the 2003/4 year the issue was the methodology the Commission used to model the possible use by TSPs of cellular telephony as a means of providing services to CNVC’s. For the 2004/5 and 2005/6 years, Vodafone objected to the Commission deciding not to take account of cellular technology. Telecom also had its own appeal on how to calculate the weighted average cost of capital (WACC) used in arriving at net cost.

**Background Concepts**

The concept of rate of return is important in rate regulation\(^ {214}\). It is the rate of return a firm is allowed to earn on an investment. In theory, the rate of return is the firm’s cost of capital on the amount of money it must spend to obtain the capital it uses to provide the regulated

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\(^{212}\) *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA).


products. Rate of return is the weighted average cost of the firm’s various sources of capital that is necessary to allow the firm to attract the capital it requires to provide the regulated product.

It is important in regulation as people will only invest if they get a return on the capital they invest. This return must be the equivalent to what they would earn from investments of equal risk. If not, individuals will not invest. Thus, regulation of prices must ensure the firms earns an adequate return on any investment. If regulation does not, then it will deter future investment.

Regulators must determine the appropriate rate of return. They can do so in two broad ways – on as accounting measure or on an economic measure of the value of the capital assets. In brief, regulators determine the value using the accounting measure by the historical level of costs. The economic measure comes to value by measuring the amount and value of the resources society serves by having the capital resources of the firm available today. Thus, the method of valuation is critical in regulation.

The decision

Vodafone argued that the Commission’s decision to calculate net cost based on Telecom’s existing network rather than considering the net cost to a network using new mobile technology was an error of the law. Telecom said taking account of mobile technology would deprive Telecom of a reasonable rate of return on its capital investments.

For the 2003/4 years appeal on the modelling issue McGechan J dismissed the appeal and the Court of Appeal by a majority did the same.

The appeals on the 2004/5 and 2005/6 years involved the new technologies. Winkelman J allowed Vodafone’s appeal – although she acknowledged her decision was not readily reconcilable with the Court of Appeal’s. She held the Commission’s decision not to use mobile technology in its modelling of net cost of an efficient provider was an error of law. It was inconsistent with its obligation to assess net cost on the basis of the unavoidable net incremental cost to an efficient provider to providing service to commercially non-viable customers.

This decision along with the earlier Court of Appeal one went direct to the Supreme Court. The Court allowed the appeal. Elias J and Tipping J did so for essentially the same reasons as Winkelman J. I shall not discuss their judgments. Rather I concentrate on the judgments of Blanchard, McGrath and Gault JJ which Blanchard J gave.

He pointed out that the Commission’s task was to determine the net cost to a TSP in each year, i.e. the unavoidable net incremental cost to a hypothetical efficient service provider of providing the service the TSO required to CNCVs. So the Commission modelled the hypothetical efficient service providers’ network. This was an optimised version of Telecom’s network. The Commission then calculated the optimised asset value and then the

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215 Vodafone New Zealand Ltd v Telecom New Zealand Ltd HC Wellington CIV-2007-485-826, 18 December 2007 per McGechan J.
appropriate WACC. It finally determined the time path (depreciation) over which the efficient service provider was to recover the capital hypothetically employed.

The Commission considered a number of asset valuations methodologies. These were: opportunity cost, historical cost, optimised replacement cost (ORC), optimised depreciated replacement cost (ODRC) and optimised deprival value. The Commission decided against using historical cost and opted for ORC. The Court noted:

“It said that in circumstances where there are long-lived assets, and in particular where there is technological change and falling costs, historical costs might be problematic and overstate the cost of replicating the service potential of the assets required to provide the TSO services, were they to be expressed in real terms. (We pause to comment that this criticism does not seem apt in relation to old assets, often called “legacy assets”, for which there is no new and enhanced technology.)”

This is where the Commission went wrong according to the majority.

It is said ORC distorted things by artificially revaluing old assets (that were already wholly or partially depreciated) which were not likely to be replaced and optimised. It said it was wrong to attribute a modern equivalent value to an old asset which was not being replaced and for which no replacement would sensibly be introduced. It claimed this artificially inflates the value of the old asset and provides a windfall for the firm in terms of an enhanced return on and of capital employed.

It cited an Australian paper by Johnstone which said such asset valuation amounts to a net present windfall to an asset owner equal to the amount of the upward revaluation. Johnstone described the as a free lunch. Thus, the Commission’s decisions were wrong and an error of law. It was incumbent upon the Commission to produce a new model which did not artificially inflate the value of the ESP’s telecommunications assets.

Discussion

In one sense the decision is of little import as the legislation changed so the decision has little precedential value. It may be a one-trip bus ticket. However, the decision throws up the following issues for regulation.

Winkelmann J’s decision as she and Elias CJ note is not readily reconcilable with the Court of Appeal’s decision. Yet the Supreme Court do not chide Winkelmann J for this state of affairs. Stare decisis concerns should mean a High Court judge should not knowingly issue a decision in conflict with the Court of Appeal.

The Supreme Court majority powerfully criticises the Commission’s use of ORC. Yet is appears from the transcript that the issue of the validity of ORC only arises on the fourth day.


\[219\] Ibid, at 68.

\[220\] Ibid.

\[221\] Ibid, at 70.

\[222\] Ibid, at 72.

of hearing. Accordingly neither the High Court nor Court of Appeal say anything about the issue. A Supreme Court should not be hearing things for the first time. That is not the task of a Supreme Court.

Also the Commission had extensively consulted on the choice of asset valuation methodology. Vodafone, apparently never said anything at the time and raised the issue in the Supreme Court. It could do so as its pleadings were side enough. This is not best practice.

The majority say the Australia Competition Tribunal had rejected ORC modelling on the hypothetical new entrant model. This supported the majority. However, the majority does not discuss how similar the statutory regimes are. The wording is actually different and could account for the difference. Yet the majority do not discuss.

According to the majority the Commission made a fundamental error in using ORC. The majority suggests historical cost (the accounting measure) is the appropriate one. However, the Commission had rejected this as it was too difficult as much of the relevant information was missing. The majority do not discuss the Commission’s reasons for choosing ORC. The Commission gave reasons after consulting with the parties and issuing consultation papers. There is no inkling of that in the Supreme Court’s decision.

It appears that the king hit was a paper by Johnstone where he called ODRC and ORC a “free lunch”. The trouble is that this paper was never before the Commission. Furthermore it is an unpublished paper. Reading the majority one would regard any regulator using ORC as extremely foolish. However, the choice of valuation methodologies is not as straightforward as the majority suggest. Each methodology has its pluses and minuses. One can find other writers, apart from Johnstone, who advocate for alternatives including ORC. Indeed in Telecommunications the OECD claims it has its advantages. So while it is admirable that they Supreme Court has used academic writing – it surprisingly only uses one viewpoint when there are multiple.

The decision gives the impression that its effect goes no further than the parties and has no impact in the future. Arguably this is not so as the Commission has used ODV (a replacement cost valuation) for gas, electricity and airports. Johnstone’s paper was not on the valuation of assets in telecommunications, rather it dealt with the energy industry – ie gas pipelines and electricity grids. The Supreme Court’s problems with the methodology in telecommunications must extend to other industries. It will be interesting to see what the Supreme Court will do when it gets an appeal from those industries.

While I raise these issues, the decision contrasts with 0867. The Court had no problem with discussing economic issues and it referred to foreign cases and writing. The Johnstone piece is also heavily mathematical. At the very least it shows, contrary to Bork, regulation raises interesting legal issues.

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225 It was published in (2003) 39 Abacus I. I do not know why the Supreme Court referred to the unpublished version.