Taking Advantage of Market Power in New Zealand: Searching for a New Approach

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O, it is excellent to have a giant's strength, but it is tyrannous to use it like a giant.[1]

Isabella's musing in Shakespeare's Measure for Measure *encapsulates one of the most difficult issues facing competition law and policy — when can it be said that a firm has taken advantage of market power for an anti-competitive purpose? Section 36 of the Commerce Act 1986 prohibits a firm with a substantial degree of market power from taking advantage of that power for certain exclusionary or restrictive purposes. Unfortunately, the courts have weakened s 36 by applying a narrow and difficult "counterfactual" test. This article traces the development of the counterfactual test and considers whether alternative tests are more appropriate. It then examines whether legislative reform is required to give s 36 more teeth.*

I TAKING ADVANTAGE OF MARKET POWER

The law encourages firms to strive for market power; this leads to innovation, efficiency and growth.[2] However once a firm achieves market power it is able to take advantage of its position to the detriment of other market participants.

In the most extreme case, a monopoly is completely unconstrained by competition. It can raise price and reduce output to the detriment of consumers.[3] Pure monopolies are, however, rare in the modern day. The law instead prohibits the taking advantage of a substantial degree of market power.

Section 36 of the Commerce Act 1986 (the Act) is premised on the idea that market power in itself is not an issue.[4] The prospect of charging monopoly prices and reaping the associated benefits attracts firms to the market and promotes competition. Section 36 is only engaged when a firm has acquired this ability and exploits it to exclude or restrict potential or current competition.

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1 NW Bawcutt (ed) *The Oxford Shakespeare: Measure for Measure* (Oxford University Press, Oxford, 2008) at 2.2.

2 *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP* 540 US 398 (2004) at 407 [*Trinko*].

3 *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at 407 [*Telecom v Clear*].

4 See also *Trinko*, above n 2, at 407.

Even once it has achieved market power, the law does not prevent a monopolist from competing. The law generally recognises that a monopolist is entitled to compete like anyone else. It is only when the monopolist crosses the line between legitimate competition and taking advantage of market power that the law intervenes.[5] So the law protects the competitive process and not the little guy. As long as competition is allowed to take place, the law is blind as to who wins and who loses.[6]

II SECTION 36

In its current form, s 36(2) of the Act reads:

> (2) A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of—
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> (a) restricting the entry of a person into that or any other market; or
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> (b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or
>
> (c) eliminating a person from that or any other market.

Section 36 has three conceptually distinct elements.[7] The impugned firm must have a substantial degree of power in a market; it must take advantage of that power; and it must do so for one of the proscribed purposes listed in s 36.

The mere coexistence of a substantial degree of market power and a proscribed purpose is insufficient to breach s 36. There must be some causal nexus between the two.[8] The connection element is therefore crucial to the s 36 cause of action. The equivalent Australian provision, s 46 of the Competition and Consumer Act 2010, is broadly the same as s 36.[9]

III THE CONNECTION ELEMENT

The Privy Council and the Counterfactual Test

In *Telecom Corp of New Zealand Ltd v Clear Communications Ltd:* (*Telecom v Clear*) the Privy Council established that the counterfactual test had to be applied in all s 36 cases.[10] Their Lordships held that it was both legitimate

5 See *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145 at [51].

6 Donald Robertson "Taking Advantage of Market Power in the Modern Economy" (2004) 10 NZBLQ 26 at 31–33.

7 Yvonne van Roy "Taking Advantage of Market Power: Should New Zealand Adopt the Approach of the High Court of Australia?" (2005) 11 NZBLQ 319 at 320.

8 *Carter Holt Harvey*, above n 5, at [51].

9 Competition and Consumer Act 2010 (Cth), s 46.

10 *Telecom v Clear*, above n 3, at 403.

and necessary to ask whether the terms Telecom was seeking to impose on Clear were no higher than those which a hypothetical firm would seek in a perfectly contestable market.[11] Their Lordships' test was stated thus:[12]

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

The word "if" has been substituted for "unless" as otherwise the test stated would be the opposite of what was clearly intended by their Lordships. Despite the New Zealand courts showing a "marked lack of enthusiasm" for the counterfactual test,[13] the Privy Council, by majority, reaffirmed the need to use it in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission*.[14]

Australian Alternatives

The High Court of Australia in *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* was the first court to apply a counterfactual type analysis.[15] However, the Court did not lay down the counterfactual test as the sole test for taking advantage of market power in Australia. More recently, despite often adopting a broadly counterfactual approach, the Court has recognised alternative analyses.

Melway Publishing Pty Ltd v Robert Hicks Pty Ltd concerned the termination of a distribution agreement between Melway, a publisher of Melbourne street directories, and one of its wholesale distributors.[16] In holding that there had been no breach of s 46, the majority of the Court applied a broadly counterfactual analysis:[17]

> Bearing in mind that the refusal to supply the respondent was only a manifestation of Melway's distributorship system, the real question was whether, without its market power, Melway could have maintained its distributorship system, or at least that part of it that gave distributors exclusive rights in relation to specified segments of the retail market.

Despite this, however, their Honours recognised two alternatives. First:[18]

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11 At 403.

12 At 403. Note that until 2001 s 36 required "use" as against "taking advantage". However, the courts have interpreted these as meaning the same.

13 *Carter Holt Harvey*, above n 5, at [50].

14 At [60].

15 *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177.

16 *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13, (2001) 205 CLR 1 at [1].

17 At [61]. A similar counterfactual approach was taken by the High Court of Australia in *NT Power Generation Pty Ltd v Power and Water Authority* [2004] HCA 48, (2004) 219 CLR 90 at [124].

18 *Melway*, above n 16, at [51] (emphasis added).

> Dawson J's conclusion [in *Queensland Wire*] that BHP's refusal to supply QWI with Y-bar was made possible only by the absence of competitive conditions does not exclude the possibility ... 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.

Under the material facilitation approach, it is unnecessary to construct a hypothetical market scenario and ask what a firm, lacking its market power, would have done. A court only needs to ask the factual question of whether a firm's substantial degree of market power made it easier for it to act the way it did.

Secondly, their Honours noted that:[19]

> In some cases, a process of inference, based upon economic analysis, may be unnecessary. Direct observation may lead to the correct conclusion. Deane J thought that *Queensland Wire* was such a case.

Under this direct observation approach, one need not do anything more than apply the statute to the facts. This is likely to apply in cases where it is obvious that there has been a breach of s 36.[20] It would then be pointless to run the counterfactual test. There would be no need to articulate a hypothetical market and ask what the firm would have done if it had lacked its market power.

The material facilitation approach was applied by the High Court of Australia in *Rural Press Ltd v Australian Competition and Consumer Commission*.[21] In holding that there had been no breach of s 46 on the facts, the majority stated that:[22]

> The Commission failed to show that the conduct of Rural Press and Bridge was *materially facilitated* by the market power in giving the threats a significance they would not have had without it. What gave those threats significance was something distinct from market power, namely their material and organisational assets.

Their Honours' ultimate conclusion appears to have been largely based on the material facilitation approach that was approved in *Melway*. The Court decided, as a matter of fact, that the conduct of Rural Press was not *materially facilitated* by its substantial degree of market power. Rather, it was facilitated by factors such as Rural Press's financial strength. The Court did not apply a strict counterfactual analysis in coming to its conclusion.

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19 At [53].

20 See, for example, *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731 (HC).

21 *Rural Press Ltd v Australian Competition and Consumer Commission* [2003] HCA 75, (2003) 216 CLR 53.

22 At [53] (emphasis added).

The Supreme Court and the Counterfactual

Despite the Commerce Commission advocating a more relaxed approach in line with the Australian authorities, the Supreme Court in *Commerce Commission v Telecom Corp of New Zealand Ltd* (*0867*) confirmed the counterfactual approach as the sole test for applying the connection element of s 36.[23]

The case concerned Telecom's implementation of the "0867" scheme. The Commerce Commission argued that by implementing the scheme Telecom had used its dominant position for a proscribed purpose: to stop customers transferring from Telecom's internet service providers to those hosted by Clear. Both the High Court and the Court of Appeal applied the counterfactual test and held that there had been no use of market power.[24] The Supreme Court unanimously agreed.

The Supreme Court examined the tests from the major Australian cases and concluded that those approaches were nothing more than manifestations of the counterfactual. In relation to the material facilitation test from *Melway*, it was said:[25]

> 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*.

However, under the material facilitation approach, as applied in *Rural Press*, there is no need to construct a hypothetical competitive market in which the impugned firm is stripped of its market power. It simply involves asking a factual question.

Their Honours also suggested that the direct observation test did not indicate the abandonment of counterfactual analysis.[26] This appears to be incorrect. The majority in *Melway* referred to the approach of Deane J in *Queensland Wire*, which did not involve a counterfactual analysis, as an example of direct observation.[27] Furthermore, the general theme of the majority judgment in *Melway* suggests an alternative approach was intended.

Their Honours came to the conclusion that all the reasoning in the Australian case law involved, either expressly or implicitly, consideration of what the dominant firm would have done in a competitive market. All the

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23 *Commerce Commission v Telecom Corp of New Zealand Ltd* [2010] NZSC 111, [2011] 1 NZLR 577 [*0867*] at [30]–[31].

24 Commerce Commission v Telecom Corp of New Zealand Ltd (2008) 12 TCLR 168 (HC) at [77]–[90]; and Commerce Commission v Telecom Corp of New Zealand Ltd [2009] NZCA 338, (2009) 12 TCLR 457 at [87]–[98].

25 *0867*, above n 23, at [21].

26 At [24].

27 *Melway*, above n 16, at [53].

reasoning involved, in effect, a counterfactual approach.[28]

Given the Court's discussion of the alternative approaches, it seems that these may at least inform the counterfactual analysis. So although there may be different ways of applying the test,[29] in every case it is still necessary to construct a hypothetically competitive market. However, this does not appear to be a correct reading of the Australian decisions.

Their Honours may have been led into error by referring to the counterfactual as a "comparative" approach.[30] Inevitably, there will always be some comparison between what a firm would do with and without its market power. However, unlike under the counterfactual test, under the Australian alternatives it is not necessary to construct an alternative market and ask how a defendant, lacking its substantial degree of market power, would have acted in that market. The analysis can be a question of fact.

By conflating the counterfactual with a simple comparative question, the Court concluded that all the tests were manifestations of the same approach and that it was still necessary to apply that approach in New Zealand.

In light of *0867*, then, it seems that the position has changed very little, if at all. It is still necessary to apply the counterfactual test to determine whether a firm has taken advantage of its substantial degree of market power. It may be that the material facilitation and direct observation approaches can be incorporated into a counterfactual analysis, but the fact remains that the Commerce Commission or any private plaintiff bringing an action under s 36 is still faced with the difficulty of satisfying the counterfactual test.

Reactions to *0867*

The Supreme Court's decision has met with mixed response.[31] Scott has argued that the *0867* test is not the same as the Australian alternatives and does not capture conduct that is anti-competitive only when carried out by a firm with a substantial degree of market power. Cross and others have also criticised the test, preferring to focus on elements such as the anti-competitive effect and purpose of the relevant conduct. Purpose is a separate issue to taking advantage of market power and, as currently drafted, the actual effect of the conduct is irrelevant under s 36.

Shortly after *0867*, the Commerce Commission announced that, in light of the Supreme Court's decision, it no longer intends to publish any guidelines on s 36 enforcement, which suggests that it sees little has

28 *0867*, above n 23, at [31].

29 Oliver Meech "'Taking advantage' of market power" [2010] NZLJ 389 at 391. The relevance of the material facilitation approach has been confirmed by the High Court in *Turners & Growers Ltd v Zespri Group Ltd* (2011) 13 TCLR 286 (HC) at [344].

30 *0867*, above n 23, at [24].

31 See, for example, Paul G Scott "Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act" (2011) 17 NZBLQ 260 at 272–274; Jeffery M Cross and others "Use of Dominance, Unlawful Conduct and Causation under Section 36 of New Zealand's Commerce Act 1986: A United States Perspective" (2012) 18 NZBLQ 333 at 337–338; and Matt Sumpter "Competition Law" [2012] NZ L Rev 113.

changed.[32] The Chair has indicated that the Commerce Commission considers that legislative reform is necessary if s 36 is to have any real effect into the future.[33] It appears likely that, unless there is legislative reform, the Commerce Commission will only pursue clear breaches of s 36.

The High Court has decided another important s 36 case since *0867*: *Turners & Growers Ltd v Zespri Group Ltd*.[34] In that case, White J and Lay Member Kerrin Vautier applied the counterfactual test as they were required to do. In doing so, the Court provided a useful summary of the approach that a court must take in defining the counterfactual market and carrying out the "comparative exercise".[35] The Court confirmed the legitimacy of considering how commercially rational business people would act and whether the conduct was materially enabled or facilitated by the firm's market power.[36]

Issues with the Counterfactual

The issues with the counterfactual have been considered at length elsewhere, and it is not necessary to repeat this analysis here. Suffice it to say, the application of the test has proven to be far from straightforward. The court's task of constructing a hypothetical market presents a number of difficulties. Rather than dwelling on these difficulties, the balance of this article examines alternative approaches that could replace or supplement the counterfactual.

A number of sources may aid the development of s 36. These include the approaches of other jurisdictions and the proposals of commentators. Many of these have the potential to improve the current position. The remainder of this article examines these various approaches and considers the best way forward for New Zealand.

IV THE UNITED STATES OF AMERICA

Section 2 of the Sherman Antitrust Act provides:[37]

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment

32 Commerce Commission "Commission ends plans to draft enforcement guidelines on misuse of market power" (press release, 18 October 2010) <www.comcom.govt.nz>.

33 Mark Berry, Chair of the Commerce Commission "The New Zealand approach to monopolisation, mergers and cartels" (speech to the Taiwan Fair Trade Commission, Taiwan, 22 February 2011); and Mark Berry, Chair of the Commerce Commission "An Update from the Commerce Commission — Keynote Speech" (speech to the Competition Law and Regulatory Review Conference, Wellington, 28 May 2012).

34 *Turners & Growers Ltd v Zespri Group Ltd* (2011) 13 TCLR 286 (HC).

35 At [342]–[344].

36 At [344]. See also *Telecom Corp of New Zealand Ltd v Commerce Commission* [2012] NZCA 278 [*Data Tails* (CA)] at [128]–[132].

37 Sherman Antitrust Act 15 USC § 2.

> not exceeding 10 years, or by both said punishments, in the discretion of the court.

The classic formulation of what amounts to liability under § 2 was given by the Supreme Court in *United States v Grinnell Corp*:[38]

> The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.

The second limb of the *Grinnell* formulation broadly corresponds to the taking advantage and purpose limbs of s 36, so the United States cases may guide the application of the New Zealand test.[39] However, such cases must be treated with caution. The wording of § 2 itself is very general, whereas the language of s 36 is more specific. Congress appears to have conferred greater discretion to the United States courts than Parliament intended to give New Zealand courts.

Grinnell confirms that a monopoly will involve an element of impropriety along with some form of exclusionary practice.[40] Although these terms are by no means selfdefining, they at least confirm that one must establish more than mere monopoly before being able to show a breach of § 2. Drawing on *Grinnell*, the Supreme Court of the United States has expressed a number of guiding principles for § 2 cases.

First, in *Copperweld Corp v Independence Tube Corp* the Court stated that "[s]ubjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote."[41] Unilateral action is generally more acceptable than concerted action. Section 2 should, therefore, be applied sparingly. The costs of stifling innovation and investment outweigh the benefits of a clear, bright line standard for intervention. The courts arguably start by examining cases sceptically.[42]

Secondly, efficiency and the conduct's effect on consumers are relevant considerations.[43] A key requirement of monopolisation under § 2 is using something other than superior efficiency to eliminate rivals.

Thirdly, lack of a normal business justification for conduct is significant.[44] The Supreme Court confirmed the importance of business justification in *Eastman Kodak Co v Image Technical Services Inc*.[45] Under

38 *United States v Grinnell Corp* 384 US 563 (1966) at 570–571.

39 van Roy, above n 7, at 321–322.

40 *Image Technical Service Inc v Eastman Kodak Co* 903 F 2d 612 (9th Cir 1990) at 619.

41 *Copperweld Corp v Independence Tube Corp* 467 US 752 (1984) at 775.

42 Eleanor M Fox "Is There Life in *Aspen* After *Trinko*? The Silent Revolution of Section 2 of the Sherman Act" (2005) 73 Antitrust LJ 153 at 169.

43 *Aspen Skiing Co v Aspen Highlands Skiing Corp* 472 US 585 (1985) at 605.

44 At 608.

45 *Eastman Kodak Co v Image Technical Services Inc* 504 US 451 (1992) at 483 [*Kodak*].

the *Grinnell* standard the Court stated that, "[l]iability turns, then, on whether 'valid business reasons' can explain [a firm's] actions."[46] Accordingly, in light of *Aspen Skiing Co v Aspen Highlands Skiing Corp.* and *Kodak*, it seems that the existence, or lack thereof, of a legitimate business justification for the conduct in question will be crucial in assessing § 2 liability.[47]

While United States courts have largely developed their law on the basis of general principles, there is no reason why these cannot guide the development of s 36. New Zealand and United States competition laws are based on the same premises and underlying policy goals. However, changes of ideology have coloured United States case law throughout the years, and this needs to be borne in mind if those cases are to be applied here. United States courts have also assessed of the effect of conduct in determining liability. Section 36 is a purpose-based section and, as currently drafted, clearly does not require an anti-competitive or detrimental effect for liability.

V THE EUROPEAN UNION

Article 82 of the Treaty Establishing the European Community provides:[48]

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.
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> Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

There are a number of clear differences between s 36 and art 82. First, art

46 At 483.

47 Karen L Grimm "General Standards for Exclusionary Conduct" (working paper, Federal Trade Commission, 3 November 2008) at 8.

48 Consolidated Version of the Treaty Establishing the European Community [2002] OJ C325/33 (opened for signature 25 March 1957, entered into force 1 January 1958), art 82. Note that art 82 has since been amended by the Treaty of Lisbon [2007] OJ C306/1 (opened for signature 13 December 2007, entered into force 1 December 2009), and has been renamed art 102. The European cases discussed in this section refer to art 82.

82 requires dominance whereas s 36 merely requires a substantial degree of market power. Secondly, s 36 requires that the firm in question take advantage of its market power, which means nothing more than "use".[49] Article 82, however, requires abuse of a dominant position. This suggests an element of impropriety is required. Thirdly, art 82 does not contain a specific purpose element, which suggests that any question of purpose is included in the abuse element.

Article 82 also provides a non-exhaustive list of infringing conduct. The scope of art 82 is wider than s 36, including conduct such as unfair selling prices. Whereas s 36 only applies to exclusionary conduct, art 82 can apply to both exploitative and exclusionary conduct.[50]

In addition to the wording of the provisions, there is an obvious ideological difference between the European approach and the approach with which New Zealand competition lawyers are familiar. Under art 82, a dominant firm is said to have a "special responsibility" not to allow its conduct to impair undistorted competition.[51] Accordingly, dominant firms may not have a right to adopt certain conduct that would be unobjectionable but for their dominance.[52] In effect, then, a dominant firm is regarded in Europe as the proverbial "bull in a china shop": its very existence is a threat to competition and means that it should be restrained from causing any further damage.[53]

Whereas Australasian and United States competition laws are ultimately concerned with ensuring dominant firms compete on their merits, European law goes further and aims to shield the market from distortions brought about by dominant firms.[54] Further, in Europe there is no requirement of a causal connection between the firm's conduct and its dominant position.[55] This is a fundamental requirement for liability under s 36.

It is clear from the above that there are fundamental ideological and policy differences between European and New Zealand law. European courts are especially concerned with the problem of not condemning anti-competitive conduct whereas New Zealand courts are wary of condemning pro-competitive conduct. European decisions will therefore be of limited utility to New Zealand courts. As the Privy Council in *Carter Holt Harvey* observed:[56]

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49 See also *Queensland Wire*, above n 15, at 190–191.

50 See Richard Whish *Competition Law* (6th ed, Oxford University Press, Oxford, 2009) at 199–205.

51 Case 322/81 *Nederlandsche Banden-Industrie Michelin NV v EC Commission* [1983] ECR 3466 at [57].

52 Peter Roth and Vivien Rose (eds) *Bellamy & Child: European Community Law of Competition* (6th ed, Oxford University Press, Oxford, 2008) at [10.061].

53 James Kavanagh, Neil Marshall and Gunnar Niels "Reform of Article 82 EC—Can the Law and the Economics be Reconciled?" in Ariel Ezrachi (ed) *Article 82 EC: Reflections on its Recent Evolution* (Hart Publishing, Oxford, 2009) at ch 1 at 3.

54 Thomas Eilmansberger "How to Distinguish Good from Bad Competition Under Article 82 EC: In Search of Clearer and More Coherent Standards for Anti-competitive Abuses" (2005) 42 CML Rev 129 at 132–133.

55 Case 6/72 *Europemballage Corp & Continental Can Co Inc v EC Commission* [1973] ECR 217 at [27].

56 *Carter Holt Harvey*, above n 5, at [65].

> [I]n the light of this description of the way art 82 has been applied by the ECJ, that it is unsafe for any conclusions to be drawn in the context of s 36 of the 1986 Act as it must be applied in New Zealand from the decisions of that Court in cases brought by the EC Commission under that article.

This is close to a complete rejection of European law's usefulness in New Zealand in this context. However, European case law can still play some role. In particular, there is no reason why the various tests for specific conduct that have been developed in Europe should not inform the development of New Zealand law. However, New Zealand courts must always bear in mind the fundamental differences between the policies and priorities of New Zealand and European competition law.

VI ALTERNATIVE TESTS

As well as the general approaches of the United States and European courts, commentators and courts have developed various alternative and supplementary tests. Some of these may guide New Zealand courts in s 36 cases.

The Profit Sacrifice Test

The profit sacrifice test requires a court to ask whether a dominant firm, through its conduct, has sacrificed short-run profits in the expectation of recouping those profits in the future after its rivals have exited the market.[57] As Areeda and Turner note, "predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains".[58]

The test does not appear to have been accepted by any court as a sole test for liability. It has, however, been useful in some cases and in particular in cases of predatory pricing. Courts (including New Zealand's) have developed tests for predatory pricing that focus on the lowering of prices below cost in the expectation of recouping those losses once rivals have been excluded from the market.[59]

The Supreme Court of the United States recognised the relevance of profit sacrifice in *Trinko*, noting that "[t]he unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a

57 Grimm, above n 47, at 20.

58 Phillip Areeda and Donald F Turner "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act" (1975) 88 Harv L Rev 697 at 698. The authors went on to say that predation would make "little economic sense" absent these conditions, which may suggest that they favoured a wider "no economic sense" test as discussed below.

59 See *Carter Holt Harvey*, above n 5, at [60]; and *Brooke Group Ltd v Brown & Williamson Tobacco Corp* 509 US 209 (1993) at 222–227.

willingness to forsake short-term profits to achieve an anticompetitive end."[60]

While the test is useful in some cases, it has the potential to exclude certain forms of monopolistic conduct. Not all monopolistic conduct requires a sacrifice of short-run profits.[61] Filing a false or overbroad patent application, for example, is likely to be cheaper than filing a properly defined one.[62] This would not result in any sacrifice of short-run profits but would potentially have an exclusionary effect. So, while the test may be useful in assessing some conduct, it may be less useful in other cases.

The Organisation for Economic Co-operation and Development (OECD) has indicated that conduct will be permitted under the profit sacrifice test if a defendant has more than one purpose (besides eliminating competition).[63] A further criticism is that the test may include some conduct that excludes competitors but is ultimately beneficial to consumers, for example research and development.[64]

Salop offers the most powerful criticism of the test for New Zealand's purposes:[65]

> Proper implementation of the profit-sacrifice standard is complex and would lead to subjectivity in practice precisely because *the profit-sacrifice test requires the court to determine the outcome in a hypothetical market.* The hypothetical market of the profit-sacrifice test is not simply the actual market before the challenged conduct was initiated. The outcome in this hypothetical market also is not the same as the outcome in the real-world market absent the challenged conduct. Instead, *the profit-sacrifice standard requires an assessment of the defendant's likely conduct in the hypothetical absence of an ability to raise prices.*

Under the profit sacrifice test, a court must ask whether a firm would have engaged in the same conduct if it did not have the ability to raise its prices and recoup its losses by driving a competitor out of the market. That is, if it lacked its market power. This is nothing more than an application of the counterfactual test.[66]

The profit sacrifice test may, then, inform the decisions of New Zealand courts in certain cases; evidence of a profit sacrifice in the short-run may point towards a breach of s 36, but should not be determinative.

New Zealand's predatory pricing law, as articulated in *Carter Holt Harvey*, contains elements of profit sacrifice reasoning, indicating that such

60 *Trinko*, above n 2, at 409 (emphasis in original).

61 Einer Elhauge "Defining Better Monopolization Standards" (2003) 56 Stan L Rev 253 at 280.

62 Robert O'Donoghue and A Jorge Padilla *The Law and Economics of Article 82 EC* (Hart Publishing, Oxford, 2006) at 186.

63 Organisation for Economic Co-operation and Development (OECD) *Policy Roundtables: Competition on the Merits* (2005) <www.oecd.org> at 26.

64 At 26.

65 Steven C Salop "Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard" (2006) 73 Antitrust LJ 311 at 358 (emphasis added).

66 This may explain why in *Carter Holt Harvey*, above n 5, the Privy Council applied what seemed to be a conduct-specific predatory pricing test under the guise of the counterfactual.

reasoning may play a role in the future development of s 36.[67] However, it should not be taken as a sole standard of liability.

The No Economic Sense Test

Rather than simply asking whether the firm has made a short-run loss, the no economic sense test asks whether the conduct would be expected to be profitable *apart* from any gains that arise from the elimination of competition.[68] The no economic sense test is premised on the idea that "some potentially harmful conduct must be tolerated to avoid even greater harms from chilling risk taking and aggressively competitive conduct".[69]

Profit sacrifice is neither necessary nor sufficient for liability.[70] If there is a short-run profit sacrifice the test goes on to ask why it is rational for the firm to make that sacrifice.[71] In some cases the monopolist's increased profits may be contemporaneous with the conduct.[72] The question is not only whether the conduct is profitable, but also why the conduct is profitable.[73]

The Federal Trade Commission and the United States Department of Justice have endorsed the test in some cases,[74] but the Department has been more circumspect in recent times.[75] Werden suggests that although the Supreme Court of the United States has not approved the test, a number of decisions of the Court are consistent with its underlying rationale.[76]

The no economic sense test still involves a degree of counterfactual analysis. In determining whether a dominant firm's actions make economic sense but for their exclusionary effects, the court will be drawn into the question of whether the firm would have engaged in the same actions in a hypothetical market where it lacked its market power. The no economic sense test should, therefore, be rejected as the sole test for s 36 liability in New Zealand.

The Equally Efficient Firm Test

The equally efficient firm test was first proposed by Posner:[77]

67 See for example, *Carter Holt Harvey*, above n 5, at [67] and [79].

68 Gregory J Werden "Identifying Exclusionary Conduct Under Section 2: The 'No Economic Sense' Test (2006) 73 Antitrust LJ 413 at 414.

69 At 433.

70 Gregory J Werden "The 'No Economic Sense' Test for Exclusionary Conduct" (2005) 31 J Corp L 293 at 300.

71 At 300.

72 At 300.

73 At 300.

74 United States Department of Justice and Federal Trade Commission "Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner in *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP*" (2003) United States Department of Justice Website <www.justice.gov> at 7.

75 United States Department of Justice *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (September 2008) at 43.

76 Werden, above n 70, at 296.

77 Richard A Posner *Antitrust Law* (2nd ed, The University of Chicago Press, Chicago, 2001) at 194–195.

> [I]n every case in which [an exclusionary practice] is alleged, the plaintiff must prove first that the defendant has monopoly power and second that the challenged practice is likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor. The defendant can rebut by proving that although it is a monopolist and the challenged practice exclusionary, the practice is, on balance, efficient.

This test recognises the centrality of efficiency to competition law. Although it is unsympathetic toward competitors (its only sympathy is to competition), the test allows courts to avoid drawing value judgments.

The equally efficient firm test can play an important role in cases of predatory pricing.[78] In such cases, average variable cost is used as a proxy for marginal cost and a firm is unable to exclude an equally efficient competitor by pricing above marginal cost.[79] The United States courts have noted the concept of the equally efficient competitor in cases concerning other conduct such as bundled rebates.[80]

Although it does not appear that any court has accepted it as the sole test of liability, Lambert suggests that the decision of the Supreme Court of the United States in *Weyerhaeuser Co v Ross-Simons Hardwood Lumber Co Inc* implicitly endorses the equally efficient firm test.[81]

Despite the test's inherent attraction, it fails to recognise that even the introduction of a less efficient rival can increase competition in a market place.[82] The presence of a new firm may lower market price and increase quantity, suggesting there may be an increase in allocative efficiency to outweigh any loss in productive efficiency.[83] As Gavil notes, in a situation like this, "comparative efficiency" is not a useful proxy for consumer welfare.[84]

Similarly, the less efficient firm may be a new entrant that is building up its efficiency. This standard looks at competition at a single point in time.[85] But it may be detrimental to competition to exclude a new entrant it has the chance to develop economies of scale and business structures and so improve its efficiency and its ability to compete.

The test has also been criticised as hard to administer. The term "equally efficient competitor" is not self-defining and while it may be simple to use average variable costs as a proxy for marginal costs in assessing predatory pricing, it is unclear how other forms of conduct would

78 Herbert Hovenkamp "Exclusion and the Sherman Act" (2005) 72 U Chi L Rev 147 at 153–154. See also *Barry Wright Corp v ITT Grinnell Corp* 724 F 2d 227 (1983) at 232.

79 O'Donoghue and Padilla, above n 62, at 189; and OECD, above n 63, at 29.

80 See, for example, *LePage's Inc v 3M (Minnesota Mining and Manufacturing Co)* 324 F 3d 141 (3rd Cir 2003) at 155.

81 *Weyerhaeuser Co v Ross-Simons Hardwood Lumber Co Inc* 549 US 312 (2007); and Thomas A Lambert "*Weyerhaeuser* and the Search for Antitrust's Holy Grail" [2006–2007] Cato Supreme Court Review 277 at 292.

82 OECD, above n 63, at 29.

83 At 29.

84 Andrew I Gavil "Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance" (2004) 72 Antitrust LJ 3 at 59.

85 At 59.

be assessed.[86] Gavil suggests that it may not be the efficiency of the firm that one must assess, but rather the efficiency of the conduct.[87] Although this may make it easier to assess efficiencies, it is unclear why Gavil makes this suggestion. Competition law is concerned with the end result: whether competition is reduced. This depends on the efficiency of the various firms in the market place, not on the efficiency of any one line of conduct in which a single firm may choose to engage at a point in time.

The equally efficient firm test should not be the sole test for s 36 liability in New Zealand. Efficiency is an important concern under the Act, but it is not the sole concern. The principal aim of the Act is to protect consumers — efficiency is simply a means to this end. That said, in many cases the most efficient market will also be the best for consumers. Accordingly, the equally efficient firm test still has a useful part to play in s 36 cases. It should, however, be only an indication of liability.

The Impairing Rivals's Efficiencies Test

Elhauge proposes another efficiency-based test in an attempt to reconcile what he sees as two conflicting lines of authority. Under one line of authority, conduct that excluded competitors would be legal if it had a legitimate business purpose. The other line of authority held that any efficiency benefits must be weighed against anti-competitive harm.[88] The question under Elhauge's test is:[89]

> [W]hether the alleged exclusionary conduct succeeds in furthering monopoly power (1) only if the monopolist has improved its own efficiency or (2) by impairing rival efficiency whether or not it enhances monopolist efficiency.

If the first question is answered in the affirmative, the conduct is legal. If the second question is answered in the affirmative, the conduct is illegal.[90] Conduct that falls under the first category is permitted because the root cause of the market power is the monopolist's increased efficiency — something upon which the law looks favourably. Conduct that falls under the second category, however, is prohibited, as the monopolist is only able to increase or maintain its market share by impairing the efficiency of its rivals.[91]

As it is a relatively recent suggestion, it appears that the test has yet to be tested in the courts. Nevertheless, the OECD considers it may be the most useful test to date.[92]

Elhauge's test has the benefit of being focused on efficiency rather

86 Grimm, above n 47, at 28–29.
87 Gavil, above n 84, at 59.
88 Elhauge, above n 61, at 315.
89 At 315.
90 At 330.
91 See Elhauge, above n 61, at 330.
92 OECD, above n 63, at 33.

than subjective concepts such as fair or normal competition. The test avoids the potential administrative difficulties in balancing efficiency gains with anticompetitive effects.[93] The test is also unsympathetic towards competitors. A dominant firm is free to engage in a course of conduct that excludes rivals or reduces their efficiency so long as this is a result of the superior efficiency of the dominant firm.

Elhauge might have also solved an issue with the profit sacrifice test in the context of refusals to deal. Under Elhauge's test not all unconditional refusals to deal would be labelled as anti-competitive, whereas under the profit sacrifice test such refusals would be anti-competitive as, by definition, refusing to sell to a competitor would result in the sacrificing of potential profit.[94] Elhauge's test requires some form of discrimination between competitors for conduct to be caught. This has merit as there should be no competition law duty to deal with competitors. However, it is unclear how Elhauge's test would solve the issue in cases such as *Queensland Wire* when there is only one competitor and thus no discrimination is possible.[95]

Crampton has suggested including a proportionality or balancing test under the first limb of the Elhauge test,[96] but such an approach would surely lead to the administrative difficulties that the test was thought to solve.

As Hovenkamp notes, the test is highly interventionist.[97] Under the test's second limb, any conduct that impairs the efficiency of a rival would be condemned, regardless of any efficiency gains the dominant firm may achieve.[98] Accordingly, conduct may be caught even where there is a net efficiency gain in the market. This would run counter to the underlying norms of competition law and could potentially lead to over-deterrence.

Elhauge's test encounters the same problems as the equally efficient firm test in defining efficiency. So, despite the OECD's endorsement, it seems that on the whole this test could lead to both under-deterrence on the first limb and over-deterrence on the second limb. Accordingly, it is a test that ought to be treated with caution at this early stage in its development and, without any refinement, should not be used on its own.

In addition, the test is more effects-based than purpose based, whereas the wording of s 36 focuses only on the purpose of the conduct. Accordingly, the impairing rivals' efficiencies test should be rejected as the sole test for s 36 liability in New Zealand.

The test may still play a useful part in s 36 cases. Demonstrating either that a firm has increased its efficiency or impaired the efficiency of a rival would be a useful indicator of both the taking advantage and purpose elements of s 36. It should, however, be only one factor to take into account.

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93 At 34.

94 At 34.

95 *Queensland Wire*, above n 15.

96 At 857.

97 Herbert Hovenkamp "Antitrust and the Dominant Firm: Where do we Stand?" (paper presented for Section 2 Hearings, Federal Trade Commission, 2006) at 15.

98 At 15.

The Rule of Reason Approach

A number of commentators and courts have concluded that it is almost impossible to develop one single test to catch all forms of anti-competitive conduct. As such, various rule of reason approaches have emerged in which anticompetitive effects are weighed against changes in consumer welfare. The rule of reason is a general approach under which various conduct-specific tests can be developed in a common law fashion.[99]

The United States Court of Appeals for the DC Circuit in *United States v Microsoft Corp* stated the rule of reason approach in its most detailed form:[100]

> First, 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 consumers. ... Second, the plaintiff, on whom the burden of proof of course rests, ... must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect. ... Third, if a plaintiff successfully establishes a *prima facie* case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a "procompetitive justification" for its conduct. ... If the monopolist asserts a procompetitive justification ... then the burden shifts back to the plaintiff to rebut that claim. ... Fourth, if the monopolist's procompetitive justification stands unrebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit. ... Finally, in considering whether the monopolist's conduct on balance harms competition and is therefore condemned as exclusionary for purposes of § 2, our focus is upon the effect of that conduct, not upon the intent behind it.

The inherently broad nature of this approach allows for the flexibility required by the innumerable kinds of conduct that may be caught by monopolisation provisions. At the same time, it ensures that the ultimate aim of competition law — consumer welfare — is achieved. Novel practices will still be captured under the rule of reason approach if they are anticompetitive.[101] This flexibility is the key benefit of a rule of reason approach. A court that is able to apply a rule of reason approach will not be forced to fit any and every form of conduct into one inflexible test.

Although the rule of reason seems to require the courts to balance consumer welfare enhancements against anticompetitive effects, in practice the courts will rarely, if ever, have to do so:[102]

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99 Mark S Popofsky "Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules" (2006) 73 Antitrust LJ 435 at 437.

100 *United States v Microsoft Corp* 253 F 3d 34 (DC Cir 2001) at 58–59 (emphasis in original and citations omitted).

101 William J Michael "Holmes and the Bald Man: Why Rule of Reason Should Be the Standard in Sherman Act Section 2 Cases" (2006) 4 Pierce L Rev 359 at 377.

102 Gavil, above n 84, at 73.

> [D]espite nearly a century of devotion to the "balancing" concept, in fact there is a remarkable dearth of examples of courts actually engaging in any kind of balancing. For the most part, litigated cases turn on the absence of sufficient evidence of anticompetitive effects (inefficiencies) or of business justification (efficiencies).

Regardless, the law is no stranger to balancing exercises. Indeed, cases under § 1 of the Sherman Act follow the same rule of reason approach without major difficulty.[103]

A broad general standard that gives rise to numerous conduct-specific tests is not unusual in the Common Law world. An obvious example is the law of negligence where Lord Atkin's famous neighbour principle has guided the development of specific tests in areas such as nervous shock and economic loss.[104] It is the inherent generality and flexibility of the neighbour principle that makes it so effective. This is the attraction of a rule of reason approach to "taking advantage of market power" cases: it allows the law to catch conduct that may not be caught under the counterfactual, or any other specific test, but that the legislature clearly intended to be covered by s 36.

It may be difficult to quantify economic harm and benefits and then to weigh them against one another.[105] However, just because it is impossible to quantify gains and losses precisely does not mean estimates cannot be made. It would simply be a question of raising expert evidence, which both competition law and the law in general deal with on a day-to-day basis. Furthermore, it is rare for the courts to actually engage in balancing. If a court finds that there is an anticompetitive effect and then no pro-competitive justification, the concerns with administration and balancing are resolved. All the more, any costs or difficulties associated with a balancing exercise must surely be outweighed by the benefits of the courts being free to assess each case on its facts rather than being forced to use a single narrow test.

The rule of reason has also been criticised for creating uncertainty.[106] For a firm looking to engage in a course of conduct, this is true to some extent. However, while business certainty should be accommodated as much as possible, the overarching concern is that the law achieves its aim. Monopolisation provisions are drafted in broad language so they can capture many forms of conduct in many different market circumstances. Insisting on a bright line test runs counter to this purpose.[107] It is submitted that, in this context, the desire for business certainty is overstated and tends to cloud the development of the law in an effective way. Business certainty is no

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103 See, for example, *The Standard Oil Co of New Jersey v United States* 221 US 1 (1911) at 61–62, 66–68, and 98–100.

104 *Donoghue v Stevenson* [1932] AC 562 (HL) at 580. Admittedly negligence, unlike competition law, is a creature of the common law. However, the fact that in drafting s 36 Parliament provided no definition of what amounts to taking advantage of market power suggests that any such definition was seen as best left to the courts to develop.

105 See generally Werden, above n 70, at 431–432; and A Douglas Melamed "Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal" (2005) 20 Berkeley Tech LJ 1247 at 1252–1255.

106 See Elhauge, above n 61, at 317.

107 William S Comanor "Is There a Consensus on the Antitrust Treatment of Single-Firm Conduct?" [2008] Wis L Rev 387 at 389.

doubt important, but an effective competition law regime is more important. The courts may have to recognise that standards for liability cannot be both certain and flexible at the same time.[108] Furthermore, there is no reason why the development of the law and, for example, the issuing of enforcement guidelines by the Commerce Commission, could not lead to greater certainty over time.

Given the current wording of s 36 and the lack of any effects element, it seems that the rule of reason in the form outlined above could not apply in New Zealand. Nevertheless, Ahdar has proposed a possible rule of reason approach for New Zealand. First, the plaintiff must show:[109]

> (a) an anti-competitive effect from the defendant's conduct — namely, a substantial lessening of competition in a market; and
>
> (b) an anti-competitive purpose on the defendant's part.

Having satisfied both requirements, a prima facie case of contravention is established. The burden then shifts to the defendant to demonstrate:[110]

> (a) a plausible, benign reason for its conduct; and
>
> (b) there is no other less restrictive alternative open to it (to achieve a lawful object) than the conduct at issue.

Ahdar claims that this does not demonstrate a major departure from the current situation as the courts will usually expect to see harm to the competitive process before taking a case seriously.[111] However, even if the courts do require this in practice, it is neither required by nor implicit in s 36. It is conceivable that a firm with a substantial degree of market power might engage in a line of conduct for one of the proscribed purposes, but for some reason produce no anti-competitive effect. Under the current wording of s 36, such conduct would be in breach. If Parliament had wanted courts to take effects into account under s 36, it could have introduced a requirement for a substantial lessening of competition, as there is under both ss 27 and 47.

So, despite its clear attraction and flexibility, the rule of reason approach does not fit with the way s 36 is drafted. Furthermore, it does not seem possible to design a rule of reason approach to fit with s 36 as without an effects element such an approach would be pointless. While actual anti-competitive effects will provide cogent evidence of anti-competitive purpose in many, if not most cases, s 36 does not leave room for a balancing of anti-competitive and procompetitive effects. If a firm with a substantial degree of market power takes advantage of that power for a proscribed purpose it will be liable under s 36 whether or not there are any actual anti-competitive effects.

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108 Matt Sumpter *New Zealand Competition Law and Policy* (CCH New Zealand Ltd, Auckland, 2010) at 259.

109 Rex Tauati Ahdar "The unfulfilled promise of New Zealand's monopolisation law: Sources, symptoms and solutions" (2009) 16 CCLJ 291 at 302–303 (emphasis omitted).

110 At 302–303.

111 At 303.

VII THE WAY FORWARD

New Zealand's current law on taking advantage of market power is clearly unsatisfactory. This article now considers the best way forward for s 36.

Some Preliminary Considerations

Under the Australia New Zealand Closer Economic Relations Agreement, New Zealand's competition laws should, to the extent possible, be consistent with those of Australia. This is currently not the case owing to the liberal interpretation Australian courts (and now the Australian Parliament) have give to s 46 of the Competition and Consumer Act 2010.

However, if a more effective approach than that of Australia is possible, it may be better for the New Zealand courts or Parliament to adopt that approach. Trans-Tasman harmonisation is without doubt an important consideration, but it should not impede the effective operation of s 36. Trans-Tasman harmonisation does not mean that New Zealand must adopt the approach of Australia; if the New Zealand courts or Parliament can offer a more effective approach, then harmonisation should give way to it.

Certainty is another important consideration. So far as is possible, the law should be prospective so that firms can assess whether a course of conduct is likely to be in breach of s 36. However, certainty is not paramount. Certainty should not frustrate the law's purpose. As Ahdar notes, a lack of certainty at the outset may be inevitable given the complex nature of the phenomenon.[112] As the United States Supreme Court noted in *Trinko*, "the means of illicit exclusion, like the means of legitimate competition, are myriad."[113] Defining bright line standards for conduct runs the risk of opening up loopholes to be exploited.[114]

One does not have to look far to find another area of law in which there is little in the way of direct *ex ante* guidance. In respect of tax avoidance — an area of substantially more importance to most firms than s 36[115] — the courts have provided little more than general guidance. This is generally considered desirable for the anti-avoidance provisions in the tax legislation to achieve their intended purpose.

Options Moving Forward

In *0867*, the Supreme Court unanimously confirmed that the counterfactual had to be applied in every s 36 case. It is possible that the development of conduct-specific tests under a broad counterfactual approach could at

112 At 296.

113 *Trinko*, above n 2, at 414.

114 *Melway*, above n 16, at [92] per Kirby J.

115 See generally *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289; and *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433.

least improve certainty in the law. However, the issues associated with the counterfactual approach would remain. Accordingly, barring a major change of heart from a future Supreme Court bench, it is likely that any real change in the approach to s 36 will have to come from legislative reform.

This final section examines three possibilities for reform. It first considers the development of conduct-specific tests under the counterfactual umbrella. Attention then turns to two possible approaches to legislative reform that would remove the restrictive approach to s 36 required by the counterfactual test to give the section more teeth.

1 Development of Conduct-Specific Tests

To some extent the courts have already developed conduct-specific tests under the umbrella of the counterfactual, particularly in the areas of predatory pricing and access pricing. In the predatory pricing context, the Privy Council in *Carter Holt Harvey* developed a specific test for predatory pricing with reference to the counterfactual:[116]

> A dominant firm uses its position of dominance when it engages in price cutting with a view to recouping its losses without loss of market share by raising prices without fear of reprisals afterwards.

It is arguable that this is not a strictly counterfactual approach. Their Lordships relied on *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission*, where the High Court of Australia's approach to predatory pricing did not strictly involve a counterfactual analysis.[117] As Berry notes, this meant that the Privy Council applied both general and specific rule formulations.[118] That said, the basis of their Lordships' test was that, in a competitive market, a firm would not be able to price at a loss and then recoup those losses once a new entrant is eliminated. In this sense, it is a counterfactual test. It is not, however, strictly necessary to construct a hypothetical market — it is a largely cost-based analysis. It therefore remains to be seen how courts will approach predatory pricing cases post-*0867*, given the Supreme Court's requirement that a hypothetical market be constructed in all cases.

A conduct-specific test may also apply in cases of access pricing. This test is the Efficient Component Pricing Rule (ECPR) that was first applied in *Telecom v Clear*.[119] Again, this test derives from counterfactual analysis. The ECPR has been applied by the Court of Appeal in the "data tails" litigation since *0867*.[120]

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116 *Carter Holt Harvey*, above n 6, at [60] (citations omitted).

117 *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* [2003] HCA 5, (2003) 215 CLR 374 at [370]–[375] per Kirby J.

118 Mark Berry "Competition Law" [2005] NZ L Rev 267 at 277.

119 *Telecom v Clear*, above n 3.

120 Data Tails (CA), above n 36.

So it seems that the courts are gradually developing conduct-specific tests under the counterfactual umbrella. That said, these tests all have a counterfactual element and, in light of *0867*, it may become more difficult for the courts to develop conduct-specific tests. Furthermore, the given extent of potential conduct that could breach s 36, in some instances it may be impossible to develop a conductspecific test under the counterfactual.

2 Adopt the Australian Approach

Explicit adoption of the Australian approach would recognise what many have seen as obvious: that the direct observation and material facilitation tests are not simply manifestations of the counterfactual. Although these tests involve a form of comparative analysis, they do not involve constructing a hypothetical market.

Despite Parliament's apparent intention in amending s 36 in 2001, the courts have not incorporated the Australian cases into New Zealand law. Further legislative amendment to s 36 would be necessary in order to adopt the Australian position.

The Australian Parliament expressly included the various other approaches to the "taking advantage" analysis in s 46(6A) of the Competition and Consumer Act 2010, which reads:[121]

> (6A) In determining for the purposes of this section whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:
>
> (a) whether the conduct was materially facilitated by the corporation's substantial degree of power in a market;
>
> (b) whether the corporation engaged in the conduct in reliance on its substantial degree of power in the market;
>
> (c) whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of power in the market;
>
> (d) whether the conduct is otherwise related to the corporation's substantial degree of power in the market.
>
> This section does not limit the matters to which the court may have regard.

The Australian position gives courts the discretion to apply the material facilitation test or whichever approach the court considers appropriate. This gives courts the power to assess each case on its facts without having to resort to strict counterfactual analysis in every case.

Following the Australian position would eliminate many of the controversies that arise when the hypothetical market has to be constructed. For example, the nature of the facts in *Carter Holt Harvey* meant that a counterfactual analysis was problematic.[122] Allowing a material facilitation

121 Competition and Consumer Act 2010 (Cth), s 46(6A).

122 *Carter Holt Harvey*, above n 5. That is, the alleged predatory pricing of one product line in order to protect another product line.

or direct observation approach might have led to a different and arguably better result. As Land notes, in a truly competitive market there would have been no good reason to make continued losses on Wool Line.[123] On this basis, one could conclude that the conduct was materially facilitated by the firm's dominant position without having to confront the issues that arise under counterfactual analysis.

Adopting the Australian position would be a step in the right direction. It would be consistent with the trans-Tasman harmonisation objective. It would provide more certainty as firms would be able to ask themselves simpler questions before engaging in a course of conduct. Furthermore, it would help the law to achieve its objectives by capturing conduct that would be likely to escape the counterfactual test. The Chair of the Commerce Commission has indicated on several occasions that reform along the lines of the Australian s 46(6A) is the only way to give s 36 any effect.[124]

3 Effects Test

The rule of reason approach appears to be the most effective of the approaches outlined above. However, owing to the lack of an explicit effects test under the current wording of s 36, it cannot apply in New Zealand. If Parliament were to amend s 36 to include an effects test, it would be possible for New Zealand to adopt a rule of reason-type approach and improve the application of s 36.

The idea of adding an effects test to s 36 is not new. In 1999, Alliance MP Laila Harré introduced a Bill before Parliament that proposed adding a subsection to read: "[i]n a manner that has, or is likely to have the effect, of substantially lessening competition" after the (then) use and purpose elements.[125] Regardless of the reasons for which the Bill was introduced, it is suggested that the clause had the potential to achieve a more effective application of s 36.[126]

Provisions that include both an element of misuse of market power and effects are not unheard of. Section 79(1) of the Competition Act in Canada, for example, requires both that a person is engaging in "a practice of anti-competitive acts", which seems to relate to the purpose and taking advantage elements of s 36, and that the practice has "the effect of preventing or lessening competition substantially in a market".[127]

The introduction of a provision such as that proposed in the 1999 Amendment Bill would allow the courts to take a multi-stage approach

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123 John Land "Counterfactual Analysis under the Commerce Act" (paper presented to the Competition Law and Policy Institute of New Zealand Workshop, Wellington, August 2010) at [4.31].

124 See Berry, above n 33.

125 Commerce (Control of Dominant Position) Amendment Bill 1999 (265-1), cl 2.

126 Commerce (Control of Dominant Position) Amendment Bill 1999 (265-1) (explanatory note) at 1–2; and (31 March 1999) 576 NZPD 15813–15824.

127 Competition Act RSC 1985 c C-34, s 79(1); and see generally Michael Trebilcock and others *The Law and Economics of Canadian Competition Policy* (University of Toronto Press, Toronto, 2002) at ch 8 for a discussion of the application of this section.

similar to that proposed by Ahdar and discussed above.[128] Under such an approach, the plaintiff would first have to show both an anti-competitive effect and an anti-competitive purpose on the part of the defendant, which would establish a prima facie case for breach. The burden would then shift to the defendant to show that it did not take advantage of its substantial degree of market power for that purpose.

It would be open to the defendant to rely on any of the various tests discussed above to show that market power had not been taken advantage of. For example, if the defendant could show that its efficiency had increased as a result of the conduct, this would point against a "taking advantage" as the firm had simply used its efficiency to its benefit. Such an approach would be consistent with the proposed amended wording of s 36, although it would be clearer to impose such burdens by statute.

There has been recent support for incorporating an effects test in s 36.[129] An effects test has been regarded as useful in removing the tendency to engage in conduct with an anticompetitive effect. It is also useful in reducing the damage that can be done to the competitive process while plaintiffs gather evidence of an anti-competitive purpose.[130] An effects test also avoids punishing conduct that may have absolutely no effect on the competitive process; without any actual lessening of competition "even the most vicious intent is harmless to the competitive system."[131]

For the reasons outlined in this section, it is submitted that the most favourable way forward is for an effects element to be added to s 36 and for the courts to interpret it in a way that adopts a rule of reason approach. This would give s 36 flexibility; it would avoid a restrictive test for taking advantage of market power like the counterfactual, while placing the burden for this element on the defendant — the party who is best able to adduce the relevant evidence. Such an approach would only prohibit conduct that actually harms the competitive process, instead of any conduct undertaken with an anti-competitive purpose.

Adopting an effects test would also bring s 36 into line with s 27, disposing of the anomalous situation where a course of conduct may breach s 27 because an agreement is involved but not fall foul of s 36.[132] It would also bring New Zealand law into line with major overseas jurisdictions such as the United States, the European Union and Canada.

128 Ahdar, above n 109, at 302–303.

129 See Land, above n 123, at [5.1]–[5.12]; and Peter R Taylor "'Keeping it Real' – Escaping the Oppression of the Counterfactual and Return to Factual Analysis" (paper presented to the Competition Law and Policy Institute of New Zealand Workshop, Wellington, August 2010) at [118]–[123].

130 Land, above, n 123 at [5.10].

131 *AA Poultry Farms Inc v Rose Acre Farms Inc* 881 F 2d 1396 (7th Cir 1989) at 1401.

132 Land, above n 123, at [5.8].

VIII CONCLUSION

Section 36 aims to prevent a firm with a substantial degree of market power taking advantage of that power for a proscribed purpose. The way the courts have interpreted the connection element — requiring a counterfactual test that assesses how a firm would have acted in a hypothetical competitive market — raises more issues than it solves and diminishes the utility of s 36.

Despite these issues and the potential of alternative Australian approaches, the Supreme Court in *0867* confirmed that it was necessary in every s 36 case to employ such a test, even if it backed away from the counterfactual label. The Supreme Court arguably incorporated some of the Australian tests into a counterfactual framework, but ultimately the position is that our highest court has reaffirmed the need to set up a hypothetical market in every s 36 case.

To give s 36 its intended effect the courts should be able to examine each case on its own facts and use the various tests as guidance — no test should be determinative. Adding an effects element to s 36 would allow a rule of reason approach to be taken and would lead to a considerably more flexible and effective application of the section.