
**THE DEVIL WE KNEW? DEREGULATION AND
MISUSE OF MARKET POWER IN NEW
ZEALAND'S TELECOMMUNICATIONS INDUSTRY**

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*For A.
Ex malo bonum.*

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LIST OF ABBREVIATIONS

ACCC – Australian Competition and Consumer Commission

AUSTEL – Australian Telecommunications Authority

CERTA – Australia New Zealand Closer Economic Relations Trade Agreement

DSTN – Digital Services Transport Network

DSL – Digital Subscriber Line

ECPR – Efficient Component Pricing Rule (more common name of the Baumol-Willig Rule)

FCC – Federal Communications Commission

ICA – Interconnection Agreement

ISP – Internet Service Provider

KSO – Kiwi Share Obligation

NAFTA – New Zealand Australia Free Trade Agreement

OECD – Organisation for Economic Co-operation and Development

OFTEL – Office of Telecommunications (United Kingdom Telecoms regulator)

PSTN – Public Switched Telephone Network

TSP – Telecommunications Service Provider

UBS – Unbundled Bitstream Service

INTRODUCTION

The telecommunications sector remains a vital element within New Zealand's economy, and must remain so if the country hopes to maintain market growth and a high standard of living in an increasingly technological world. With that in mind, this paper will consider the difficulties faced by Parliament and the courts over the last two decades in their attempts to regulate the behaviour of a dominant, vertically-integrated incumbent within New Zealand's newly privatised telecommunications sector. In particular, the expanded role of the courts will be assessed in terms of defining the limits of acceptable competitive behaviour under the 'light-handed' competition law regime adopted by Parliament in the 1980s and 1990s.

The focus of this paper will be on interconnection disputes between Telecom Corporation of New Zealand Ltd ('Telecom') and its rivals, and the effectiveness of the Commerce Act 1986 in dealing with unilateral abuses of dominance within the sector. The pivotal 1994 decision by the Privy Council will be analysed in careful detail, as will the decision of the courts in adopting a strict counterfactual test which considerably limited the scope for finding misuse of dominance within section 36 of the Commerce Act. The reasons behind the ineffectiveness of subsequent attempts by both the Court of Appeal and the legislature to lower this threshold will also be considered, as will the subsequent impact of the recent Supreme Court decision on misuse of market power.

It will be argued that the perseverance by the courts to maintain a high threshold for finding anti-competitive behaviour reflected not just a concern for the underlying principles and jurisprudence of competition law, but also a pragmatic understanding of the limits within which the courts can effectively adjudicate. A failure to understand the practical limitations of the judiciary, particularly in complex industries such as the telecommunications sector, will invariably distort any understanding of their decisions and the weight the courts have placed on the conflicting ideologies underlying competition law.

Finally, this paper will consider the effectiveness of the eventual move away from light-handed regulation, and identify how well the subsequent regulation achieves the stated objectives of New Zealand's competition law. It will be argued that the more balanced role of the courts and regulators within the current regime provides the most effective model to achieve workable and effective competition for the sector in the future.

CHAPTER ONE: COMPETITION LAW AND THE NEW ZEALAND TELECOMMUNICATIONS SECTOR

1.1 *The Purpose of Competition Law*

Competition law is generally implemented as a system of legislative intervention used by market economies to develop optimal efficiency within markets. The economic argument underpinning the law is that this is achieved by promoting productivity, efficient allocation of resources and by encouraging dynamic efficiency through innovation.¹ However agreement on how to balance these sometimes conflicting policy objectives has proved elusive. Early developments in antitrust law in the United States, most notably the Sherman Act 1890, attempted to avoid the monopolisation of trade by cartels and developed competition law as part of a wider focus on the populist redistribution of wealth.² Later scholars and policy-makers (such as the Chicago School in the 1970s) have subsequently stressed the importance of efficiency as a central aspect of competition law, and expressed a desire to allow market forces a greater role in controlling conduct.³ Of course, an approach which stresses reliance on the market must recognise that some competitors will seek victory at all costs. And while it is clear competition laws generally require judicial interpretation and enforcement, just how much discretion is left to the general courts, and how much is reserved for regulatory bodies, varies by jurisdiction.⁴

1.2 *Umbrellas, consumers and the quest for efficiency: balancing the ideologies of Competition Law*

Most would agree that some competition is a good thing, and is in fact a vital ingredient within the marketplace. Given the right circumstances, it can deliver

¹ Pieter Slot and Angus Johnston *An Introduction to Competition Law* (Hart Publishing, Oxford, 2006) at 1.

² Sherman Act 15 USC § 2; Slot above n 1 at 2-3. Antitrust law is an alternative term for competition law used in the United States. While New Zealand normally uses the term competition law both will be used interchangeably.

³ Matt Sumpter, Ben Hamlin and James Mellsop *New Zealand Competition Law and Policy* (CCH New Zealand, Auckland, 2010) at 17-20.

⁴ Maureen Brunt *Economic Essays on Australian and New Zealand Competition Law* (Kluwer Law International, The Hague, 2003) at 5-6.

lower prices, better quality and greater choice to consumers.⁵ The danger of individual firms or participants acquiring too much market power is that these benefits decrease and lead to a transfer of wealth from consumer to producers; a situation which results in consumers ‘paying more and receiving less’.⁶ But just how undesirable wealth transfer is depends on the ideological approach taken. This is also true of the emphasis placed on efficiency. In *Tru Tone Ltd v Festival Records Retail Marketing Ltd*, the Court of Appeal recognised that competition is a means of producing efficient allocation of resources.⁷ The High Court of Australia also stressed in *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd and Another (Queensland Wire)* that competition law dealing with market power should be focussed on shielding consumers.⁸ However questions remain over whether allocative efficiencies work best for consumers in the short-term (for example, a reduction in immediate prices) or whether wealth transfer to producers can provide long-term benefits to consumers through investment and innovation.⁹ In the end, the decision as to which best suits the market is often one of economic policy, given the variance in opinion amongst economists and politicians alike.

Underlying these considerations is a fundamental question within competition law; which behaviour is acceptable within markets, and which should be impugned? In *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd*, the High Court of Australia approved Scalia J’s statements in the Supreme Court of the United States when he said that participants with substantial market power should have their activities ‘examined through a special lens’.¹⁰ In these circumstances, otherwise innocuous behaviour may become unacceptable. However there is also the danger of turning on successful companies simply because they win, and competition law has been criticised for harming the self-

⁵Sumpter, above n 3, at 5.

⁶ Rex Ahdar "Consumers, Redistribution of Income and the Purpose of Competition Law" [2002] ECLR 341 ["Consumers"] at 353.

⁷ *Tru Tone Ltd & Ors v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA) at 358.

⁸ *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd and Another* (1989) 167 CLR 177 [*Queensland Wire*] at 191.

⁹ Stephen F Ross "The Goals of Antitrust" in S F Ross (ed) *Principles of Antitrust Law* (Foundation Press, Westbury, 1993) 1 at 4-5.

¹⁰ *Eastman Kodak Co v Image Technical Services Inc* (1992) 504 US 451 at 488 in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13; 205 CLR 1 at [29].

correcting properties of the market and for being too clumsy a mechanism for social engineering.¹¹

Early ideas of preserving small, independent entrepreneurs against larger organisations have not survived into modern competition law.¹² In *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd (Clear)*,¹³ the Privy Council approved the now ubiquitous statement from Posner J in *Olympia Equipment Leasing Company v. Western Union Telegraph Company*.¹⁴ Posner J, stated that a monopolist is entitled, like everyone else, to compete with its rivals and if it is not permitted to do so it ‘would be holding an umbrella over inefficient competitors’.¹⁵ Subsequent governments have struggled to find a system that both rewards innovation and avoids the worst excesses of collusion and monopolisation. The Courts have faced similar difficulties when interpreting antitrust legislation, especially when the economic effects of business practices are often difficult to determine.¹⁶ The danger of competition law failing to balance these goals is that it may stifle the competitive process. Conversely, if policy makers or adjudicators are too cautious in dealing with dominant firms, the underlying purpose to protect consumers may suffer.¹⁷

Most market economies do adhere to some form of antitrust legislation, and the eventual structure of the law generally reflects whichever ideological objectives have been adopted. The balance between general competition laws which cover most economic activities and allow more judicial discretion, or more precise sector-specific rules, invariably affects how that law is subsequently applied.¹⁸

¹¹ Frederic Sautet "The Shaky Foundations of Competition Law" [2007] NZLJ 186 at 188; Sumpter, above n 3, at 16-17. This last criticism will be considered more specifically in relation to the telecommunications sector in Chapter Four.

¹² Ross, above n 9, at 6.

¹³ *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (1994) 32 IPR 573; [1995] 1 NZLR 385; (1994) 5 NZBLC 103,552; (1994) 6 TCLR 138 (PC) [*Clear*] at 154.

¹⁴ *Olympia Equipment Leasing Company v Western Union Telegraph Company* F 2d 370 (7th Cir 1986) [*Olympia*]

¹⁵ *Olympia*, above n 14, at 375.

¹⁶ Ross, above n 9, at 2.

¹⁷ Rex Ahdar "Escaping New Zealand's monopolisation quagmire" (2006) 34 ABLR 260 ["Monopolisation quagmire"] at 276.

¹⁸ Damien Gérardin and Michel Kerf *Controlling Market Power in Telecommunications: Antitrust vs Sector-specific Regulation* (Oxford University Press, Oxford, 2003) ["Controlling market power"] at 13.

1.3 Problems of monopoly and common law supply doctrines in New Zealand's telecommunications sector

Monopolies within markets raise policy concerns when implementing competition law. Generally speaking, monopolists are associated with higher production costs, higher prices and a lack of innovation.¹⁹ This is because in monopoly situations the market equilibrium price (in which quantity demanded and supplied meet) is not decided by marginal consumers and producers. Instead the monopolist will theoretically restrict output once revenue gained equals the incremental increase in the cost of producing another unit.²⁰ Essentially, there is less incentive to produce more if this reduces the price of the goods and services provided, leading to higher prices.²¹

Linked to the concept of monopoly are common law doctrines which could arguably apply to New Zealand's telecommunications sector. Given the nature of telecommunications, there is a strong requirement for ubiquity of access to other networks.²² Clearly, any new competitor would gain few customers if they could not contact anyone who remained with the incumbent supplier. It is also possible that, given the importance that communication plays in the lives of individuals within modern society, the telecommunications network is an essential facility. The English doctrine of essential facilities, articulated initially by Sir Matthew Hale, suggests that certain types of private property, such as

¹⁹ Ibid, at 5.

²⁰ Keith Hylton *Antitrust Law: Economic Theory and Common Law Evolution* (Cambridge University Press, Cambridge, 2003) at 12-15. A monopoly situation will also allow for positive economic profits (where the price is likely to be greater than the average cost to produce). As a result there is a wealth transfer from consumers to the monopolist. While this wealth transfer is not seen as bad by all economists, this situation can also lead to a 'dead weight loss' scenario. In terms of overall efficient allocation of resources, a monopolist may undersupply despite having the ability to produce more. Consumers willing to pay a price that exceeds the marginal cost (but that doesn't exceed the monopolist's price) simply do not purchase these goods or services, which all economists accept is inefficient. The phenomenon of texting levels in New Zealand, in the face of expensive mobile interconnection prices, provides a practical example of this theory. For a more in-depth economic analysis of the problems monopolies present for competition see Sumpter, above n 3, at 27-53.

²¹ Damien Gérardin and Michel Kerf "Levelling the playing field: is the WTO adequately equipped to prevent anti-competitive practices in telecommunications?" in D Gérardin and D Luff (eds) *The WTO and Global Convergence in Telecommunications and Audio-Visual Services* (Cambridge University Press, Cambridge, 2004) 130 ["Levelling the playing field"] at 134. An Organisation for Economic Co-Operation and Development ('OECD') report on telecommunications confirmed that in 1998 retail prices across surveyed non-competitive markets were on average 50% higher than comparable competitive industries.

²² *Telecom v Clear* (1994) (PC), above n 15, at 140.

inns and bridges, can become ‘affected with a publi[k] interest, and they cease to be *juris privati* only’.²³ The argument is that this creates a degree of public jurisdiction over what is effectively private enterprise. The doctrine has been developed alongside competition law and adopted in the United States, although it is questionable whether this applies to the telecommunications sector where clear regulatory oversight exists.²⁴

Courts in New Zealand have been cautious in adopting the doctrine. The Court of Appeal in *Auckland Electric Power Board v Electricity Corporation of New Zealand Ltd* stated a similar common law doctrine imposes upon monopoly suppliers of essential services (or ‘prime necessities’) a duty to supply at a reasonable price.²⁵ However, the Privy Council in *Telecom v Clear* rejected the idea that there is a requirement to provide an essential service on reasonable or justifiable terms.²⁶ Later in *Commerce Commission v Bay of Plenty Electricity Limited* Clifford J expressed some approval for the doctrine as espoused in *Queensland Wire*.²⁷ However this seems at odds with the Privy Council’s decision, as well as the approach in *Union Shipping v Port Nelson Ltd*, where the court warned importing the essential facilities doctrine ‘may prove painfully difficult to correct’.²⁸

1.4 *The Swinging Pendulum: Competition Law in New Zealand and the Commerce Act 1986*

Early competition legislation in New Zealand reflected a general desire to protect consumers from oppressive commercial practice through heavily intrusive price controls on goods and services.²⁹ However the 1980s revealed a rethink of these traditional approaches to competition law at a time when the

²³ Sir Matthew Hale *A treatise relative to the maritime law of England, in three parts* (T Wright, London, 1787) at 77-78.

²⁴ *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP* 540 US 398 (2004) at 399, 413-415.

²⁵ *Auckland Electric Power Board v Electricity Corporation of New Zealand Ltd* [1994] 1 NZLR 551 at 557.

²⁶ *Telecom v Clear* (1994) (PC), above n 15, at 155.

²⁷ *Commerce Commission v Bay of Plenty Electricity Limited* HC Wellington CIV-2001-485-917, 13 December 2007, Clifford J, Professor Richardson at [387]-[389].

²⁸ *Union Shipping v Port Nelson* [1992] NZLR 662 (HC) at 705.

²⁹ Ahdar “Consumers”, above n 6, at 349. See generally Control of Prices Act 1947 and Trade Practices Act 1975.

Chicago School's focus on economic incentives to promote market efficiency still held sway in the United States.³⁰ In 1984 the Third Labour Government began privatising state-owned assets as part of its broader policy of 'Rogernomics', concerned as they were by the poor financial performance of state entities under heavy regulation.³¹

The introduction of the Commerce Act 1986 reflected this broader political framework and showed a desire to protect the competitive process, rather than competitors, by allowing monopolists to compete on their merits.³² The Government chose to rely on general competition law to stimulate the market and maintain access to essential networks within the economy.³³ A greater degree of self-governance and a reliance on the market was encouraged, and provisions such as sections 27 and 36 were triggered only if anti-competitive concerns were raised.

Part 1 of the Commerce Act created the Commerce Commission as a sector wide regulatory body, while Part 2 of the Act prohibited or limited various restrictive trade practices including those lessening competition, price fixing and taking advantage of market power.³⁴ Part 3 restricted certain business acquisitions, while Part 4 provided a scheme by which certain goods or services could be regulated.³⁵ Section 36 remains the key Commerce Act provision for the telecommunications sector, dealing as it does with unilateral misuse of market power. The central requirement of the original Act stipulated:³⁶

36 Use of dominant position in a market

- (1) No person who has a dominant position in a market shall use that position for the purpose of –
(a) restricting the entry of any person into that or any other market; or

³⁰ Sumpter, above n 3, at 20.

³¹ James Every-Palmer "The State and Monopolies: New Zealand's Experience" (2010) 12(2) Otago LR 227 at 229.

³² Commerce Amendment Bill 2001 (296-2) (select committee report) at 3; (15 September 1988) 492 NZPD 6601.

³³ Ministry of Commerce *Commerce Act Review; Guarantee of Access to Essential Facilities* (1989) at 27.

³⁴ Commerce Act 1986, ss 8-26, 27, 30, 36.

³⁵ *Ibid*, ss 47, 52-54.

³⁶ Commerce Act 1986, s 36(1). Note s 36 was substituted, on 26 May 2001, by s 9(1) of the Commerce Amendment Act 2001. The current equivalent section is s 36(2).

- (b) preventing or deterring any person from engaging in competitive conduct in that or in any other market; or
- (c) eliminating any person from that or any other market.

The section exemplified the open-textured language within the legislation, which allowed a relatively wide scope of application to industry behaviour, and consequentially a similarly wide degree of discretion in enforcement.³⁷ Unlike the adoption of the Office of Telecommunications ('OFTEL') in the United Kingdom, or the Australian Telecommunications Authority ('AUSTEL'), New Zealand circumvented partial deregulation and eschewed any industry-specific regulation.³⁸ As the Privy Council would later point out, the 'decision was deliberately taken to leave the matter to market forces, at least in the first instance'.³⁹ The new 'light-handed' regulatory regime relied on market mechanisms to ensure competition, subject to the underlying rules within the Commerce Act and the Fair Trading Act 1986.⁴⁰ The facilitation of access to services such as the telecommunication network would be achieved through general prohibitions against use of market power, the threat of regulation under Part 4 of the Act and, in the case of the Telecommunication sector, disclosure regulations.⁴¹

The reliance on certain provisions of the Commerce Act, despite the minimal guidance provided within the legislation, was further exacerbated by a perceptible narrowing of the Commerce Commission's jurisdiction and competency. In 1992 the Commission had undertaken and produced a *Report on Telecommunications*. In this the Commission expressed concern that the assistance provided by the Commerce Act was of a 'protracted, expensive and uncertain kind', and that Telecom Corporation of New Zealand Ltd ('Telecom') was effectively acting as a de facto regulator.⁴² However, the Court of Appeal

³⁷ Gérardin, "Levelling the playing field", above n 21, at 139. Terms such as 'use' and 'dominance' allow significant scope for interpretation.

³⁸ Rex Ahdar "Battles in New Zealand's Deregulated Telecommunications Industry" (1995) 23 ABLR 77 ["Battles"] at 77.

³⁹ *Telecom v Clear* (PC), above n 15, at 140.

⁴⁰ *Ibid.*

⁴¹ The Treasury and Ministry of Commerce, *Regulation of Access to Vertically-Integrated Natural Monopolies: A Discussion Paper* (1995) at 1; Telecommunications (Residual Provisions) Act 1987, s 5.

⁴² Dr Ross Patterson, Telecommunications Commissioner "Regulation of Telecommunications: The lessons learned over the last 25 years and their application in a broadband world" (Speech to

reviewed the power of the Commission to produce a report criticising both the Telecommunications Disclosure Regulations and Telecom.⁴³ In his judgment, Cooke P stated that there was no general prescription of the commission's function and powers, and that the Courts should not imply such wide-ranging general powers of inquiry.⁴⁴ His Honour emphasised the limited investigatory role of the Commission and pointed out that the legislation was intended to be partly self-policing.⁴⁵ This restricted understanding of the Commission's investigatory and adjudicatory powers was contrasted by the power of the Courts to overturn regulatory determinations on both substantive grounds and on points of law.⁴⁶ It was clear that heavy reliance on the Courts, with a limited role for regulatory bodies, was a defining feature of the 'light-handed' approach.

1.5 How close is close? Trans-Tasman harmonisation of Competition Law

Cooke P, in *New Zealand Apple and Pear Marketing Boards v Apple Fields Ltd*, recognised that the globalisation of industry and the growth of regional trade agreements require a degree of commonality in approaches to legal interpretation.⁴⁷ This is particularly the case for Australia and New Zealand, who on 1 January 1983 signed the Australia New Zealand Closer Economic Relations Trade Agreement ('CERTA').⁴⁸ The objectives of the treaty and subsequent memoranda included a commitment to harmonising approaches to restrictive trade practices and business law between the two jurisdictions.⁴⁹

the 22nd Annual Workshop of the Competition Law and Policy Institute of New Zealand, Wellington, 5 August 2011) at 3.

⁴³ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [1994] 2 NZLR 421; (1994) 5 NZBLC 103,431; (1994) 5 TCLR 482 (CA) at 483 per Cooke P; Telecommunications (Disclosure) Regulations 1990 (SR 1990/120).

⁴⁴ *Commerce Commission v Telecom* [1994] (CA), above n 43, at 485-6.

⁴⁵ *Ibid.*, at 492.

⁴⁶ *Ibid.*, at 487-488.

⁴⁷ *New Zealand Apple and Pear Marketing Boards v Apple Fields Ltd* [1989] 3 NZLR 158 (CA) at 164.

⁴⁸ Australia New Zealand Closer Economic Relations Trade Agreement (opened for signature 28 March 1983, entered into force 1 January 1983), art 19.

⁴⁹ *Ibid.*, arts 1, 12(1); Memorandum of Understanding Between the Government of New Zealand and the Government of Australia on the Coordination of Business Law [Published 02 July 2010].

Despite these attempts at harmonisation, neither CERTA nor any subsequent agreements entail any requirement of replication, and attempts at coordinating legislation and precedent must consider both the underlying purpose of the particular legislation, and the special circumstances within each economy.⁵⁰ For New Zealand, this includes considering the high concentration of industry and the significant diseconomies of scale associated with its small size, population and geographical isolation.⁵¹ These factors may have been behind the decision to use different wording in the Commerce Act which arguably reflected a higher threshold for finding misuse of market power in New Zealand, particularly when viewed in an economic sense.⁵²

Nevertheless, the general format and structure of the Commerce Act was modelled to a significant degree on the Australian Trade Practices Act 1974 (the 'TPA').⁵³ Section 36 of the Commerce Act dealing with misuse of market power was a good example, as it was broadly equivalent to section 46 of the TPA.⁵⁴ This Act has subsequently provided jurisprudence guidance for the New Zealand courts.⁵⁵

⁵⁰ (296-2) Select Committee Report, above n 32, at 5; (4 April 2001) 591 NZPD 8734.

⁵¹ Terence Arnold, David Boles de Boer and Lewis Evans "The Structure of New Zealand Industry: Its Implications for Competition Law" in Mark Berry and Lewis Evans (eds) *Competition Law at the Turn of the Century: A New Zealand Perspective* (Victoria University Press, Wellington, 2003) 24 at 25.

⁵² Commerce Act, s 36. In subsection 36(2), for example, the term 'dominant position' was used rather than 'substantial degree of market power'.

⁵³ On 1 January 2011 the Trade Practices Act 1974 (Cth) was renamed the Competition and Consumer Act 2010 (Cth) ('CCA'). To avoid confusion, references to the earlier act will maintain the TPA title.

⁵⁴ Commerce Act 1986, s36; see also *Commerce Commission v Telecom* [1994] (CA), above n 43, at 494; TPA s46:

46 Misuse of market power

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

⁵⁵ (296-2) Select Committee Report, above n 32, at 12.

1.6 Regulatory holidays? The impact of the Commerce Act 1986 on the telecommunications industry

Prior to the early 1980s the telecommunications network in New Zealand had been regulated via state ownership as part of the Post Office. Problems of monopoly pricing and interconnection relating to the Public Switched Telephone Network ('PSTN') had been resolved by state pricing regimes and a legislative ban on competition within the sector.⁵⁶ The 1970s and 1980s saw a broader international trend of moving away from heavy-handed methods of regulating telecommunications, although the approach towards privatisation and opening markets to competition varied by jurisdiction.⁵⁷ As the Privy Council later pointed out, while Australia and the United Kingdom provided statutory rights to interconnect with public telephony systems, New Zealand instead adopted the 'light-handed' regime outlined above.⁵⁸

The Telecommunications Act 1987 came into force 1 January 1988 and established the deregulatory framework for the industry soon after the introduction of the Commerce Act.⁵⁹ The 1987 Act provided for the privatisation and subsequent sale of Telecom, which occurred on 12 September 1990.⁶⁰ The telecommunications market was also opened for competition on 1 April 1989, with Clear Communications Ltd ('Clear') being the first additional network operator to enter the sector in October 1990.⁶¹ In a series of letters to the Minister of Commerce and press releases in 1988 and 1989 Telecom undertook not to discriminate between new providers and its subsidiaries regarding access to the PSTN, and to negotiate in good faith on a fair and

⁵⁶ Every-Palmer, above n 31, at 228-229.

⁵⁷ The United States, for example, relied on both general anti-trust and sector-specific legislation to oversee the privatisation process, and had already appointed industry regulators such as the Federal Communications Commission ('FCC') under earlier legislation. See Communications Act 47 USC §151; Telecommunications Act 47 USC.

⁵⁸ *Telecom v Clear* (1994) (PC), above n 15, at 140.

⁵⁹ Telecommunications (Residual Provisions) Act 1987, s1(2). The act was renamed by the Telecommunications Act 2001, s 159(3).

⁶⁰ Ahdar "Battles", above n 38, at 78. Ameritech Corporation, Bell Atlantic, and a consortium of smaller businesses purchased the company and its network for \$4.25 billion.

⁶¹ Telecommunications (Residual Provisions) Act 1987, s3; *Telecom v Clear* (1994) (PC), above n 15, at 142-143.

reasonable basis.⁶² Whether or not these undertakings formed the foundation of the decision not to impose industry-specific regulation on top of the Commerce Act's requirements is open for debate.⁶³ However, it is clear strict regulation was eschewed in favour of negotiations between new entrants as to connectivity. To support this process, disclosure regulations were established by the Telecommunications Act to provide some guidance to new participants within the negotiation process.⁶⁴ Additionally, the Kiwi Share Obligation ('KSO') was incorporated into article 11 of Telecom's constitution and was consequentially enforceable under the Companies Act 1993. This allowed the Government an effective veto regarding certain amendments to the constitution.⁶⁵ The KSO also provided for free local calling, established caps on line rentals in line with inflation, and required parity between urban and rural standard line rental prices.⁶⁶ All else would be left to the market forces to resolve, at least in the first instance.

The characteristics of New Zealand telecommunications market remain problematic in terms of implementing and adjudicating a general, 'light-handed' regulatory regime. While the privatisation process removed the artificial legislative barriers to entry in the market, the PSTN network still represented a natural monopoly (and remains so). This meant that Telecom, as the incumbent fixed line network provider, could supply the entire market demand at a lower cost than two or more firms replicating the exchanges and copper wire infrastructure.⁶⁷ Not only was it economically inefficient to duplicate the market; but as Telecom also supplied retail services to consumers, the sector was saddled with a vertically-integrated incumbent.⁶⁸

⁶² Telecom Corporation of New Zealand Ltd "Telecom supports Government Telecommunications Deregulation Plans" (press release, 16 June 1988); Letter from Telecom to Minister of Commerce regarding interconnection (6 July 1989).

⁶³ Patterson "Regulation of Telecommunications", above n 42, at 3.

⁶⁴ Telecommunications (Disclosure) Regulations 1990, reg 4(1)(d).

⁶⁵ *Constitution of Telecom Corporation of New Zealand Ltd* (as amended 7 October 2004) art 11; Companies Act 1993, s31(2).

⁶⁶ Ministry of Economic Development *Telecommunications Service Obligations (TSO) Regulatory Framework: Discussion Document - Annex A: Profile of the Kiwi Share Obligations* (2007) at 74-75.

⁶⁷ Treasury *Regulation of Access*, above n 41, at 1.

⁶⁸ *Ibid*, at 3-5.

Telecom's domination of the market attracted criticism from the Commerce Commission, as well as academic and industry commentators, who pointed out that general competition law would be ineffective without strong regulation or structural separation of the incumbent.⁶⁹ The complexity of the industry, and the perverse incentives Telecom would have to stifle competition as an incumbent with high market power seemed to necessitate tighter regulation. Instead Parliament, through the Commerce Act, effectively abdicated the role of monitoring the industry to the market itself. If this failed, participants could bring their complaints before the courts.

The structure of the Commerce Act had also narrowed the potential remedies available for resolving interconnection disputes. Any idea that Telecom as the network incumbent might be subject to the 'special responsibility' doctrine adopted by the European Union was rejected by the Privy Council in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission*.⁷⁰ Their Lordships reviewed Article 86 of the Treaty establishing the European Economic Community ('Treaty of Rome'), which provided that any abuse by participants in a dominant position within the common market should be prohibited. Leading European cases were considered, particularly *Akzo Chemie BV v EC Commission*, in which Advocate General Lenz stated, 'Article 86 does not require that the dominant undertaking in the market should have used its economic power to bring about the abuse'.⁷¹ As a result, their Lordships concluded that the wording of section 36, requiring use of a dominant position, precluded extending the special responsibility doctrine to New Zealand. Similarly, while an outright denial or refusal to deal might contravene section 36 of the Commerce Act, the Court of Appeal in *Vector Ltd v Transpower New Zealand Ltd* stated clearly that the essential facilities or prime necessity doctrine had been impliedly repealed by the regulatory provisions in Part 4 of the Act.⁷²

⁶⁹ See Damien Gérardin, Isabel Neto and Michel Kerf "Antitrust vs. Sector-specific Regulation in Telecom: A Close Look at Interconnection" (2005) Social Science Research Network <www.ssrn.com> ["Antitrust"] at 1 and Ahdar "Battles", above n 38, at 115-116.

⁷⁰ *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145; (2004) 11 TCLR 200; (2004) 2 NZCCLR 158 at [8].

⁷¹ *Case 62/86 Akzo Chemie BV v EC Commission* [1993] CMLR 215 at 238 in *Carter Holt Harvey* (PC), above n 70, at [63].

⁷² *Vector Ltd v Transpower New Zealand Ltd* [1999] 3 NZLR 646 (CA) at 666.

1.7 The way forward

The decision to establish a ‘light-handed’ regulatory regime was one of policy, albeit grounded in the economics concerning the efficient allocation of resources. However, providing only broad guidance to the courts in the hope that the judiciary would effectively regulate the sector was dangerous. As the Court of Appeal revealed in its decision on the competency of the Commerce Commission, general or open-textured legislation may be interpreted narrowly. And with the rejection of any doctrines suggesting that a duty to supply remained in New Zealand law, the Judiciary showed a perceptible reluctance in moving into areas that had traditionally been the province of strict regulation. The future regulation of the sector would rely heavily on the approach the Courts took towards section 36 of the Commerce Act.

CHAPTER TWO: THE JUDICIAL INTERPRETATION OF SECTION 36

2.1 The general approach to section 36

Underlying the entire Commerce Act, and particularly section 36, is the question of what is acceptable competition. Perfect competition, in which there is complete freedom of entry, no dominance, homogeneity of product, and where market equilibrium can be achieved, is generally accepted as unrealistic and unattainable.⁷³ Instead, Parliament adopted a more practical requirement. Section 3(1) of the Commerce Act defines competition as ‘workable or effective competition’. The Court of Appeal later expanded on this definition, describing workable competition as a ‘market framework where participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency’.⁷⁴ This concept remains a key consideration when deciding whether the Act is achieving its stated goals.

The Privy Council in *Clear* confirmed that to find misuse of market power in section 36(2) all three elements of the subsection must be present; a dominant position, use of that position, and use for an impugned purpose.⁷⁵ The Court of Appeal also affirmed that the onus is on the plaintiff to establish proof of each element on the balance of probabilities.⁷⁶ McHugh J, in the later Australian High Court judgment *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission*, pointed out that a finding of market power would also require the court to identify the relevant market as an additional first step.⁷⁷

⁷³ For an in-depth analysis of the economics behind perfect competition see Sumpter, above n 3, at 34-35.

⁷⁴ Commerce Act, s 3(1); *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) at 564-565.

⁷⁵ *Telecom v Clear* (1994) (PC), above n 15, at 154.

⁷⁶ *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd* (1990) 3 NZBLC 101,501; [1990] 1 NZLR 731 at 743 and *Tru Tone v Festival* (CA), above n 7, at 358.

⁷⁷ *Boral Besser Masonry Ltd (now Boral Masonry Ltd) v Australian Competition and Consumer Commission* (2003) 195 ALR 609; (2003) ATPR 41-915 (HCA) at [262]. While the TPA’s terminology within s46 is different, the structure and elements are the same.

2.2 Defining ‘dominance’

Originally section 3(8) of the Commerce Act identified the factors to be considered when deciding if a market participant that exercised a dominant influence in the market included market share, and the extent to which a participant was constrained by competitors, suppliers and consumers.⁷⁸ Once again, strong correlations with s46 of the TPA were apparent, although in 2001 Parliament repealed the section.⁷⁹ The Government may have been concerned by the approach taken by the Court of Appeal in *Telecom Corporation of New Zealand Ltd v Commerce Commission* (‘AMPS-A Case’) where the Court held that ‘dominant’ should be given its ordinary dictionary meaning, thus imparting a high threshold.⁸⁰ The move was possibly an attempt to lower the dominance threshold by re-aligning the legislation towards economic analyses and away from literal interpretations.⁸¹ Of course, removing these guidelines provided still greater discretion to the Judiciary in deciding whether a position of dominance had been misused.

What is apparent from the judgments is the recognition by the Courts that dominance (or in Australia, market power) is not a breach of the section itself.⁸² Despite the early approach taken by the Court of Appeal in the *AMPS-A* case, throughout the 1990s the threshold for finding dominance was lowered. Courts in both Australia and New Zealand confirmed that absolute control or monopoly was not necessary to find dominance, and that a dominant firm did not have to be totally free from constraints to exert market power.⁸³ This interpretation was part of a broader, practical approach which focuses on a factual inquiry as to whether the participant is ‘constrained in a way it would be in a competitive market’.⁸⁴

⁷⁸ Commerce Act 1986, s 3(8).

⁷⁹ Commerce Amendment Act (No 2) 2001 (no 2), s 9(4).

⁸⁰ *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429; (1992) 4 NZBLC 102,724; (1992) 4 TCLR 648 (CA) [AMPS-A] at 653.

⁸¹ (296-2) (select committee report), above n 32, at 11.

⁸² *Queensland Wire*, above n 8, at 194.

⁸³ *Port Nelson (CA)*, above n 74, at 574-575; *Carter Holt Harvey (PC)*, above n 70, at [69].

⁸⁴ *Commerce Commission v Telecom Corporation of New Zealand Ltd and Anor* [2010] NZSC 111, [2011] 1 NZLR 577 [0867] at [33].

Market definition is fundamental to a finding of market power or dominance is effective market definition, although in truth there has been little difficulty in establishing Telecom's dominance in the retail, wholesale and mobile telecommunications markets. In the national interconnection disputes with Clear, and recently in *Commerce Commission v Telecom Corporation of New Zealand Ltd* ('Data Tails') involving the wholesale and retail markets for data transmission, Telecom's dominance was established relatively easily.⁸⁵ In *Commerce Commission v Telecom Corporation of New Zealand Ltd* ('0867 HC'), the High Court found dominance in the network retail sector but not the wholesale. However the Court of Appeal found dominance in both markets, and the Supreme Court subsequently assumed this fact without analysis.⁸⁶

2.3 Finding purpose

The specific anti-competitive purposes outlined in subsections 36(2)(a) – 36(2)(c) are a clear legislative signal that not all uses of dominance within markets are barred; only those which restrict entry, seek to eliminate a participant, or prevent competition.⁸⁷ McGechan J confirmed that purpose may be objective, subjective or a mixture of both. In the same judgment he also pointed out that the anti-competitive intent need not be the sole purpose, but only a substantive one which was 'real or of substance'.⁸⁸ This approach was later confirmed by the inclusion of subsection 2(5) in the Commerce Act. Finally, so long as an anti-competitive purpose is present, there is no requirement that it be achieved to breach the section.⁸⁹

The Privy Council in *Clear* confirmed that purpose may be readily inferred if the other elements of dominance and use have been satisfied. Indeed, their Lordships went so far as to state that:⁹⁰

⁸⁵ *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland, CIV-2004-404-1333, 9 October 2009, Rodney Hansen J, M Richardson at [41-42]; *Telecom v Clear* (1994) (PC), above n 15 at 154.

⁸⁶ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [9] – [11].

⁸⁷ *Carter Holt Harvey* (PC), above n 70, at [23] – [24].

⁸⁸ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 (HC) at 527-529, 544-545.

⁸⁹ *Apple Fields Ltd v New Zealand Apple and Pear Marketing Board* (1993) 7 PRNZ 184 (HC) at 189.

⁹⁰ *Telecom v Clear* (1994) (PC), above n 15 at 154.

If a person has used his dominant position it is hard to imagine a case in which he would have done so otherwise than for the purpose of producing an anticompetitive effect

In that case, the Board felt that use and purpose would not be easily separated, as there would be no need to use dominance in ordinary competition. Their Lordships felt it would be most improbable, if Telecom had used its dominance, that it would not be for the purpose of deterring its bitter rival.⁹¹ This perhaps reflects a pragmatic realisation that the two concepts are so linked that it is artificial to separate them.

It should be noted, however, that this interpretation of purpose is a judicial gloss not expressed in the statute, and has been criticised. Professor Rex Ahdar, in several articles looking at competition law in New Zealand, has suggested that a lessening of the purpose requirement has led to an inability to distinguish between acceptable and unacceptable behaviour, and has placed additional pressure on the importance of the test for use within section 36.⁹² Ahdar recommended a re-emphasis on purpose as the pivotal element, and suggested a defining test delineating hard competition from specific focussed strategies aimed at harming rivals.⁹³ This approach has merit, and is similar to the approach taken by Gault J in *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* when he stated ‘It is the purpose of the conduct which distinguishes what is proscribed from what is legitimate’.⁹⁴ Nevertheless it becomes problematic when one considers how difficult this test may be to apply in practice, and that deciding what amounts to behaviour designed to harm rivals may stray into policy considerations. A return to aggressive market control, with the subsequent impact this would have on workable competition, would certainly be contrary to the stated purpose of the Commerce Act.

⁹¹ Ibid.

⁹² Rex Ahdar "The unfulfilled promise of New Zealand's monopolisation law: Sources, symptoms and solutions" (2009) 16 CCLJ 291 ["Unfulfilled promise"] at 297; Ahdar "Monopolisation quagmire", above n 17, at 268.

⁹³ Ahdar "Unfulfilled promise", above n 92, at 304-305.

⁹⁴ *Clear Communications Ltd v Telecom Corporation of NZ Ltd* (1993) 4 NZBLC 103,340, (1993) 5 TCLR 413 (CA) at 430.

2.4 The emergence of the strict counterfactual test

By far the most contentious interpretation of section 36(2) has been the interpretation of ‘use’ by the Courts. As outlined in 2.2, the mere existence of market power is insufficient to establish a breach. However as ‘use’ is not defined in the Commerce Act, the courts are left with considerable discretion but little guidance concerning its interpretation. Unsurprisingly, the judiciary looked to the underlying principles behind competition law in an attempt to resolve this ambiguity. Perhaps more surprising for the Legislature, this resulted in a particularly narrow interpretation.

In cases such as *Queensland Wire*, *Union Shipping* and *Tru Tone*, the courts had defined some of the parameters of the Commerce Act, but it was the 1994 decision of the Privy Council in *Clear* that defined the judicial approach to unilateral anti-competitive breaches. For Telecom and the telecommunications sector, it was also the culmination of a series of negotiations, arbitrations and litigated cases as the newly privatised sector struggled to develop in an environment in which the underlying rights of participants remained relatively undefined.⁹⁵ Essentially, the case was an opportunity for the incumbent to test its commercial behaviour against the limits of the law, and to see whether the judiciary would resort to effectively making business decisions in defining anti-competitive behaviour.

Clear, Telecom’s first rival in the New Zealand telecommunications sector, had been involved in negotiations to enter the national toll call market as well as the local business customer market in the central business districts (‘CBDs’) of Auckland, Wellington, and Christchurch.⁹⁶ By August 1991 a final agreement was reached over the toll network, but negotiations stalled over connecting to the PSTN local loop connection which Telecom controlled.⁹⁷ After proceedings commenced in 1991, Telecom changed tack and submitted that the pricing of the

⁹⁵ See generally *Telecom v Commerce Commission* [AMPS-A] above n 80; *Commerce Commission v Telecom* [Report], above n 38.

⁹⁶ *Telecom v Clear* (1994) (PC), above n 15, at 140.

⁹⁷ *Ibid.* Initially, the key areas of dispute were whether Telecom could require Clear customers to dial an access code for interconnection, and whether they could demand an access levy to connect with its larger network and to cross-subsidize its commitments under the KSO.

interconnection agreement should follow the Baumol-Willig rule (more commonly described as the Efficient Component Pricing Rule or ‘ECPR’).⁹⁸ Clear in turn claimed that Telecom’s actions were anti-competitive by attempting to recover the loss of monopoly rents, and that it was using its dominant position contrary to section 36.

In the High Court, Ellis J had held that the ECPR was not anti-competitive. His Honour stated the rule would allow Telecom to compensate for the KSO, and also that Clear had not proved monopoly rents were so high that they could not enter the market if they were an efficient operator (incumbents, however, seem to have no such requirement for efficiency).⁹⁹ By contrast, the Court of Appeal had rejected the ECPR as anti-competitive as it effectively indemnified a monopolist for their loss of profits, and instead suggested a return to negotiations to establish a price based on incremental costs and a reasonable return on capital.¹⁰⁰

The Privy Council took a different approach to the matter. While accepting that Telecom was dominant in the litigated markets, and that Telecom’s purpose was undoubtedly to harm Clear, it stressed the Courts could not infer use of dominant position from anti-competitive purpose.¹⁰¹ Instead, the Bench confirmed that a participant “uses” a dominant position for the purposes of s 36 only if he acts in a way which a person not in a dominant position, but otherwise in the same circumstances, would have acted.¹⁰² This hypothetical jurisprudential approach saw the Privy Council adopting a particularly strict ‘but-for’ counterfactual approach to the meaning of ‘use’. Regardless of the anti-competitive effect, or the greater impact the actions of dominant firms might have, no participant would transgress section 36 unless they behaved in a way that deviated entirely from market norms. If a firm in a hypothetically

⁹⁸ Ibid, at 144-145. Gérardin “Antitrust”, above n 69, at 2. The Baumol-Willig rule, a specific formulation of the broader Efficient Component Pricing Rule (‘ECPR’), incorporates not just the actual cost of interconnection but also the opportunity cost. Effectively, Telecom sought recovery of the profit they would forgo by being unable to sell those connections to the retail market.

⁹⁹ *Telecom v Clear* (1994) (PC), above n 15, at 150-151.

¹⁰⁰ *Clear v Telecom* (1993)(CA), above n 94, at 416.

¹⁰¹ *Telecom v Clear* (1994) (PC), above n 15, at 154-155.

¹⁰² Ibid, at 155.

competitive market would act in the same manner, no use of dominance could be established.

In applying the test to the facts before them, the Bench reaffirmed that the ECPR provided a proper model for demonstrating what would be charged by a hypothetical supplier in a contestable market, and that if Clear was superior in terms of efficiency, then this interconnection price would not preclude commercial success.¹⁰³ The Board, perhaps reflecting an English jurisdiction where relatively heavy regulation of the telecommunications sector remained the norm, also pointed out that Part 4 of the Act was more suited to resolving pricing issues and that it would be ‘wrong to construe section 36 so as to extend its scope to produce a quasi-regulatory system which the Act expressly provides for’.¹⁰⁴

The implications of this decision were not merely confined to the ECPR model. The Board had also effectively overruled the attempt by the Court of Appeal to simplify the approach to the section 36 test. Prior to this decision Cooke P had stated, apparently without economic analysis, that ‘the [ECPR] rule would seem obviously anti-competitive and in breach of s.36 of the Commerce Act’.¹⁰⁵ Gault J, in a lucid and compelling judgment, had in fact considered the benefits of a counterfactual analysis. However, he stressed a participant’s conduct must be assessed within a commercial context when deciding whether particular behaviour could occur in fully competitive situation and stated ‘It is perhaps timely to caution against substituting a test helpful in applying the statutory rule for the rule itself’.¹⁰⁶ His Honour felt the counterfactual analysis might become overly complicated, considering the multiple variables that might or might not occur, and that hypothetical economic models may be formulated differently according to differing opinions even among expert economists.¹⁰⁷

¹⁰³ Ibid, at 159.

¹⁰⁴ *Telecom v Clear* (1994) (PC), above n 15, at 160; Patterson “Regulation of Telecommunications”, above n 42, at 5.

¹⁰⁵ *Clear v Telecom* (1993)(CA), above n 94, at 416.

¹⁰⁶ Ibid, at 430.

¹⁰⁷ Ibid.

Gault J also suggested the essential facilities doctrine might be useful in the practical application of the section in a commercial context, by asking whether a firm had acted reasonably or with justification in the circumstances.¹⁰⁸ Finally, in attempting to lower the threshold of misuse, Gault J justified his decision by referencing Parliaments' approach to competition law, declaring that 'in view of stated Government policy it would be unrealistic to leave the matter for regulatory intervention. That would be inconsistent with the "light-handed" approach.'¹⁰⁹

The Court of Appeal had clearly attempted to apply a lower threshold for section 36 violations, focussing on the wording of the statute and commercial realities instead of complex economic models. The attempt to incorporate an element of reasonableness to the use element also represented an effort to align the law with the pre-existing common law doctrines, and perhaps with the 'special responsibility' doctrine. The judgment was also almost certainly an attempt to utilise the considerable discretion available to the Judiciary under the Commerce Act to resolve what had become a protracted dispute. Despite these arguments, the decision was roundly rejected by the Privy Council.

The Board did not share Gault J's view that the open texture of the section allowed such a degree of judicial discretion. In rejecting his Honour's suggestion, the Privy Council stated 'it is irrelevant to the Court's function to take into account Government policy', and instead once again pointed to the regulatory machinery of the Commerce Act as a means of resolving problems with monopoly rents.¹¹⁰ Additionally, the Court pointed out that the statute provides no distinction as to what does or doesn't constitute unacceptable use. This, their Lordships felt, necessitated a comparative jurisprudential exercise to discover what a hypothetical firm without dominance would do. And in any such attempt the application of valid economic models was considered

¹⁰⁸ Ibid.

¹⁰⁹ Ibid, at 436.

¹¹⁰ *Telecom v Clear* (1994) (PC), above n 15, at 161.

essential.¹¹¹ Similarly, Gault J's attempt at importing an element of reasonableness was criticised for creating unnecessary uncertainty.¹¹²

The difficulty faced in attempting to apply a reasonableness test without legislative guidance is that within business, the scope of what is reasonable behaviour will vary, as Gault himself recognised.¹¹³ Except in clear cases of anti-competitive behaviour where precedent was settled, it seems the Privy Council felt the courts should not be the body that decides what amounts to the boundaries of acceptable business behaviour. When considered in this light, a comparative exercise seems the most sensible and accurate reflection of the marketplace.

2.5 The rationale behind the counterfactual test

The Privy Council's decision in *Clear* has itself been criticised. It has been suggested that this approach still creates a moral component to the 'use' test, and that the Board was, like Gault J, placing a judicial gloss on the purpose of the legislation by protecting dominant firms.¹¹⁴ Additionally, in *Queensland Wire* the High Court of Australia had confirmed that 'use' was a morally neutral term, and need not be associated with reprehensible behaviour.¹¹⁵ By adopting a strict 'but for' test of causation for 'use', had the Board had also arguably swung the statutory test too far in favour of dominant firms? Had it ignored the greater effect the actions of these participants have on competition within markets?¹¹⁶ It seems overly simplistic to suggest that the Courts merely favoured big firms over smaller competitors, or that they ignored the needs of consumers. Instead, these decisions may have shown a pragmatic understanding of the New Zealand markets, and the role of the judiciary within the antitrust regime.

¹¹¹ *Ibid*, at 155.

¹¹² *Ibid*.

¹¹³ *Clear v Telecom* (1993)(CA), above n 94, at 430.

¹¹⁴ Ahdar "Monopolisation quagmire", above n 17, at 272.

¹¹⁵ *Queensland Wire*, above n 8, at 191.

¹¹⁶ Ahdar "Unfulfilled promise", above n 92, at 298.

Part of the reason for the rejection of a broad definition of ‘use’ lies in the concept, discussed at 1.2, that dominant firms must be allowed to compete on their merits and not be forced to shield otherwise inefficient competitors. Increasingly, the courts have looked to ‘use’ as the element to define the margin between legitimate and illegitimate behaviour.¹¹⁷ In *Queensland Wire* the Majority pointed out that a competitor who is successful enough to eliminate its rivals is not the focus of legislative sections associated with unfair business practice, even if their intent is hostile. As Mason CJ stated:¹¹⁸

the object of s. 46 is to protect the interests of consumers...Competition by its very nature is deliberate and ruthless...This competition has never been a tort and these injuries are the inevitable consequence of the competition s 46 is designed to foster.

This concern over exposing potentially ‘legitimate’ competitive practice to censure was approved by the Privy Council in *Carter Holt Harvey*, who also stressed competition is merely a means to the end of protecting consumers.¹¹⁹ The Supreme Court, in their recent unanimous decision in *0867*, also stressed dominant firms such as Telecom could engage in conduct for a purpose of the type prohibited in 36(2) as long as use of their dominance was not established.¹²⁰

The concerns expressed by the courts, some market participants, and industry experts, was that punishment for behaviour too close to the margins of legitimate action could ‘discourage normal risk-taking behaviour and promote “soft” competition by firms with monopoly power’.¹²¹ This cautious approach is not without its detractors. Ahdar suggests this sympathy for the plight of dominant firms is both ineffective and misguided.¹²² He points out the impact dominant firms can have on markets means they should not be treated with parity, and believes the ‘umbrella’ concept presumes large firms operate efficiently, which is not always the case.¹²³ This is a valid criticism, especially when one considers dominant incumbents such as Telecom; a former publicly-

¹¹⁷ *Queensland Wire*, above n 8, at 212-213.

¹¹⁸ *Ibid* at 191.

¹¹⁹ *Carter Holt Harvey* (PC), above n 70, at [24] – [25].

¹²⁰ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [11].

¹²¹ (296-2) Select Committee Report, above n 32, at 3.

¹²² Ahdar “Monopolisation quagmire”, above n 17, at 261.

¹²³ *Ibid* at 263-264.

owned utility provider with a poor track record of efficiency. However adopting a hard line approach to the behaviour of dominant firms does not necessarily represent an improvement, especially without statutory support similar to the ‘special responsibility’ doctrine in Europe. It is hard to see how illegitimising actions of dominant players for what may be reasonable business decisions will provide greater efficiency or workable competition.

Another key reason for a narrow interpretation of use is the desire for certainty. This has been particularly relevant in several leading cases relating to the telecommunications sector, an area in which large market participants engage in long-term, complex and expensive business plans and developments. In *Clear*, the Privy Council expressed concerns over the potential exposure of participants to damages and quasi-criminal penalties.¹²⁴ Similarly, the Supreme Court in *0867* pointed out that legislation must give firms and advisors a reasonable opportunity to predict in advance whether their conduct is in contravention of the Act.¹²⁵ The argument that a lack of certainty will harm innovation or limit desirable competitive conduct in the industry can of course be countered with the fact that evidence of this is inconclusive, and that a more flexible approach by the Courts is needed for differing circumstances.¹²⁶ However a flexible approach further increases the uncertainty surrounding competition law, particularly one which rejects a ‘bright-line test’ and suggests firms should err on the side of caution when adopting strategies. This is especially so within a system of antitrust legislation that provides wide discretions to the courts, and in which precedent may be reinterpreted or overturned as the case law develops.

Finally, the courts have been concerned that too low a threshold for ‘use’ could lead to a failure to identify the crucial causal link between the participant’s dominance and the impugned conduct.¹²⁷ The Privy Council in *Carter Holt Harvey* criticised the High Court decision of Williams J, who had combined use

¹²⁴ *Telecom v Clear* (1994)(PC), above n 15, at 155.

¹²⁵ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [30].

¹²⁶ Ahdar “Monopolisation quagmire”, above n 17, at 264; Ahdar “Unfulfilled promise”, above n 92, at 295-296.

¹²⁷ *Carter Holt Harvey* (PC), above n 70, at [51].

and purpose into a single test.¹²⁸ And while the Courts are willing to infer purpose from use, it is clear that the reverse does not apply.¹²⁹ This follows on fairly logically from the courts' acceptance that anti-competitive purpose is tolerable in situations where dominance does not exist, and that market power itself is acceptable when not used to an anti-competitive end. The Privy Council also warned that taking a *res ipsa loquitur*-type approach by inferring use from purpose or effect confuses the New Zealand legislation with the 'special responsibility' approach adopted by European law.¹³⁰

The decision of the Privy Council effectively established a strict counterfactual test as the key causal determinant for what was and wasn't lawful commercial initiatives by dominant firms in the marketplace. Concerns over causation and certainty, along with the acceptance that dominant firms must be allowed to compete, were affirmed as the key factors in the decision. The approach also arguably reflected pragmatism and a realisation that too low a threshold would stifle competition in New Zealand's concentrated markets. Without industry-specific legislation, it was difficult for the courts to discern at what point hard competitive behaviour becomes unlawful in any given commercial context. In the *Clear* case at least, this problem came to the fore.

As the Privy Council decision revealed, the four years of litigation had only established that the Baumol-Willig formulation was legal; Clear and Telecom still had to return to the negotiation table. After arduous manoeuvring, and substantial pressure from the Government, the parties finally reached an Interconnection Agreement ('ICA') in March 1996. Ironically, the price was set below ECPR levels.¹³¹ The reality was that by interpreting section 36 favouring certainty over flexibility, the Privy Council had significantly limited the regulation of access to the PSTN. There was also a perceptible reduction in attempts by the Commerce Commission to pursue actions under section 36. Between 1995-2001 only 12 cases were initiated, compared to 90 taken under section 46 of the TPA by the Australian Competition and Consumer

¹²⁸ Ibid at [26].

¹²⁹ Ibid at [40].

¹³⁰ Ibid at [49].

¹³¹ Gérardin "Antitrust", above n 69, at 3.

Commission ('ACCC') where the Courts had developed a more flexible approach (see 3.3).¹³² Even accounting for the difference in the size of the markets, the successful application of section 36 to limit market behaviour has been rare.

¹³² (296-2) Select Committee Report, above n 32, at 4.

CHAPTER THREE: DEVELOPMENTS IN THE APPROACH TO SECTION 36 MARKET DOMINANCE

3.1 Re-aligning regulation: the Commerce Amendment Act 2001

The 1995 joint Treasury and Ministry of Commerce Report had outlined deficiencies in the light-handed regime; identifying the telecommunication network interconnection negotiations as a particular example of this.¹³³ Additionally, in 1996 the Government issued a press release condemning the use of the ECPR model, although the threat of price regulation under Part 4 of the Commerce Act never materialised.¹³⁴ After the introduction of the Commerce Amendment Bill 2001, the Select Committee considering these amendments also expressed concerns that ECPR pricing would result in economically inefficient prices at the top end of the range in comparison to other pricing methodologies.¹³⁵ Criticism of the delays, expense and inconclusive results stemming from the Government's attempt to abdicate a regulatory role to the Courts extended to lay members of the Courts, with Professor Maureen Brunt, who had sat on the *Clear* High Court decision, later stating that the 'old light-handed regime has failed'.¹³⁶ The Committee itself agreed the current approach was inadequate in dealing with pre-existing market power, stating that it had produced anti-competitive conduct and delays which were detrimental to consumers.¹³⁷

The Legislature's response was the 2001 Bill, which attempted to solve these problems and develop flexibility by aligning the wording of the Act to that of Australia's TPA. It was believed that this approach would also limit the impact of the Privy Council's narrow precedent concerning the 'use' element in particular.¹³⁸ The Ministry of Commerce had expressed a desire to clarify and strengthen the Act so it would apply to a wider range of undesirable conduct,

¹³³ Treasury *Regulation of Access*, above n 41, at iv, 2.

¹³⁴ *Ibid*, at 7-8; Patterson "Regulation of Telecommunications", above n 42, at 3.

¹³⁵ (296-2) Select Committee Report, above n 32, at 30 – 31.

¹³⁶ Brunt, *Economic Essays*, above n 4, at 20; Ahdar "Battles", above n 38, at 116.

¹³⁷ (296-2) Select Committee Report, above n 32, at 4-5.

¹³⁸ *Ibid*, at 14; (27 February 2001) 590 NZPD 7973.

and the Select Committee felt adopting the Australian approach would lower the threshold of prohibited action.¹³⁹ Given the importance of finding market power, and the fact that the validity of business decisions of the use of dominance is often one of degree, there was an expectation that these changes would be significant.

The amendments resulted in several key changes within the Commerce Act. The title of section 36 was changed to ‘Taking advantage of market power’, and reference to ‘dominance’ was subsequently replaced with ‘substantial degree of power in a market’.¹⁴⁰ The term ‘use’ was also changed to ‘take advantage of’, and both changes reflected an adoption of the Australian terminology.¹⁴¹ A new section 36B also confirmed that purpose as required in section 36 could be inferred by the conduct of any relevant person or from other relevant circumstances.¹⁴² In terms of the wider approach to competition law, a new purpose section was added to the Commerce Act which confirmed ‘the purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand.’¹⁴³ This reference to long-term benefits seemed to signal a recognition that producers may also provide benefits for consumers through innovation and improved efficiency, and that short-term targets such as immediate reductions in price were not the only options in a broader understanding of market efficiency. The Part 4 provisions for regulatory price control of goods and services were also updated to ‘reflect more modern approaches to price control’.¹⁴⁴ Unsurprisingly, Telecom opposed the changes.¹⁴⁵

Subsequent judicial decisions showed that Parliament’s hopes of widening the scope of section 36 largely failed. The Supreme Court definitively rejected any change to the meaning of ‘use’ when they equated it to ‘take advantage of’ in the *0867* case, despite clear assertions from the Commerce Commission and the

¹³⁹ (296-2) Select Committee Report, above n 32, at 1-2.

¹⁴⁰ Commerce Amendment Act 2001, s 9(1).

¹⁴¹ *Ibid.* See also TPA, s 46.

¹⁴² Commerce Amendment Act 2001, above n 140, s 9(1); Commerce Act 2001, s 1A.

¹⁴³ *Ibid.*, s 4.

¹⁴⁴ *Ibid.*, s 12; Commerce Amendment Bill (No 2) (111-1) (Explanatory Note) at 1.

¹⁴⁵ (296-2) Select Committee Report, above n 32, at 4.

Executive that this was not the case.¹⁴⁶ A similar fate befell attempts to make changes to the section 47 merger provisions.¹⁴⁷ Clearly, an opportunity to alter the judicial approach had been rejected, and the scope of dominant firms to compete was not reduced. In order to understand why, it is necessary to analyse both the underlying competition law considerations, and the role of the Courts themselves.

3.2 *Carter Holt Harvey: the counterfactual test survives*

Shortly before the introduction of the 2001 Amendments, the Court of Appeal in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* considered accusations of predatory pricing by Carter Holt.¹⁴⁸ While generally supporting the decision of the Privy Council in *Clear*, the Court had looked to adjust the section 36 approach, partly by incorporating key Australian decisions.¹⁴⁹ In supporting the findings in the High Court, Gault J pointed to the decision of the High Court of Australia in *Melway* and a 2001 Court of Appeal decision, both of which stressed undertaking a hypothetical analysis may be difficult and sometimes unnecessary.¹⁵⁰ Williams J in the *Carter Holt* High Court decision had not expressly employed the counterfactual test, and stressed that a 'practical and common sense' approach suggested Carter Holt's actions amounted to use of a dominant position.¹⁵¹

On appeal, a narrow three-to-two majority of the Privy Council overruled both the High Court and the unanimous decision of the Court of Appeal. The majority again stressed the need for the counterfactual test and the importance of the causal connection between dominance and anti-competitive conduct

¹⁴⁶ Ibid at 14; *Commerce Commission v Telecom (0867)* (SC), above n 84, at [1].

¹⁴⁷ Michael Pickford "Merger regulation in New Zealand: Did the change from dominance to a substantial lessening of competition make a difference?" (2011) 19 CCLJ 1 at 15-16.

¹⁴⁸ Carter Holt were found to be dominant in the insulation market and were offering a 2-for-1 deal on wool insulation to combat the success of a regional competitor, New Wool Products (NWP). See *Carter Holt Harvey* (PC), above n 70, at [3] – [4]. Merely cutting prices is not anti-competitive 'predatory pricing' per se, and in fact provides benefits for consumers (see *Carter Holt Harvey* (PC), above n 70, at [60]).

¹⁴⁹ *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* (2001) 10 TCLR 247 (CA) at [72]–[77].

¹⁵⁰ *Carter Holt Harvey* (CA), above n 149, at [72]; *Melway*, above n 10, at [109]; *Telecom Corporation of New Zealand Ltd v Commerce Commission* (2001) 10 TCLR 182 at [19]–[20].

¹⁵¹ *Carter Holt Harvey* (CA), above n 149, at [77].

expressed in the wording of the section.¹⁵² Certainty was again identified as key in defining the judicial approach. The Court also reaffirmed that dominant firms have no additional duty to act reasonably, are entitled to compete on price and quality, and should not be forced to ‘stand idly by’ in the face of competition.¹⁵³ This is sensible, as a firm which develops market power and competes well by meeting customer demand incentivises entrepreneurship to a certain extent. Additionally, both the Privy Council and the High Court of Australia affirm that actions to protect or maintain dominance are acceptable, as long as market power is not relied on to do so.¹⁵⁴ It should also be noted that the Board found in terms of competition law that a reduction in prices even below the cost of production (as was the case in *Carter Holt*) is not anti-competitive use under section 36. It still requires elimination of competitors and recoupment.¹⁵⁵ Invariably, this approach would require litigation only after subsequent price rises (presumably by the Commerce Commission), given the inability of the Courts to police potential recoupment.

Baroness Hale and Lord Scott were not as convinced of the efficacy of the counterfactual approach. The Minority expressed concerns about the test which, they pointed out, was not a requirement of the statute but a judicially constructed tool.¹⁵⁶ Their Lordships major concern focussed on the potential for failing to assign the correct attributes to participants in the hypothetical analysis, and they also questioned how the behaviour of a hypothetical participant should be assessed.¹⁵⁷ The Minority’s view was that the counterfactual analysis was ‘highly unreal’ and that a causal connection could be established by looking at the economic realities and impacts of the dominant firm’s actions. In short, their Lordships simply suggested asking the statutory question.¹⁵⁸ Nevertheless the decision of the Majority showed that demands for certainty, and fears of stifling

¹⁵² Ibid at [51], [56]-[57], [60].

¹⁵³ Ibid at [8], [23]-[24]. See also [62]-[64] where the European special responsibility doctrine is again rejected as having no application in New Zealand.

¹⁵⁴ Ibid at [66], *Rural Press Ltd v Australian Competition and Consumer Commission* [2003] HCA 75; 216 CLR 53; 203 ALR 217 at [51].

¹⁵⁵ *Carter Holt Harvey* (PC), above n 70, at [60]. Recoupment was defined as the subsequent raising of prices without fear of reprisal from competitors in the marketplace.

¹⁵⁶ Ibid at [78] per Lord Scott and Baroness Hale.

¹⁵⁷ Ibid.

¹⁵⁸ Ibid at [81]-[82].

legitimate actions of dominant participants, again tipped the balance in favour of a strict counterfactual test.

3.3 Australian approaches: The ‘materially facilitated’ test

Doubts remained, particularly after the decision in *Carter Holt*, that the strict counterfactual analysis favoured by the Privy Council remained divorced from market reality in allowing dominant participant to act ‘just like any other firm’ (especially firms such as Telecom, who obtained market power essentially by default). In *Carter Holt* the obviously anti-competitive behaviour certainly could have been possible in a competitive market, but it was almost certainly Carter Holt’s dominance and its subsequent economies of scale which enabled the firm to act as they did. These concerns led to a consideration of the Australian approaches to misuse of market power. The majority of the Australian High Court had followed a similar approach to the strict Privy Council counterfactual test in *Queensland Wire*, pointing out the object of section 46 was to protect the interests of consumers and to allow firms to compete on their merits.¹⁵⁹ However, developments in *Melway* suggested that such a strict ‘but for’ causation test need not always be required. Here the Australian High Court followed Dawson J’s suggestion in *Queensland Wire* that market power could be taken advantage of (or ‘used’) ‘where a firm does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power’.¹⁶⁰ This makes a finding of misuse of market power more likely, and involves a different counterfactual consideration. Instead this test affirms that even if a participant could have acted the same way in a competitive market, they would still be in contravention of the provision if their dominance materially enabled the behaviour in question.¹⁶¹ Had this approach been adopted in New Zealand, it is likely that *Carter Holt* at least, and possibly *Clear*, would have been decided differently.

¹⁵⁹ *Queensland Wire*, above n 8, at 191-192.

¹⁶⁰ *Melway*, above n 10, at [51].

¹⁶¹ Note that the High Court of Australia later affirmed in *Rural Press*, above n 154, at [52] that the correct question remains what a firm *could* do, not what they *would* do, given a hypothetical competitive market.

Kirby J criticised the majority decision, stating that the Act should not be given a narrow interpretation that defeats its effectiveness and that it was ‘sufficient to compare what occurred with patterns of commercial behaviour that could be expected in competitive markets’.¹⁶² However this type of ‘direct observation’ approach, similar to that of Deane J in *Queensland Wire*, failed to impress the majority.¹⁶³

In the face of disagreement amongst the judiciary in New Zealand, and with alternative (and potentially wider) interpretations available in the Australian approach, the decision whether to maintain the narrow counterfactual test the Privy Council had adopted in *Clear* was by no means incontrovertible. Critics suggested the test was artificial, did not promote efficiency, and that it was wrong to assume monopolists were entitled to compete in the same manner as small firms.¹⁶⁴ Eventually, interconnection disputes in the telecommunications sector provided the Supreme Court with the opportunity for clarification.

3.4 The ‘0867’ case: the triumph of the counterfactual test?

In the *0867* case, the Supreme Court had the opportunity to vary the existing narrow precedent, or at the very least to align the approach with that of Australian law. The issue arose from the substantial expansion of residential internet ‘dial-up’ usage in the late 1990s, which increased demand on Telecom’s local PSTN network.¹⁶⁵ As Telecom was restricted from increasing local call rates by the KSO, they resorted to the ‘0867 package’.¹⁶⁶ This package

¹⁶² Ibid at [134], [139].

¹⁶³ *Queensland Wire*, above n 8, at 197-198.

¹⁶⁴ Ahdar “Monopolisation quagmire”, above n 17, at 272.

¹⁶⁵ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [6]-[7]. These calls were generally long in duration and overwhelmingly originated from residential customers and terminated with Internet Service Providers (‘ISPs’). As Clear had the majority of ISP providers at that time, the terms of the 1996 Interconnection Agreement (ICA) between Clear and Telecom meant substantial termination charges were incurred by Telecom. Clear in turn kept its charges low or free, and shared the termination fees provided by Telecom with its ISPs. This further increased congestion across the network as more retail customers accessed the internet for free or at favourable rates.

¹⁶⁶ The 0867 package essentially proceeded on the basis that internet calls were not considered to be ‘free local calls’ for the purposes of the KSO. Telecom also claimed calls from these numbers were outside the terms of the ICA, and did not incur termination charges. Furthermore, Telecom customers who did not join the 0867 plan (or were not customers of Telecom-hosted ISPs) were charged two cents per minute for any internet calls after an initial 10 hours free per month (see *Commerce Commission v Telecom (0867)*(SC), above n 84, at [8]).

encouraged ISPs to migrate from Clear's network to Telecom's, and reduced the termination charges payable by Telecom. It also arguably allowed for the legitimate better management of usage flows across the PSTN, although the Commerce Commission subsequently claimed that a substantive purpose behind Telecom's decision to introduce the package was to use its dominant position as a means of deterring competitive conduct.¹⁶⁷

The decisions in the High Court and the Court of Appeal directed themselves to the counterfactual test approved by the Privy Council in *Carter Holt* and *Clear*, although the Court of Appeal did so somewhat reservedly, pointing out the importance of harmonising New Zealand law with Australia and outlining the danger of applying this type of hypothetical test in complex circumstances.¹⁶⁸ The Supreme Court, despite the alternatives open to it, largely affirmed the existing approach. The Court again stressed the causation element stating a 'dominant firm may engage in competitive conduct, and may even have one of the proscribed purposes, provided it does not fall foul of s 36 by *using* its dominance for such a purpose.' It is important to note, however, that the Bench recognised the counterfactual test had proved 'controversial', presumably in its application in both *Clear* and *Carter Holt*, which suggests a lowering of the threshold for finding misuse was contemplated.¹⁶⁹ In reviewing the Australian cases of *Queensland Wire*, *Boral*, *Melway* and *Rural Press*, the Court pointed out that all these cases had adopted a 'comparative approach', and while in some cases direct observation may suffice over complex economic models, this does not suggest abandonment of the Privy Council's counterfactual exercise.¹⁷⁰ The Bench therefore rejected the submission that the Australian authorities represented alternatives to the counterfactual test, and stressed the lack of certainty that would result from adopting a variety of tests to decide what amounted to lawful competition.¹⁷¹ The possibility that there were different counterfactual tests available did not, it seems, amount to an alternative in the

¹⁶⁷ *Ibid* at [1].

¹⁶⁸ *Commerce Commission v Telecom Corporation of New Zealand Ltd* (2008) 8 NZBLC 102,239; (2008) 12 TCLR 168 (HC); *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338; (2009) 12 TCLR 457; [2010] NZCCLR 10 at [53]-[54].

¹⁶⁹ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [12]-[14], [31]. For the reference to controversy, see footnote 15.

¹⁷⁰ *Ibid*, at [17]-[24].

¹⁷¹ *Ibid* at [30].

eyes of the Court. In constructing a hypothetical market, the Court postulated a scenario in which at least one other non-dominant firm had its own PSTN, but in which the KSO and ICA obligations remained, and where a disproportionate number of ISPs existed on the second company's network.¹⁷² In finding against the Commission, the Court held that Telecom's position was unsustainable under the terms of the 1996 ICA, and that 'any firm acting competitively, whether dominant or not, would have taken steps to mitigate the loss by introducing a scheme analogous to the 0867 package.'¹⁷³

There were signs that the Supreme Court has nevertheless relaxed the narrow interpretation of the earlier Privy Council decisions, perhaps as part of the re-expressed desire for trans-Tasman harmonisation in commercial law, and its recognition of past difficulties in applying comparative analyses.¹⁷⁴ Of particular interest is the reference to *Melway* and an affirmation that 'use' may be found in dominance which enables or facilitates conduct to achieve an anti-competitive purpose. To put it in the Court's words 'market power gives some advantage if it makes easier – that is, materially facilitates – the conduct in issue'.¹⁷⁵ This apparent incorporation of the 'materially facilitated' test seemed to relax the requirements of the previous strict counterfactual analysis, although the Court moved away from the approach taken by the majority in *Rural Press*, by stating that deciding how a firm might act invariably involved a 'rational commercial judgment, and accordingly the test should be what the otherwise dominant firm *would*, rather than *could*, do in the hypothetical market' [emphasis added].¹⁷⁶ Adopting a commercial justification test alongside the materially facilitated approach almost certainly provides greater flexibility in the scope for monopolist firms to act, as long as this is not materially enabled by their market power or dominance.¹⁷⁷

¹⁷² Ibid at [39]-[41].

¹⁷³ Ibid at [49].

¹⁷⁴ Ibid at [31].

¹⁷⁵ Ibid at [14], [33].

¹⁷⁶ Ibid at [33]-[35]. Note also the similarities and the reference to the 'business rationale' approach from *Boral* discussed at [26].

¹⁷⁷ Oliver Meech "'Taking advantage' of market power" [2010] NZLJ 389 at 391.

Just how much flexibility the Supreme Court has imparted on the test remains to be seen. In Telecom's case the Court felt that the loss of profits, even in a competitive market, would have outweighed the potential loss of customers to a rival network had the 0867 package been adopted. Perhaps more contentiously, the Court found that the overwhelming dominance Telecom had in the residential retail market did not materially facilitate this conduct (in terms of offset these potential losses). Some commentators have argued this adjustment in approach is significant, and the Court's own reference to controversy in earlier decisions seems to point to these cases being decided differently today.¹⁷⁸ The original *Clear* case provides a useful example here. For example, in a hypothetically competitive market it is questionable whether monopoly rents would be sustainable. Instead, it is possible that a monopoly over the PSTN materially facilitated the imposing of these charges, and as a matter of commercial common sense it is doubtful that Telecom would have imposed an ECPR model if there was a competitive PSTN available alongside its own.

Questions over the workability of the old narrow counterfactual test are nevertheless tempered by a reaffirmation of the approach by the Supreme Court, at least in principle, and their reluctance to find Telecom's dominance had materially facilitated their actions in the *0867* case.¹⁷⁹ The Deputy Chair of the Commerce Commission has suggested it may be speculative to believe the Court did in fact intend to soften the counterfactual approach.¹⁸⁰ Additionally Dr Mark Berry, the Commerce Commission Chair, has rejected the possibility of the Commission developing section 36 guidelines now that the counterfactual test remains the 'sole determinative approach' to deciding unlawful use of market power.¹⁸¹ Just how much, if at all, the approach of the Courts has changed may

¹⁷⁸ See John Land and Sam Hiebendaal "Misuse of Market Power - Section 36: How the Telecom 0867 Case Has Clarified The Law" (Paper delivered to Competition Law and Regulatory Review Conference, Wellington, 14 February 2011) at 4.4.

¹⁷⁹ *Commerce Commission v Telecom (0867)* (SC), above n 84, at [34].

¹⁸⁰ *Ibid* at [31]; Susan Begg, Deputy Chair Commerce Commission, "Opening Remarks" (Speech to Competition Law and Regulatory Review Conference, Wellington, 14 February 2011).

¹⁸¹ Commerce Commission "Commission ends plans to draft enforcement guidelines on misuse of market power" (press release, 18 October 2010).

be clarified by the decision on *Telecom Corporation of New Zealand Limited v Commerce Commission*, currently before the Court of Appeal.¹⁸²

The *Data Tails* case represents one of the first successful applications of section 36 in the last two decades.¹⁸³ Essentially, this involved data transmission across the PSTN and the Digital Services Transport Network (DSTN) between December 1998 and late 2004.¹⁸⁴ The Court found Telecom had engaged in a ‘price squeeze’ was amounted to using market dominance for an (implied) anti-competitive purpose. In applying the counterfactual test the Court reaffirmed that ECPR was an appropriate pricing model, but here the charges exceeded even the ECPR and consequentially breached the Act.¹⁸⁵ The subsequent penalties against Telecom pursuant to section 80(1) of the Commerce Act were significant at \$12 million, with Rodney Hansen J providing a useful insight into the reasoning behind the quantum by identifying commercial gain, knowledge, duration and deliberate nature of the conduct among the key factors.¹⁸⁶

Interestingly, Rodney Hansen J affirmed that while no essential facilities doctrine or statutory obligation existed for Telecom to provide access to the network, *Queensland Wire* and the Privy Council in *Clear* had established ‘the existence of a duty on a vertically integrated incumbent to supply an essential wholesale input to a competitor in a downstream market’.¹⁸⁷ This is despite the Privy Council in *Clear* warning against inferring a duty where existing regulatory regimes were in place.¹⁸⁸ While there has been recent High Court support for this approach in *Bay of Plenty Electricity* (see 1.3), the Court of

¹⁸² *Telecom Corporation of New Zealand Limited And Anor v Commerce Commission* CA313/2011, awaiting judgment.

¹⁸³ Troy Pilkington, Sarah Keene and Andrew Peterson "High Court ruling: Rumours of section 36's demise greatly exaggerated?" (2009) Russell McVeagh <www.russellmcveagh.com> at 1.

¹⁸⁴ *Commerce Commission v Telecom* [Data Tails], above n 85, at [3], [13]-[15], [20]-[28]. Competitors such as Clear and Telstra Saturn Limited (‘Telstra’) had developed their own backbone networks and components in major cities. But as Telecommunications Service Providers (‘TSPs’) looking to compete in the retail market for end-to-end high speed data transmission services, they depended on access to Telecom's network in non-major CBD areas. In 1999 Telecom introduced a new retail pricing known as Streamline with significant lower prices, but did not extend these savings to the wholesale market which in some cases resulted in prices above that of retail customers.

¹⁸⁵ *Ibid* at [43]-[46], [59]-[60], [151].

¹⁸⁶ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2011] NZCCLR 19 [Data Tails Penalties] at [49]-[59].

¹⁸⁷ *Commerce Commission v Telecom* [Data Tails], above n 85, at [127].

¹⁸⁸ *Telecom v Clear* (PC), above n 15, at 155.

Appeal decision in the *Data Tails* case may yet shed more light on whether this duty will be applied in the future.

Establishing a workable test for section 36 has been far from easy. Attempts to align the approach in New Zealand to that of the Australian courts and to adopt a practical, common-sense application have been only partially successful. The counterfactual test, although relabelled as a ‘comparative analysis’ and potentially relaxed by the Supreme Court, remains extremely complicated and, at times, unreal. For example, in establishing a counterfactual market in the *0867* case, the courts confirmed that such a market would have at least two PSTNs, but would still contain the extant KSO and ICA. It is hard to see how either of these arrangements would have existed, at least in the form they did, had there been two networks. Additionally the ‘materially facilitated’ test, while supposedly lowering the threshold, hardly reduces the complexity of analysis, adding a secondary consideration to what is already a nuanced and obscure exercise in establishing use of market power.

One must question whether the approach in the Courts has led to ‘workable and effective competition’, although the new hypothetical test may provide more scope to punish anti-competitive behaviour, and the *Data Tails* case at least confirms the ECPR model provides an upper limit on what can be lawfully charged for interconnection. Direct observation or flexible ‘matter of fact and degree’ decisions based on the circumstances have largely been set aside.¹⁸⁹ In truth, it is not entirely surprising that a narrow test has been applied. Regardless of the degree of judicial discretion allowed by the statute, the legislature must consider what the courts can effectively adjudicate, particularly where solutions require ongoing monitoring to implement, or if deciding on what amounts to lawful behaviour becomes a policy decision left undefined within the legislation. Too great a focus on underlying competition law concerns may overlook these important practical considerations.

¹⁸⁹ For examples of this approach see *Magic Millions*, above n 76, at 746-747; *Tru Tone*, above n 7, at 358.

CHAPTER FOUR: THE LIMITS OF ADJUDICATION WITHIN THE LIGHT-HANDED TELECOMMUNICATIONS REGIME

4.1 *The function of the courts*

Much of the criticism levelled at the application of section 36 of the Commerce Act is that, despite years and millions of dollars spent in protracted litigation, the outcomes of cases such as *Clear* remain oddly ineffectual.¹⁹⁰ The Courts themselves are fully aware of this problem, with the Privy Council in *Clear* stating:¹⁹¹

The board would echo the sentiments of the Courts below as to the sterility of these proceedings which, having been pursued right through the appeal procedure, still do not determine the terms on which Clear's local service is to be connected to Telecom's network.

What then is stopping the Courts from adopting a low threshold, 'calling out' anti-competitiveness when they see it, and correcting breaches accordingly? The answer is essentially two-fold. Primarily, as we have seen, the legislation and underlying precedent of competition law dictate the approach of the Courts to a certain extent. Second, and just as importantly, the structure of the judicial system places practical limits on how well courts can effectively adjudicate, especially when dealing with certain types of disputes such as those within the complex and evolving telecommunications industry.

Lon Fuller considered the kinds of social tasks that can be properly assigned to the Courts as opposed to those which, by their intrinsic nature, are more suited to executive or managerial control.¹⁹² In particular, he suggested that administrative law falls into a category often unsuited for adjudicative determination, citing the tasks undertaken by the FCC as a specific example.¹⁹³ These decisions invariably involve what Fuller described as polycentric tasks; namely those in which apportioning one result has impacts on the disposition of all other associated tasks.¹⁹⁴ He identified polycentric tasks such as wage or

¹⁹⁰ Ahdar "Battles", above n 38, at 106.

¹⁹¹ *Telecom v Clear* (1994) (PC), above n 15, at 161.

¹⁹² Lon L. Fuller "The Forms and Limits of Adjudication" (1978) 92 HVL 353 at 354-355.

¹⁹³ *Ibid* at 355. The FCC, it will be remembered, is the specialist telecommunications regulator in the United States.

¹⁹⁴ *Ibid* at 394.

price setting are particularly problematic, given the difficulty courts face in keeping up with rapidly changing economic markets. He also believed that the judiciary, sitting independently across all social fields, may risk losing its impartiality and would be unsuited to taking into account the complex repercussions of these types of decisions on other sectors of society and the economy.¹⁹⁵ Naturally, Fuller recognised that polycentric elements exist in almost all decisions, and instead focused on identifying when these elements are significant enough to over-extend the proper limits of adjudication. This was, he believed, exacerbated when strict or literal interpretation of judicial precedent limits reformulations to deal with new problems.¹⁹⁶ Fuller suggested that strongly polycentric problems are best solved through contract or managerial direction; and warned that it is not the function of the Courts to create new aims or basic directives for society.¹⁹⁷ To quote Fuller directly, problems begin for the Court, ‘not when it lays down rules about contracting, but when it attempts to write contracts’.¹⁹⁸

Fuller’s approach has obvious relevance to the telecommunication industry and the role of the courts in implementing the ‘light-handed’ competition regulation adopted in the 1980s. Not only do interconnection disputes involving alternative pricing models exhibit strong polycentric traits, but as discussed in 1.2 the philosophical debates underlying competition law such as long versus short term consumer benefits, or the substantive merits of wealth transfer, can be subjective.¹⁹⁹ These are essentially policy decisions for Parliament to address, not the courts. Additionally, the judicial process is essentially reactive; it responds only to the small range of issues brought before the courts, and judges cannot address wider efficiency or welfare issues that are not pursued in litigation.²⁰⁰ The problems with this kind of piecemeal approach, in which not all interested parties have an opportunity to contribute, is further exacerbated by

¹⁹⁵ Ibid at 394.

¹⁹⁶ Ibid at 398.

¹⁹⁷ Ibid at 392. Note Fuller does not deny that the courts may have a significant role in discovering these directives within the law.

¹⁹⁸ Ibid at 404.

¹⁹⁹ Ahdar “Consumers”, above n 6, at 346.

²⁰⁰ Bronwyn Howell “Politics and the Pursuit of Telecommunications Sector Efficiency in New Zealand” (2009) 6(2) *Journal of Competition Law and Economics* 253 at 255.

the adversarial mentality developed by those who do participate in litigation within the sector.²⁰¹ Fuller, in another useful analogy, summed these problems up by stating ‘one cannot construct a bridge by conducting successive separate arguments concerning the proper angle for every pair of intersecting girders. One must deal with the whole structure.’²⁰² In short, the courts are poor machinery for deciding social or economic policy.

4.2 Judicial rejection of the regulatory role

While the structure of competition law under the light-handed regime suggested an expanded, quasi-regulatory role for the courts within the telecommunications industry, there is ample evidence that the courts themselves recognised at least some of the limitations outlined above. As discussed at 2.4, the Privy Council in *Clear* rejected the judiciary’s role in policy development, and believed extending the scope of section 36 to produce a quasi-regulatory system already provided for by Part 4 of the Act ‘could be unjust and would be impracticable’.²⁰³ Similarly, in the Court of Appeal, Cooke P considered the difficulties faced by applying general competition law that did not distinguish between practical and impractical rules, especially in relation to interconnection. When considering the ECPR model for deciding interconnectivity price, his Honour pointed out the obvious difficulties in performing constant price reviews that would be required to calculate ongoing lost opportunities. He felt the adoption of such a system would result in a ‘vista of continual disputes or arbitrations’.²⁰⁴ In the High Court Ellis J, bearing in mind the complexity of the sector, also stated that if the ECPR model was adopted it would need a carefully designed administrative mechanism, including regular reviews through a qualified and independent third party.²⁰⁵ Additionally, the United States Supreme Court in *Verizon Communications Inc v Law Offices of Curtis V Trinko LLP*, approved Professor Areeda’s observation that:²⁰⁶

²⁰¹ Patterson “Regulation of Telecommunications”, above n 42, at 11-12.

²⁰² Fuller, above n 192, at 403.

²⁰³ *Telecom v Clear* (1994) (PC), above n 15, at 160.

²⁰⁴ *Clear v Telecom* (1993) (CA), above n 94, at 417.

²⁰⁵ *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* (1992) 27 NZIPR 481; (1992) 5 TCLR 166 (HC) at 213, 216.

²⁰⁶ *Verzion v Trinko*, above n 24, at 415.

No court should impose a duty to deal that it cannot explain or adequately and reasonably supervise. The problem should be deemed irremedia[ble] by antitrust law when [a ruling] requires the court to assume the day-to-day controls characteristic of a regulatory agency.

As these statements clearly show, problems exist for the courts not just when making policy decisions, but also when they are faced with having to implement policy, given their limited ability to perform ongoing managerial tasks.

In obvious cases of anti-competitive illegality, such as tying in *Port Nelson*, pricing above retail in *Data Tails*, or as in *Clear* when Telecom required its competitor to dial an access code for interconnection, there is little doubt the courts can identify section 36 breaches.²⁰⁷ However, there has been a robust rejection by the Privy Council that the courts should adopt the role of a price regulator. Given the wide number of different economic pricing models available to achieve antitrust goals, the most appropriate model for any particular context will depend upon factors specific to the industry and the nature of the access problem involved.²⁰⁸ Accordingly, adoption of any one model will invariably involve a policy decision relating to the allocation of economic resources; exactly the kind of decision discussed by Fuller as unsuited to the judicial process.²⁰⁹ The ECPR model, for example, while creating prices at the high end of the range, guarantees the incumbent existing profit margins (thus minimising resistance to entry) and also discourages inefficient entry into markets.²¹⁰ Bearing this in mind, it is understandable why the courts were willing to identify that an interconnection pricing scheme was legal, but refused to impose the price itself. They would have, in Fuller's words, ceased adjudication and begun the task of drafting the terms of agreement.

4.3 Weaknesses in the open-textured legislation

As discussed in Chapter One, the purpose of the light-handed regulatory regime was to provide cross-sector adjudication, while allowing the courts the discretion to deal with different anti-competitive problems as they arose. Ahdar

²⁰⁷ *Clear v Telecom* (1992) (HC), above n 205, at 218-219; *Port Nelson* (HC), above n 88, at 558; *Commerce Commission v Telecom* ('Data Tails'), above n 85, at [129]-[132].

²⁰⁸ *Treasury Regulation of Access*, above n 41, at 8.

²⁰⁹ Fuller, above n 192, at 400.

²¹⁰ *Gérardin Controlling Market Power*, above n 18, at 45.

suggests that because of this approach, a ‘bright-line test’ is largely impossible, and that a ‘know it when they see it’ methodology should be adopted by the courts, with large firms erring on the side of caution if they wish to avoid sanction.²¹¹ This approach has merit, as it would allow the courts to vary their approach according to whether the participant with market power has developed as a result of hardened competitive victories (consider *Carter Holt*) or whether they won essentially by default; for example, by taking over a previously exclusive state-owned natural monopoly.

What broad, open-textured legislation does not do, of course, is provide certainty. Nor does section 36 provide guidance to the courts on how to apply the law without falling into the pitfalls of legislating from the bench, or presiding over polycentric disputes. To avoid this, the judiciary have taken a narrow approach to finding anti-competitive behaviour. And yet, without this flexibility, section 36 does not seem particularly well equipped to deal with the complex problems of natural monopolies without forcing the judiciary into making business decisions. This is particularly the case in telecommunications, but is also apparent in other industries such as the electricity sector. In *NT Power Generation Pty Ltd v Power and Water Authority*, the Australian High Court questioned the ability of the Judiciary to make decisions in circumstances where they had limited involvement or expertise in particular commercial enterprises.²¹² Courts, of course, often deal with complex commercial issues, but there are limits to the specialist expertise they can bring to bear on a case. Even with a degree of specialisation on the Bench, and with the support of lay representatives with economic expertise, one cannot help but wonder whether an industry expert would be more suited to resolving many of the problems faced by the telecommunications sector.

In truth, while it is possible to view a narrow counterfactual test as merely favouring dominant firms, it is just as valid to argue that this approach is an attempt by the Courts to correctly limit their role to deciding only reasonably

²¹¹ Ahdar “Monopolisation quagmire”, above n 17, at 265; Ahdar “Unfulfilled promise”, above n 92, at 295-296.

²¹² *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 210 ALR 312; (2004) ATPR 42-021 (HCA) at [150].

clear cases of anti-competitive behaviour. If so, the Judiciary are not following a particular policy agenda or kow-towing to big business. They are instead delineating the boundaries of effective adjudication, and signalling to the Legislature that complex and policy-driven decisions must be left to Parliament.

4.4 Viable alternatives?

There are no easy solutions once one takes into account the language of the legislation, the underlying concerns surrounding certainty, and the difficulties of using the courts as quasi-regulatory body. Indeed, the list of alternatives grows thin. The light-handed approach of the Commerce Act did little to benefit competition within the telecommunications sector, although it certainly allowed Telecom to exploit its bargaining power, prolong negotiations, and limit the speed at which its competitors could enter the market.²¹³ One solution to this problem, suggested by Ahdar, is to develop alternative interpretations for ‘taking advantage of’ that move away from the current test. Among the alternatives suggested is a composite test in which, if the plaintiff shows anti-competitive effect and purpose, then the defendant must also show a plausible, benign reason for the conduct.²¹⁴ Ahdar’s alternatives generally support establishing lower thresholds, and a focus on benefits for consumers which echo the purpose of the Act. As we have seen, the courts have at different times also attempted to simplify this process, or apply a more practical approach to the requirements of the section. However these solutions still run the risk of invalidating hard but lawful competition. Nor do they properly address the problems associated with frequently drawing the courts into a regulatory role. Additionally, with the exception of the potential softening and apparent adoption of the ‘materially facilitated’ test, the Supreme Court has unanimously affirmed the continuing existence of a comparative, hypothetical approach. Logically, then, although one might criticise its approach, any viable alternative must come from outside the current options if it is to find favour from the Bench.

²¹³ See Malcolm Webb and Martyn Taylor "Light-Handed Regulation Of Telecommunications In New Zealand: Is Generic Competition Law Sufficient?" (1999) 2 Intl J of Telecommunications L and Policy 1 at 17.

²¹⁴ Ahdar “Unfulfilled promise”, above n 92, at 302-303.

Altering section 36 to clarify or change the existing approach remains a possibility. Here the two most workable options would be to follow Australia in codifying the materially facilitated test within the legislation, or to expressly adopt the ‘special responsibility’ doctrine which prevails in Europe. In Australia, the Trade Practices Legislation Amendment Act 2008 incorporated the materially facilitated test into the ‘taking advantage’ element.²¹⁵ Section 46(6A) also allows the court to consider whether conduct was ‘likely to have been engaged in’ if the corporation lacked market power.²¹⁶ This approach in New Zealand would provide more certainty, accord with current judicial thinking, and achieve the goal of trans-Tasman harmonisation of commercial law. But whether New Zealand competition law requires a lower threshold is questionable, especially considering our degree of market concentration. A blanket adjustment could easily stifle competition and embroil the Courts in complex and polycentric disputes once more. Additionally, Parliament itself seems uninterested in further adjustments in the immediate future, and no change to section 36 has been recommended in the latest draft Commerce Bill.²¹⁷

The special responsibility doctrine also has its problems. As discussed in 1.3, the doctrine was incorporated into European Union law by the Treaty of Rome.²¹⁸ This approach requires only that a firm have market dominance and a specified anti-competitive purpose to breach the Treaty. No ‘use’ of this power is required as explained by the European Court of Justice:²¹⁹

A finding that an undertaking has a dominant position is not in itself a recrimination but...the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition.

The adoption of a similar amendment in New Zealand would effectively remove the need for the counterfactual test, in the same way section 46(1AA) of the CCA in Australia has negated this element where predatory pricing occurs.²²⁰

²¹⁵ Competition and Consumer Act 2010 (Cth), s 46(6A).

²¹⁶ *Ibid.*

²¹⁷ Commerce (Cartels and Other Matters) Bill 2011 (Consultation draft).

²¹⁸ Treaty establishing the European Economic Community (opened for signature 25 March 1957, entered into force 1 January 1958) [Treaty of Rome], art 86.

²¹⁹ Case 322/81 *Michelin v EC Commission* [1983] ECR 3461 at 3511.

²²⁰ Competition and Consumer Act, above n 215, s 46(1AA).

While the courts have rejected this doctrine under the current legislation, Parliament could resolve this by legislative amendment relatively quickly. However the danger of removing the ‘take advantage of’ element, coupled with the ability to infer purpose, means the only remaining requirement would be a finding of market power. As discussed at 2.2, market definition remains a key factor in finding dominance or power. The Courts, if pressed once more into making regulatory decisions, may respond by defining markets widely as a means of raising the threshold in the face of this approach. And as the Australian High Court pointed out, too narrow or too broad an interpretation of market boundaries can distort the subsequent analysis of market power.²²¹ This is further complicated by the fact that market boundaries are not always clearly delineated, with some critics suggesting this process invariably involves an arbitrary judicial decision.²²² The danger of the legislative fix is that, in the end, the underlying problems remain.

It is tempting to espouse a complicated or radical alternative to the current section 36 interpretation that could theoretically erase the complexity and ineffectiveness of past approaches. The reality, however, is that what may look attractive in theory invariably faces the same difficulties of application. Similarly, legislative amendment to lower the threshold for unilateral indiscretions may create an easier test, but will not resolve the inevitable problem that the courts will be dragged into making business decisions, or worse, be forced to shape and implement economic policy. So while it may seem trite to espouse the virtues of the status quo, it is necessary to consider whether the decision to introduce heavier regulation into the telecommunications industry is, in fact, the almost inevitable resolution to these problems.

²²¹ *Queensland Wire*, above n8, at 195-196, 199-200.

²²² Sautet, above n 11, at 189.

CHAPTER FIVE: RE-REGULATION AND BEYOND

5.1 The Fletcher report and wider policy moves toward regulation

Long before the Supreme Court made its determination in 0867 Parliament realised that the light-handed regime was failing in the telecommunications sector. As discussed in 3.1, the 1995 Treasury report recognised that lack of progress in negotiations had been a barrier to competition, and that the delays had affected consumers in terms of sector innovation and efficiency.²²³ The uncertainty and delays within the industry throughout the 1990s resulted in reduced investment across the network, and by June 2001 Telecom still retained 96% of residential fixed line customers.²²⁴ It was hard to see how section 36, as enacted by the courts, was promoting the legislative objective of effective or workable competition.

The late 1990s saw a shift away from the light-handed approach in key sectors; a new Part 4A of the Commerce Act increased regulation in the electricity sector, along with the Electricity Industry Reform Act 1998 which included the structural separation of participants in the industry.²²⁵ In Australia, the introduction of TPA Part XIB had also established a specific telecommunications regulatory regime, aimed at facilitating competition through network access.²²⁶ The Australian Government had layered industry-specific legislation onto existing general competition laws, as Parliament believed these had proved insufficient in developing competition within the industry.²²⁷ In 2000, a ministerial inquiry into the telecommunications sector (the ‘Fletcher Report’) reviewed what a regulatory scheme would require to deliver ‘cost-efficient, timely, innovative telecommunications services’.²²⁸

²²³ Treasury *Regulation of Access*, above n 41, at 1, 10.

²²⁴ Gérardin *Controlling Market Power*, above n 18, at 150, 157.

²²⁵ Commerce Amendment Act (No 2) 2001 s 3; Electricity Industry Reform Act 1998, s 17.

²²⁶ See CCA, above n 53, Part XIB.

²²⁷ Matthew Berkahn "General and Industry Specific Regulation of Competition in the Telecommunications Industry" (2000) 5 Deakin L. Rev. 157 at 158-159.

²²⁸ Hugh Fletcher and others, *Ministerial Inquiry into Telecoms: Final Report* (2000) [Fletcher Report] at 1-5. While still favouring light regulation, the report recommended the appointment of a specialist Telecommunications Commissioner and the adoption of industry codes of practice. The report also proposed that specific and designated services be defined within the

5.2 The beginnings of re-regulation: the Telecommunications Act 2001

Many of the recommendations of the Fletcher Report were adopted by the Telecommunications Act 2001. Part One established the office and role of the Telecommunications Commissioner, and Parts Two and Three defined a specific telecommunications regulatory regime.²²⁹ The Act itself focussed on facilitating competition within the sector through improved access to networks.²³⁰ Section 3(1) identified the general purpose of the Act to ‘regulate the supply of telecommunications services’. However section 18(1) remains the key interpretive provision in terms of market power, identifying Part 2’s purpose ‘to promote competition in telecommunications markets for the long-term benefit of end-users’.²³¹ Section 18(2) also identified efficiency as a key factor in deciding whether an act or omission would result in these long-term benefits.²³² These provisions echo the wording of section 1A of the Commerce Act, although it is clear that a more specific regulatory regime was adopted to achieve this goal.

The Telecommunications Act established a number of areas including interconnection, resale of retail services, and number portability as designated services subject to regulation. Schedule 1 also outlined a specific interconnection pricing methodology to be adjudicated by the Commerce Commission. A right of appeal could be exercised, with the Telecommunications Commissioner able to undertake a more detailed pricing review.²³³ The old KSO was updated and incorporated into the Telecoms Service Obligations Deed (‘TSO’) by Part 3 of the Act, which included an enhanced monitoring scheme.²³⁴ Crucially, appeals to the courts on determinations by these regulatory bodies were possible only on questions of law (although the right to have a decision judicially reviewed remained

sector, and that these would be subject to determinations by the Commissioner should negotiations between participants fail.

²²⁹ Telecommunications Act 2001.

²³⁰ Cabinet Economic Development Committee *Outcome of the Implementation Review of the 2001 Telecommunications Act* (prepared for the Ministry of Economic Development 2005) at 1-2.

²³¹ Telecommunications Act 2001, ss 3(1), 18(1).

²³² *Ibid*, s 18(2).

²³³ *Ibid*, s 59A, sch 1.

²³⁴ *Ibid*.

unaffected).²³⁵ The Commerce Commission and the Telecommunications Commissioner were established as specialist industry adjudicators, while the Courts' role was specifically limited to purely legal issues. Clearly, this was an attempt to find some balance between the different roles normally occupied by specialist regulators and the Courts.

The strengthening of regulatory bodies reflects a convergence in best practice and a move towards a mixed model of both industry-specific and general competition law for New Zealand, aligning the country within similar regimes in the United States, the United Kingdom and Australia.²³⁶ But it also reveals a recognition that the existing legislation and adjudication by the Courts had failed to achieve workable competition, at least within the telecommunications sector. By expanding the role of the Commission, Parliament ensured bodies with greater technical knowledge could deal more effectively with complex disputes. These regulators also had the advantage of being able to apply industry-wide goals and proactively make determinations prior to problems being raised in litigation.²³⁷

5.3 The 'nuclear option': structural separation and later amendments

The developments under the 2001 Telecommunications Act initially lead to greater access to Telecom's network, with New Zealand ahead of Australia in terms of Digital Subscriber Line ('DSL') internet use up until 2002.²³⁸ However this growth stagnated in 2003-2004, and a 2005 review of the Telecommunications Act prepared for the Ministry of Economic Development ('MED') identified that the telecommunications market remained highly concentrated in 2004, with Telecom retaining over 65% of market share.²³⁹ In

²³⁵ Ibid, s 60.

²³⁶ Gérardin *Controlling Market Power*, above n 18, at 354-355.

²³⁷ Ibid, at 16; Commerce Commission *Annual Telecommunications Monitoring Report 2010* (2011) at 30.

²³⁸ Point Topic Ltd "New Zealand Broadband Overview" (2011) Point Topic <www.point-topic.com> at 1.

²³⁹ CECD *Review*, above n 230, at 9. Note that Telecoms overall market share includes mobile and cable access; networks with a greater degree of replication and competition. In broadband and telephone access services the effective concentration remained even higher.

comparison to OECD countries, fixed line access and call charges in New Zealand ranked 22nd out of 30 jurisdictions, while medium usage mobile telephone costs ranked last.²⁴⁰ In the face of concerns that overall performance remained poor and that arbitration remained expensive and ineffective, Parliament introduced the Telecommunications Amendment Act in 2006.²⁴¹

The new amendments empowered the Commission to set the terms and conditions of supply on an industry basis, rather than bi-laterally. It also introduced further unbundling measures for the local loop (which became a regulated service), and provided the Telecommunications Commissioner with tougher investigative and enforcement powers.²⁴² A new Part 2A also established the requirements for the operational separation of Telecom. The key purposes of this intrusive regulatory step were once again to promote long term benefits for end-users, but also to require transparency and non-discrimination of supply, and to facilitate investment in infrastructure and services.²⁴³ Structural separation, suggested in Australia and applied successfully in the United States, was implemented with a further amendment to the Act on June 2011.²⁴⁴ By dismembering Telecom into autonomous business units, it is hoped this will remove the natural monopoly element from the sector.²⁴⁵ It remains to be seen whether the amendments will achieve their stated goals, or merely transfer existing problems of market power to those of collusion to be dealt with under sections 27 and 30 of the Commerce Act. Whatever the outcome, the response to the ineffective 'light-handed' regime seems to have been recourse back to the stick of heavy regulation.

The structural separation of Telecom does not, however, completely answer the problems of market power within the sector when considered against the long-term benefits of consumers and improving competition. Separating the

²⁴⁰ Ibid, Appendix 1.

²⁴¹ Telecommunications Amendment Act (No 2) 2006.

²⁴² Ibid, ss 7, 11, 13. Unbundling allows other operators access to specific components on the incumbent's physical network such as the copper wires and local switches. In this way they are able to create their own networks alongside the existing infrastructure without unnecessary duplication. See Gérardin *Controlling Market Power*, above n 18, at 48-49.

²⁴³ Ibid, s 32; Telecommunications Act 2001, s 69A. Operational separation involved splitting Telecom into three business units, with the network access arm (Chorus) separated from the wholesale and retail units.

²⁴⁴ Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011, pt 2.

²⁴⁵ Ahdar "Battles", above n 38, at 114-115.

monopolistic and competitive segments of the incumbent may eliminate incentives for Telecom to discriminate in interconnection against its rivals, assuming there is sufficient regulatory oversight.²⁴⁶ However, there are drawbacks to this kind of heavy regulation, particularly in a small market like New Zealand. Such a move would reduce economies of scale, and it is debateable how many participants the sector the sector could sustain in unfettered competition.²⁴⁷ Additionally, breaking up Telecom's supply and retail arms may reduce economies of scope (that were important in supporting the KSO) and also limit the ability of end users to access a synergy of products in a 'one stop shop'.²⁴⁸ There is also the possibility of increased transaction costs, and the reality remains that the local access network remains a natural monopoly in the hands of Chorus.²⁴⁹ It may be that by removing discriminatory incentives, the Legislature is seeking to relax to the existing regulatory regime (as evidenced by the proposal of a 'regulatory holiday' relating to the UFB rollout), but such a move may be premature.²⁵⁰

A more effective mechanism for achieving the stated regulatory objectives lies in the unbundling of the local loop, particularly since the introduction of subsection 18(2A) to the Telecommunications Act.²⁵¹ This confirms that competition which provides long-term benefits to end users must have additional consideration of initiatives to innovate involving 'significant capital investment'.²⁵² Unbundling can avoid the unnecessary duplication of network components that will provide particular benefit to New Zealand with its high sunk costs and small retail markets. It will also facilitate entry into the sector, promoting further competition and innovation.²⁵³ While this will require continued regulatory oversight (with its associated administrative costs), the past

²⁴⁶ Gérardin *Controlling Market Power*, above n 18, at 59.

²⁴⁷ *Ibid.*

²⁴⁸ John Panzar and Robert Willig "Economies of Scope" (1981) 71(2) *American Economic Review* 268 at 268. Economies of scope lower the average cost of producing two or more products through savings in areas like distribution, branding and advertising.

²⁴⁹ Commerce Commission *Response to MED Discussion Document 'Regulatory Implications of Structural Separation'* (2010) at 3.

²⁵⁰ Letter from Telecom Users Association of NZ to MPs regarding Telecommunications (TSO Broadband and Other Matters) Amendment Bill (11 April 2011). The regulatory holiday concept is currently under review.

²⁵¹ Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011, s 7.

²⁵² Telecommunications Act 2001, s 18(2A).

²⁵³ Gérardin *Controlling Market Power*, above n 18, at 49.

experience of the ‘light-handed’ regime suggests there should be no rush to deregulate and recreate an environment in which participants may exchange regulatory contributions for heftier legal bills. There remains, of course, the concern that technical co-ordination required through unbundling may create incentives for operators to collude. However, should this happen, the underlying Commerce Act principles will once again apply.

Interconnection problems and disputes involving market power of the type outlined in the *Clear, 0867* and the *Data Tails* litigation are no longer resolved in the courts, at least in the first instance, as these now reflect designated services subject to determinations by the Commerce Commission.²⁵⁴ For example, in a dispute between TelstraClear and Telecom over wholesale bit-stream service, the Commission investigated the matter and issued a determination pursuant to section 27 of the Telecommunications Act. The price decided on was established at a retail rate minus 16%, which generally followed best practice and international benchmarks.²⁵⁵ While both parties initially lodged a request for review, a commercial agreement was reached prior to this on 13 January 2006.²⁵⁶ Similar decisions were made on the pricing of Unbundled Bitstream Service (‘UBS’) in 2006, and on unbundled sub-loop services in 2009.²⁵⁷ Number portability, another point of contention within the sector, was also resolved through the determination process and made available to all customers on 1 April 2007.²⁵⁸

As we have seen, the common objectives recognisable in both the Commerce and Telecommunications Acts are the promotion of competition for the long term benefit of consumers or end-users. In the telecommunications sector, the

²⁵⁴ *Commerce Commission v Telecom* (‘Data Tails’), above n 85, at [32]. Note that the *0867* and *Data Tails* litigation related to activities undertaken prior to regulation.

²⁵⁵ Commerce Commission *Determination on the TelstraClear Application for determination of designated access services (including Private Office Networking)* (Decision No 563, 9 December 2005) at [260].

²⁵⁶ Point Topic, above n 238, at 8.

²⁵⁷ Commerce Commission *Determination on the applications for determination for access to, and interconnection with, Telecom’s fixed PDN* (Decision 582, 22 June 2006); Commerce Commission *Standard Terms Determination for Telecom’s Sub-Loop Unbundled Copper Local Loop Network Services* (18 June 2009).

²⁵⁸ Commerce Commission *Determination on the multi-party application for determination of ‘local telephone number portability service’ and ‘cellular telephone number portability service’ designated multinetwork* (Decision 554, 3 August 2005).

success of the mixed approach within the Telecommunications Act over the protracted experience of the ‘light-handed’ regime is apparent. Sector reports produced as a requirement of the Telecommunications Act point to growth in competition, especially in broadband, with Telecom’s market share there falling below 60%.²⁵⁹ By 2010, Telecom’s overall share in industry revenue had dropped to 57%, and total investment in the telecommunication sector had increased from \$917 million in 2005/2006 to \$1.542 billion in 2009/2010.²⁶⁰ It is dangerous to suggest that the new legal and regulatory framework alone is to answer for these improvements in the face of technological developments, including the Ultra-fast Broadband (‘UFB’) Initiative.²⁶¹ Nevertheless the increased certainty, and a greater number of industry participants, has seen the sector revitalised after almost fifteen years of stagnation.

5.4 The continuing role of the courts

It has not been the purpose of this chapter to suggest the Judiciary have ceased to play any part in the adjudication of the telecommunications sector. In fact it is clear the courts maintain their role in enforcing obvious section 36 breaches (as discussed in 4.2). In the *Data Tails* decision, the High Court recognised that section 63 of the Telecommunications Act limited the role of the Courts in relation to regulatory determinations made by the Commerce Commission. However Rodney Hansen J also pointed out that Part 2 of the Commerce Act continues in an important supporting role by allowing the resolution of disputes where the regulatory regime is silent.²⁶² Key anti-competitive activities not directly addressed by the sector-specific legislation include collusive behaviour and mergers, which may assume greater importance after the process of Telecom’s structural separation is complete.

The Courts also provide an important avenue for ensuring regulatory accountability through the section 56 appeals process, and through the process

²⁵⁹ Commerce Commission *2007 Telecommunications Market Monitoring Report* (2008) at 5.

²⁶⁰ Commerce Commission *Annual Telecommunications Monitoring Report 2010* (2011) at 5-7.

²⁶¹ Jim Stevenson "Ultra fast changes: Recent broadband developments" (2011) Buddle Findlay <www.buddlefindlay.com>.

²⁶² *Commerce Commission v Telecom [Data Tails]*, above n 85, at [156]-[162]; Telecommunications Act, s 63.

of judicial review.²⁶³ This is important given the vulnerability regulatory bodies face from sector lobbying and political capture, particularly given section 19A of the Telecommunications Act requires the industry regulators to ‘have regard to any economic policies of the Government’.²⁶⁴ While the Judiciary cannot, of course, reject clear policy decisions from Parliament, they can provide important guidance in defining them, and ensuring rapid re-regulation is subject to effective legal analysis. The power of the Courts to decide whether the sector and its regulatory bodies are meeting their international obligations under the World Trade Organisation (‘WTO’) agreements on basic telecommunications will similarly remain unaffected.²⁶⁵

Finally, the ability of the courts to effectively adjudicate over problems within the telecommunications sector becomes infinitely more effective when specific legislation and initial determinations made by regulatory bodies provide clearer and more practical rules for the courts to apply.²⁶⁶ In this way, precedent can be developed more rapidly than on a case by case basis, and a more robust body of principles can be developed and brought within the rule of law.

²⁶³ See *Ihug Ltd & Anor v Telecom Corporation of New Zealand Ltd & Anor* HC, Wellington CIV-2006-485-001578, 20 September 2006, which involved an appeal against a Commission ruling, and *Vodafone New Zealand Ltd v Telecom New Zealand Ltd* HC, Wellington CIV-2008-485-002194, CIV-2008-485-002195, CIV-2008-485-002341, 1 April 2010, which involved a procedural judicial review over TSO contributions by Vodafone.

²⁶⁴ Telecommunications Act, s 19A(1); Treasury *Regulation of Access*, above n 41, at 6.

²⁶⁵ General Agreement on Trade in Services (opened for signature 15 April 1994, entered into force on 1 January 1995) (GATS), art XVIII. The treaty establishes modest requirements concerning access to and use of public basic telecommunications networks and services.

²⁶⁶ Fuller, above n 192, at 374; Gérardin *Controlling Market Power*, above n 18, at 156.

CONCLUSION

New Zealand's telecommunications sector has provided challenges for the implementation of competition law, given its degree of concentration in the hands of a vertically-integrated incumbent, and the problematic natural monopoly created by the PSTN. The introduction of the Commerce Act reflected a desire to encourage self-governance and to rely on the market to promote competition. This 'light-handed' approach largely failed. Clearly, part of the reason for this failure was the narrow approach the Courts adopted in deciding what amount to 'use' of dominance or market power within section 36

The purpose of this paper has been to point out that the decisions of the courts were not simply influenced by the underlying principles and precedents of competition law. It is clear that the often conflicting methods used to achieve the underlying antitrust goals of efficiency, certainty and protecting consumers have been important. Additionally, concerns over placing too low a threshold on misuse have influenced the judiciary's approach, even when these fears of stifling the actions of dominant firms led to decades of costly and time-consuming litigation. In the end, while the lower courts at times attempted to apply the section in a flexible manner, focussing on economic realities and the ordinary meaning of the words in the Commerce Act, these approaches were supplanted by the Privy Council's strict counterfactual test. Even accounting for the potential broadening of the approach by the later Supreme Court decision, the comparative approach remains relatively narrow. An obvious signal had been sent to the Legislature that clear direction would be required to change this interpretation.

While the case for dominant incumbents like Telecom may have been overstated, this was by no means the only reason the highest appellate courts resisted lowering the threshold of section 36 violations, despite legislative attempts to do so. The reasoning behind their approach also recognised that the courts were not particularly suited to adjudicating on matters of policy, or adopting the role of quasi-regulators within the telecommunications sector. This

realisation that the courts could not effectively micro-manage policy implementation within a complex industry was eventually acknowledged in the new regulatory regime established by the Telecommunications Act 2001. As a result of those changes, the current mix of general and sector specific rules, alongside the introduction of specialist regulatory bodies, has restored a degree of balance within the sector. Whether the more heavy-handed decisions to structurally separate Telecom and unbundle the PSTN will result in greater competition remains to be seen. Nevertheless, with complex issues such as interconnection left to the Commerce Commission and the Telecommunications Commissioner, the courts will be able to retain their role as adjudicators on matters of law. Empowered by the development of clearer industry rules under the new regime, the judiciary will also be able to maintain its role in addressing obvious anti-competitive breaches of the Commerce Act.

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