

## THE 0867 CASE - DEATH KNELL OF THE COUNTERFACTUAL?

Sarah Keene, Victoria Irwin and Andrew Fincham, Russell McVeagh<sup>1</sup>

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***The price which society pays for the law of competition, like the price it pays for cheap comforts and luxuries, is great; but the advantages of this law are also greater still than its cost / for it is to this law that we owe our wonderful material development, which brings improved conditions in its train. But, whether the law be benign or not, we must say of it: It is here; we cannot evade it; no substitutes for it have been found; and while the law may be sometimes hard for the individual, it is best for the race, because it ensures the survival of the fittest in every department.***

Andrew Carnegie (1835 - 1919). Scottish-born American industrialist and philanthropist

***The successful competitor, having been urged to compete, must not be turned upon when he wins.***

Judge Hand, *United States v Aluminium C. of America*, 148 F.2<sup>nd</sup> 416 (2d Cir. 1945), at 430.

### MISUSE OF MARKET POWER - A JURISPRUDENCE IN TURMOIL

Misuse of market power is not a new concept. It has been part of competition law jurisprudence since the enactment of §2 of the Sherman Act in 1890. Yet recent developments show that regulators and courts are still struggling to set appropriate parameters for enforcement of this second limb of competition policy. Indeed, the tension in its application is as old as the rule itself.

#### United States

In 2008, the Department of Justice ("DOJ") issued a 200 page report providing administrative guidance on §2 ("**US DOJ Report**").<sup>2</sup> The introduction set out the importance of §2 of the Sherman Act to anti-trust policy in the US, and the lengths the DOJ had gone to in order to provide clear, objective, effective and administrable guidance in respect of §2 enforcement:<sup>3</sup>

The U.S. antitrust laws reflect a national commitment to the use of free markets to allocate resources efficiently and to spur the innovation that is the principal source of economic growth. **Section 2 of the Sherman Act plays a unique role in U.S. antitrust law by prohibiting single-firm conduct that undermines the competitive process** and thereby enables a firm to acquire, credibly threaten to acquire, or maintain monopoly power.

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<sup>2</sup> Department of Justice *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) < <http://www.justice.gov/atr/public/reports/236681.pdf>> (17 February 2010).

<sup>3</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) vii < <http://www.justice.gov/atr/public/reports/236681.pdf>> (17 February 2010).

Competition and consumers are best served if section 2 standards are sound, clear, objective, effective, and administrable. **After more than a century of evolution, section 2 standards have not entirely achieved these goals, and there has been a vigorous debate about the proper standards for evaluating unilateral conduct under section 2.**

The DOJ and FTC held hearings over a year, including 29 panels, involving academics, businesspeople and antitrust practitioners. The DOJ Report incorporated their views, extensive scholarly commentary, and the jurisprudence of the Supreme Court and lower courts.

Yet on 11 May 2009, with a change in government, the DOJ issued a media release in which Christine A. Varney, Assistant Attorney General in charge of the Department's Antitrust Division advised:<sup>4</sup>

...the Department is withdrawing, effective immediately, a report relating to monopolization offenses under the antitrust laws that was issued in September 2008. As of today, the Section 2 report will no longer be Department of Justice policy. Consumers, businesses, courts and antitrust practitioners should not rely on it as Department of Justice antitrust enforcement policy.

**The report, "Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act," raised too many hurdles to government antitrust enforcement and favored extreme caution and the development of safe harbors for certain conduct within reach of Section 2, Varney said.** Varney announced the withdrawal of the report today at a speech at the Center for American Progress.

"Withdrawing the Section 2 report is a shift in philosophy and the clearest way to let everyone know that the Antitrust Division will be aggressively pursuing cases where monopolists try to use their dominance in the marketplace to stifle competition and harm consumers," said Varney. "The Division will return to tried and true case law and Supreme Court precedent in enforcing the antitrust laws."

Although the DOJ Report is now withdrawn, so its conclusions as to the DOJ's approach are no longer valid, the Report remains a useful summary of the US law relating to misuse of market power, and of the issues raised with its application.

## Australia

After a (now notorious) meeting in a pub in Birdsville, in which two senators sympathetic to the small business lobby agreed the appropriate amendments to s 46 of the Trade Practices Act 1978 ("**TPA**"), the Trade Practices Legislation Amendment Act (No. 1) 2007 (No. 159, 2007) (the "**Birdsville amendments**") was passed into law and commenced on 25 September 2007 in what seemed like record time for Australian legislation.

The Birdsville amendments resulted in the insertion of s 46(1AA). This new provision altered the existing test for predatory pricing, requiring only that a company have a substantial market share (not 'market power') for a sustained period when it priced below cost, and removing the requirement for a connection between market power and its 'misuse'.<sup>5</sup>

The amendments were not unanimously well-received in the competition community:

- Mallesons<sup>6</sup> and Minter Ellison<sup>7</sup> noted that the Act offered no guidance as to what constitutes a 'substantial share of a market', what will amount to a 'sustained period', or how to

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<sup>4</sup> Department of Justice, *Justice Department Withdraws Report on Antitrust Monopoly Law* 11 May 2009 <<http://www.justice.gov/opa/pr/2009/May/09-at-459.html>> (17 February 2010).

<sup>5</sup> CCH *Trade Practices, Consumer and Contract Law* [5-570].

<sup>6</sup> Mallesons Stephen Jacques *Parliament poised to amend Section 46 to prohibit predatory pricing* 14 September 2007 <<http://www.mallesons.com/publications/2007/Sep/9106862W.htm>> (17 February 2010).

determine whether a price is 'less than the relevant cost to the corporation'. This lack of definition may deter corporations from meeting competition, for example matching low cost imports or new entrants with more cost-efficient, innovative processes and products. Mallesons<sup>8</sup> also noted that the new test ignored the fundamental competition law principle that market share is not determinative of market power and risks deterring corporations from engaging in legitimate competitive conduct.

- The ACCC even commented that creating 'dual' prohibitions against predatory pricing (s 46(1) and 46(1AA)) could give rise to 'considerable confusion' arising from application of these 'fundamentally different concepts' and that this uncertainty has the 'potential to dampen legitimate competitive behaviour'.<sup>9</sup>

The vocal objections to the Birdsville amendments gave rise to further proposals to amend s 46. Ultimately these were passed in the Trade Practices Legislation Amendment Act 2008 (No. 116, 2008) which commenced on 22 November 2008. The new amendment inserted:

- subsection (1AAA) - explaining that predatory pricing may breach s 46(1) even if the firm cannot recoup the losses incurred by it.
- Subsection (6A) - codifies case law to aid in interpreting 'take advantage of.'

However, although the original Bill initially proposed to remove 'substantial market share' from the subsection (1AA)<sup>10</sup> and explicitly provide that predatory pricing may breach s 46(1), rather than being a separate offence, the removal of subsection (1AA) was opposed and failed to pass into law. As a result there are now still two sections of the TPA which specifically address predatory pricing, one of which refers specifically to recoupment.<sup>11</sup>

## Europe

The European Commission issued as recently as 24 February 2009 its "Guidance on the Commission's enforcement priorities in applying Article 82 [now 102] of the EC Treaty to abusive exclusionary conduct by dominant undertakings" ("**EU Guidance**").<sup>12</sup> That Guidance is equally still in its 'bedding in' phase.

## THE NEW ZEALAND POSITION

In New Zealand, the previous Commission Chair expressed frustration with the Commission's ability to enforce s 36 along similar lines to that reflected in Varney's media release quoted above.

<sup>7</sup> Minter Ellison *The 'Birdsville Amendment' - A new prohibition on below-cost pricing* 11 December 2007 <<http://www.minterellison.com/public/connect/Internet/Home/Legal+Insights/Newsletters/Previous+Newsletters/A-C-The+Birdsville+Amendment>> (17 February 2010).

<sup>8</sup> Mallesons Stephen Jacques *Parliament poised to amend Section 46 to prohibit predatory pricing* 14 September 2007 <<http://www.mallesons.com/publications/2007/Sep/9106862W.htm>> (17 February 2010).

<sup>9</sup> Minter Ellison *Proposed amendments to Predatory Pricing an overstated significance?* 18 July 2008 <<http://www.minterellison.com/public/connect/Internet/Home/Legal+Insights/Newsletters/Previous+Newsletters/A-C-Proposed+amendments+to+Predatory+Pricing>> (17 February 2010).

<sup>10</sup> *ibid.*

<sup>11</sup> Blake Dawson *Amendments to the TPA - single figure pricing and misuse of market power* 14 November 2008 <[http://www.blakedawson.com/Templates/Publications/x\\_publication\\_content\\_page.aspx?id=53619](http://www.blakedawson.com/Templates/Publications/x_publication_content_page.aspx?id=53619)> (17 February 2010). Mallesons notes that they are not aware of any previous case under section 46 that failed due to a plaintiff's inability to show recoupment. Accordingly, it is questionable whether this change will have much impact upon section 46 actions. See Mallesons Stephen Jacques *Recent amendments made to misuse of market power* December 2008 <<http://www.mallesons.com/publications/update-combine.cfm?id=1565027>> (17 February 2010).

<sup>12</sup> European Commission *Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* Official Journal of the European Union C 45/7 (24 February 2009) <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>> (17 February 2010).

On 25 February 2009, the Commerce Commission issued a media release indicating its intention to review the enforcement of s 36, which outlined the concerns the Commission had with the operation of s 36.<sup>13</sup>

The Commerce Commission has commenced a review of the effectiveness of the enforcement framework for addressing allegations under section 36 of the Commerce Act that a firm has taken advantage of its market power.

...

**Commission Chair Paula Rebstock noted that** virtually all competition law regimes have similar provisions addressing prohibited unilateral or 'single-firm' conduct (known elsewhere as 'abuse of dominance' or 'monopolisation') and that **there is presently ongoing debate internationally regarding the appropriate scope and effective enforcement of such provisions.**

"If large firms are permitted to leverage their market power to limit competition, incentives to growth and innovation will be reduced and consumer welfare harmed. **The role of section 36 is particularly important in New Zealand because many of our markets are highly concentrated. We are therefore reviewing our recent performance in section 36 cases to see how it can be made more effective,**" said Ms Rebstock.

The expert panel appointed to advise the Commission on the review included the Right Honourable Thomas Gault DCNZM, Professor Sir John Vickers of Oxford University, formerly head of the UK's Office of Fair Trading, Professor Stephen Calkins of Wayne State University Law School, Peter Hinton of Simpson Grierson and Jim Farmer QC. The release advised that the Commission expected to complete its review in late 2009.

The Commission withdrew its review in October 2009.<sup>14</sup> Dr Mark Berry, Chairman of the Commission, indicated at the outset of this conference that the Commission would reconsider recommencing that review, once the Supreme Court has issued its decision, but that it did not consider it appropriate to be progressing it while still a litigant before the Court.

In the meantime, New Zealand practitioners and businesses affected by the application of s 36, as those in the US after withdrawal of the DOJ Report, must continue to look to the cases decided by the Courts and derive from those cases such principles of general application as may be appropriate.

Two such judgments were issued in 2009 in relation to the application of s 36 to Telecom.

The first, *Telecom Corporation of NZ Ltd v Commerce Commission*<sup>15</sup> referred to as the "0867 litigation" ("**0867**") was a decision of the Court of Appeal, upholding a High Court decision that Telecom had not misused its market power. The second was a High Court decision issued in October 2009,<sup>16</sup> in what is referred to as the "Data Tails litigation", in which the Court found Telecom had misused its market power. Both cases relate to conduct that occurred approximately a decade ago.

The Commission has appealed the 0867 decision. The Supreme Court granted leave to appeal and is expected to consider this year whether the Court of Appeal was right in the manner in which it applied the relevant s 36 test in the 0867 litigation later this year. Particularly in the context of so little (and in the case of the Australian legislation, so little coherent) guidance on the appropriate

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<sup>13</sup> Commerce Commission *Release no 102: Commerce Commission review of enforcement framework relating to single-firm conduct* (25 February 2009) <<http://www.comcom.govt.nz/BusinessCompetition/Anti-competitivePractices/commercecommissionreviewofenforcem.aspx>> (17 February 2010).

<sup>14</sup> Jenny Keown, *Berry backs off power probe*, (15 October 2009), Dominion Post.

<sup>15</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 ("**0867**").

<sup>16</sup> *Commerce Commission v Telecom Corporation of New Zealand* (9 October 2009) HC, Auckland, CIV-2004-404-1333 ("**Data tails**").

scope of the misuse of market power prohibition, the Supreme Court's decision will be of critical importance to many New Zealand businesses.

### THE 'COUNTERFACTUAL TEST' ON THE BLOCK: THE 0867 PROCEEDINGS

The 0867 case began in July 2000, when the Commission issued proceedings against Telecom Corporation of New Zealand Ltd ("**Telecom**"), claiming that the introduction of an access services plan constituted a use by Telecom of its dominant position for an anti-competitive purpose (the then-applicable prohibition under s 36 of the Commerce Act 1986, prior to its amendment in 2001). The Commission sought a declaration that this contravened s 36 of the Commerce Act, a pecuniary penalty, and costs.

The background facts to the case are complex. In essence the dispute arose out of Telecom and Clear's interconnection agreement ("**ICA**").<sup>17</sup> A 1996 ICA enabled Clear to provide local interconnections, as well as connections which bypassed Telecom's core network. Clear was, however, required to pay Telecom a higher rate per minute than Telecom was required to pay Clear for terminating access on Clear's network.

Calls are billed on the basis that the customer pays the network originating the call. Therefore, under the ICA, the network being used by the customer had to pay a per minute termination charge to the network used by the receiving customer. This arrangement did not account for a rapid increase in internet usage. Internet Service Provider ("**ISP**") traffic is all one way, in that a residential customer dials a call with an ISP, but nothing originates in the other direction. The calls are also typically longer than standard calls. Clear had very few residential customers, so if a customer was on Telecom's network, calling an ISP on Clear's network, termination fees were a lucrative source of revenue for Clear. Clear and other ISPs began to share the termination charge revenue paid by Telecom, and kept their ISP charges to customers low.

So in 1999, Telecom introduced an 0867 number for internet calls to address the massively increased load on Telecom's network, and the imbalance in fees paid by Telecom to Clear. Telecom introduced the 0867 service, under which carriers would not be paid termination fees for calls to those numbers, in order to counter the imbalance and encourage customers to "migrate" to the 0867 regime. Under the arrangement, residential customers could continue to obtain unlimited access to internet services by using the 0867 service, but if they chose not to, they would be charged two cents per minute after ten hours of use per month. Further, the charge did not apply to calls to the 0873 number used by Telecom's ISP, Xtra. Accordingly, residential customers who accessed internet services for more than 10 hours per month were incentivised either to use the 0867 scheme or Xtra. Carriers who did not enter the agreement with Telecom risked losing the ISPs on their network.

Clear considered that, in introducing the 0867 service, Telecom had abused its dominant position in the market in order to prevent Clear and others from engaging in competitive conduct, and took their concerns to the Commission. The Commission launched proceedings seeking pecuniary penalties against Telecom.

The High Court held that, although Telecom was dominant, its conduct was in fact pro-competitive and not an abuse of a dominant position.<sup>18</sup> The Commission appealed. The Court of Appeal dismissed the appeal. On 30 October 2009, the Supreme Court granted the Commission leave to appeal from the Court of Appeal decision, as to whether the Court of Appeal erred in:<sup>19</sup>

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<sup>17</sup> The commercial effect of the decision of the Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 had been to effectively approve Telecom's approach to charging Clear for access to its fixed network ("PSTN") and so allow Telecom to charge Clear far more for interconnection charges than Clear had hoped for.

<sup>18</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* (2008) 12 TCLR 168. Although the case was heard under the old "abuse of dominance" test, the High Court effectively found that the new "misuse of market power" test did not require a different analysis to answer the question of 'use' or 'abuse' of market power.

<sup>19</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZSC 113.

- applying a counterfactual test; and in
- consequently concluding that in introducing the 0867 service Telecom had not used a dominant position in the national retail market for fixed-line telephone services to residential customers and/or the national wholesale market for network access.

## WHAT IS THE COUNTERFACTUAL TEST?

In order to show a breach of s 36 of the Commerce Act, a plaintiff must prove:

- the defendant had a substantial degree of market power (or, prior to 2001, it was dominant);
- it 'took advantage' of that market power in engaging in the affected conduct (or, prior to 2001, it 'used' its dominant position); and
- the conduct was engaged in for one of the prohibited exclusionary purposes described in s 36.

In respect of the second, 'taking advantage', formerly 'use', element of that test, there have been two key Privy Council decisions. The first is the 1995 Privy Council decision in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd*<sup>20</sup> ("**Telecom v Clear**"). The second is *Commerce Commission v Carter Holt Harvey Building Products Group*<sup>21</sup> ("**CHH**"). In both cases the Privy Council found that, in determining whether a company with market power had 'used' its dominant position, the Court should apply the 'counterfactual test'. This involves asking whether the dominant company had acted in a way in which a person not in a dominant position in that market but otherwise in the same position would have acted.<sup>22</sup> The counterfactual therefore requires the Court to postulate a hypothetical business, which was not in a dominant position in that market but otherwise in the "same circumstances" as the company under investigation,<sup>23</sup> and ask itself how that company would have acted.

In the CHH case, both the High Court and Court of Appeal had not applied the counterfactual test to CHH's conduct. However, the majority of the Privy Council found:<sup>24</sup>

It is, as the Board said in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* at p 403, both **legitimate and necessary** when giving effect to s 36 to apply the counterfactual test to determine whether the defendant had used its position of dominance.

The counterfactual test has been applied in two other recent decisions of the High Court. In the first, *Commerce Commission v Bay of Plenty Electricity Ltd* ("**BOPE**"), the High Court referred to the fact that the only appropriate test for use and taking advantage was the counterfactual test<sup>25</sup> while recognising that application of that test is not always without difficulties.<sup>26</sup>

The Court considered that the question must be whether a firm with dominance and/ or a substantial degree of market power *could rationally*, in the sense that it could and could profitably – over a relevant time frame – engage in the impugned conduct if it did not possess that dominance or substantial market power.<sup>27</sup> The Court recognised that the counterfactual test, rather than any assessment of the extent of any anti-competitive effect, was the principal methodological tool to determine the questions of use/ taking advantage.<sup>28</sup>

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<sup>20</sup> *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385,403.

<sup>21</sup> *Carter Holt Harvey Building Products Group Limited v Commerce Commission* [2004] UKPC 37 ("**CHH**")

<sup>22</sup> *ibid* [9].

<sup>23</sup> *ibid* [77].

<sup>24</sup> *ibid* [60].

<sup>25</sup> *Commerce Commission v Bay of Plenty Electricity Ltd* (13 December 2007) HC, Wellington, CIV-2001-485-917, [305], [309].

<sup>26</sup> *ibid* [310].

<sup>27</sup> *ibid* [318].

<sup>28</sup> *ibid* [458].

Finally, and most recently, there is the *Data tails* decision. In that case, the Commission applied for declaratory relief and a pecuniary penalty against Telecom, alleging that it took advantage of its substantial market power, or used its dominant position, for an improper purpose in setting its prices to competitors for high speed data transmission services at an excessive level.<sup>29</sup> The Court applied the *Baumol-Willig Rule* (known as the "efficient component pricing rule" - "**ECPR**"), upheld by the Privy Council in *Telecom v Clear* and, carrying out its own ECPR calculation, concluded that Telecom had priced its services above competitive levels because it priced above ECPR. It was then a reasonably simple application of the Privy Council decision in *Telecom v Clear* for it to find that a company in Telecom's position, but without market power, would not set prices for data tails at above the ECPR.<sup>30</sup>

## WHY IS THE COUNTERFACTUAL TEST USED?

The decisions that support the use of the counterfactual test rely on the statutory language of the misuse of market power test. It is said that the requirement for a plaintiff to show "taking advantage" or "use" of market power requires consideration in every case of the **causal connection** between the market power and the alleged misuse.

For example, French J observed in *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Ltd* [1992] FCA 511, after referring to *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd*<sup>31</sup> ("**Queensland Wire**"):<sup>32</sup>

**It is... an essential element of a cause of action based upon s46 that the alleged contravener is said to have used its market power.** The conduct must either by necessary implication from its very nature or by reference to other pleaded facts and circumstances constitute a use of that power. It is not sufficient to show that a corporation with market power has engaged in conduct for the purpose of preventing entry of another person into a market or deterring or preventing a person from engaging in competitive conduct in that or any other market. An extreme example illustrates the point. If a corporation with substantial market power were to engage an arsonist to burn down its competitor's factory and thus deter or prevent its competitor from engaging in competitive activity, it would not thereby contravene s46. **There must be a causal connection between the conduct alleged and the market power pleaded such that it can be said that the conduct is a use of that power.**

So, too, the majority in the Privy Council in *CHH* observed that the word "use" under s 36 of the Act requires a causal relationship between the conduct alleged and the dominance or market power of the firm. The majority of the Board concluded that was the basis on which the counterfactual test is founded:<sup>33</sup>

If a dominant firm is acting as a non-dominant firm otherwise in the same position would have acted in a market which was competitive, it cannot be said to be using its dominance to achieve the purpose that is prohibited.

The use of counterfactual analysis to determine causation has intuitive appeal. As the Court of Appeal said in 0867, after hearing extensive argument on alternative formulations to the Privy Council's counterfactual test:<sup>34</sup>

For it is hard to see why in any exercise such as the present a court would not at least ask, in relatively straightforward terms: "What would have happened if the impugned firm was not dominant in the particular market?"

<sup>29</sup> *Data tails supra* note 15.

<sup>30</sup> *Commerce Commission v Telecom Corporation of New Zealand* (9 October 2009) HC, Auckland, CIV-2004-404-1333 [43].

<sup>31</sup> *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177

<sup>32</sup> *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Ltd* [1992] FCA 511 [17], per French J.

<sup>33</sup> *CHH* [52].

<sup>34</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 [55].

Counterfactual analyses have a pedigree outside the Commerce Act. They feature in the disciplines of social and cognitive psychology, linguistics, philosophy, medical research and economics, including the way in which counterfactuals affect economic and financial decisions, and the interpretation of economic models as counterfactual worlds.<sup>35</sup>

Some academics have identified factual causation as inherently a counterfactual test in that all statements about causality are essentially "counterfactual conditionals". The literature suggests the only exception to this (although this is disputed) may be the test of the "necessary element of a sufficient set" ("**NESS**").<sup>36</sup> Under the NESS test, there are two main enquiries:

1. What are the relevant sets of factors and occurrences which would have enabled the event to occur?
2. Is the relevant factor (eg market power) a *necessary* element in the set of relevant factors to an event occurring? (That is, would the event have occurred with the other factors in that set on their own without the relevant factor?)

If a company could, for example, raise prices without having market power, while market power may be *an* element of a sufficient set, it cannot be a *necessary* element of a sufficient set. Therefore, causation cannot be established. Under this theory, market power would not be a cause at fact and s 36 would not be breached.<sup>37</sup> As this description shows, the NESS test does not deliver a materially simpler, more relevant, or more intuitively appealing inquiry than a counterfactual analysis.

The Stanford Encyclopaedia of Philosophy describes the origins of counterfactual theories of causation in the analysis of J.S. Mill and the early empiricists in the mid 1800s, but notes that the true potential of the counterfactual approach to causation did not become clear until counterfactuals became better understood through the development of possible world semantics in the early 1970s, the best-known of the theories being that of David Lewis (1973).<sup>38</sup>

A recent study undertaken by the Department of Economics, University of Modena and Reggio Emilia, Italy considers more "natural" uses of counterfactual conditionals in considering economic concepts.<sup>39</sup> The paper reminds us that counterfactuals are a cognitive tool individuals use incessantly in everyday life for judgements, evaluations, and decisions. Indeed, even the moral requirement that a person "do unto others as you would have them do unto you", captured in the Bible, requires the postulation of a hypothetical where it is not you doing the action, but another person inflicting that action on you.

## WHAT ARE THE PROBLEMS WITH THE COUNTERFACTUAL TEST?

As the Privy Council observed in *CHH*, the key issue in use of the counterfactual test is that there is no guidance as to how to formulate the counterfactual, including which attributes of the dominant companies to keep, and which to exclude from the counterfactual formulation. "[T]he use by a dominant firm of its financial ability to cut prices must be distinguished from its use of its position of

<sup>35</sup> See C. A. Magini *MPRA Paper No 9304: Opportunity Cost, excess profit and counterfactual conditionals* 25 June 2008 <<http://mpr.ub.uni-muenchen.de/9304>> (17 February 2010) for a list of references.

<sup>36</sup> The NESS test is different to a "but for" test in which an action must be necessary to an outcome, in that the relevant factor need only be a necessary part of a set of conditions which work together to result in the particular outcome. For example, if two hunters independently but simultaneously shoot and kill a third person, it is clear that each should be held responsible for the death. Yet the but-for test might yield the conclusion that neither has caused the harm. Under the NESS test, both would independently be caught, as under the relevant sets of conditions, each hunter shot the third party sufficient to kill them.

<sup>37</sup> However, if it is only the combination of market power and rivals' increases in costs that make it possible to raise prices, then both the market power and rivals' cost increases are causes of the price increase, even if it is possible to imagine another set of factors not involving market power and rivals' cost increases, under which prices could have been increased. Accordingly, the causation test would be satisfied and s 36 breached. It is also relevant to note at this point that causation at law is a subset of causation of fact and should not be considered to capture the same breadth of conduct.

<sup>38</sup> Stanford Encyclopaedia of Philosophy *Counterfactual Theories of Causation* 30 March 2008 <<http://plato.stanford.edu/entries/causation-counterfactual/>> (17 February 2010).

<sup>39</sup> *ibid.*

dominance, the measure of which is its market power. The financial ability to cut prices is not market power."<sup>40</sup> However it is inescapable that in many, if not all, cases, the attributes chosen within the counterfactual will determine the end decision.

The problem of defining the counterfactual in a way that second-guesses the result of its application was identified by counsel for the Commission in 0867:<sup>41</sup>

Counsel for the Commission was critical of this formulation in this Court largely (though not exclusively) because he argues **that the counterfactual as thus constructed effectively defines away the problem.** The Privy Council had decreed that there be the same workable competitive market, save that there would be a nondominant Telecom. But as the Commission argues, the asymmetric and above cost termination payment regime in the 1996 ICA, Telecom's KSO obligations, and the disproportionate number of residential customers on Telecom's network compared with its competitors had led to a huge traffic imbalance. But all of these circumstances are said to be attributes of Telecom's *actual* dominant position, and if they are attributed to X (a non-dominant Telecom) then that company also has market power.

Mr Farmer's argument is, at heart that by definition what was constructed cannot be a competitive market. It assumes that no firm would be earning supranormal profits...

The question of how to select the attributes of the hypothetical competitor was also considered by the minority judges in *CHH*. What does the hypothetical competitor look like? Is it a financially prudent operator? Or an entrepreneurially minded operator, who could stand the loss of a few thousand dollars?<sup>42</sup> How are the attributes of the counterfactual comparator to be identified? The dissenting judges comment that the construction of an accurate counterfactual in this scenario was "highly unreal."<sup>43</sup> According to the minority, the difficulties in applying the counterfactual test to these facts were so acute that it was more appropriate simply to ask whether CHH had "used" its dominant position:<sup>44</sup>

How could a competitor who was not in a dominant position expect to protect the share of a favoured product in a competitive market by selling another product at a highly uncommercial price? The comparison seems to us, on the facts of the present case, wholly unreal. It seems to us, wholly preferable, simply to ask the statutory question. Did [CHH] use its dominant position?

Similarly, in 0867, the Court of Appeal struggled with the hypothetical:

The reality of the case is that it is about terminating charges which are markedly above cost and the willingness of Telecom, under threat of regulation, to share its monopoly rents with Clear. Any realistic counterfactual must take monopoly rents as a given. **It is difficult to see how there can be any plausible counterfactual about the distribution of monopoly rents where non-dominance has to be assumed: in the absence of dominance there can be no monopoly rents.**

However, this proposition appears to show a misunderstanding as, absent dominance, monopoly rents may still be imposed. For example, monopoly rents can be a component factor of ECPR pricing. A monopolist pricing above ECPR and facing a shadow firm about to make the investment to enter the market will attract that competitor to the market, whereas a monopolist pricing at ECPR, recovering the fixed costs of investments in its pricing, will not attract entry from the shadow firm.

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<sup>40</sup> CHH [60].

<sup>41</sup> 0867, [84].

<sup>42</sup> CHH [78].

<sup>43</sup> *ibid* [78] – [79].

<sup>44</sup> *ibid* [81] – [82].

Ultimately, however, the Court of Appeal found in favour of Telecom as it took the view that the Commission's case depended on the hypothetical Telecom giving undue weight to the potential loss of customers as a result of introducing the 0867 service.<sup>45</sup>

The issue is not what company X "would" or "should" have done. The issue is what it "could" rationally have done in this particular competitive market. The answer to that is not the expression of precise economic modelling or the production of a mathematical proof. Company X had to consider a number of factors, only one of which was the effect of a potential loss of customers.

[The Commission's case that] ...the potential loss of customers would necessarily and inevitably have outweighed the other matters at issue is a very long bow indeed. We would have thought that it would have to be demonstrated that there was highly likely to be a very significant loss of customers for that factor to become ascendant.

Potential pitfalls in the regulator asserting that only the courses of action that it retrospectively regards as profit-maximising are legitimate, in order to draw an inference that any other conduct must be abusive, have been echoed in the comments of US DOJ Report in evaluating the "no economic sense" test as a general standard under §2 of the Sherman Act.<sup>46</sup>

No defendant should be required to show that it maximised profits among all conceivable choices. Hinging antitrust liability on such second guessing raises serious concerns that such a standard would undermine rather than promote the goal of economic growth and increased consumer welfare.

## WHAT ARE THE ALTERNATIVES?

### Australian tests

In 0867, the Commission's case before the Court of Appeal was that:<sup>47</sup>

**...Mr Farmer's essential proposition is that unlike the Privy Council, the High Court of Australia has not regarded the counterfactual as the sole test of use.** He suggested that given the difficulties of application, and perhaps even appropriateness in some cases, it is not always necessary to apply it. Courts can and should instead have regard to at least two other approaches: the direct observation approach suggested by Deane J in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, which was referred to with approval in *Melway*, and the "materially facilitated" approach which was referred to in *Melway* (at [51]). See also *Rural Press Ltd v Australian Competition and Consumer Commission* (2003) 216 CLR 53; *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90; and *Pacific National (ACT) Ltd v Queensland Rail* [2006] FCA 91.

In its decision, the Court of Appeal noted the disparity that would occur where Australian and New Zealand law were to be on different footings on the counterfactual issue; it left the issue for determination by the Supreme Court.<sup>48</sup>

As outlined briefly above, the Trade Practices Legislation Amendment Act 2008 (No. 116, 2008) which commenced 22 November 2008 inserted a new subsection (6A) which codifies the pre-existing judicial reasoning on the taking advantage element.<sup>49</sup> It sets out four matters to which the court may have regard in determining whether a corporation has taken advantage of its market power under s 46(1). Subsection 6A now provides:

<sup>45</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338, [98].

<sup>46</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 42 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

<sup>47</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 [53].

<sup>48</sup> *ibid* [54].

<sup>49</sup> CCH *Trade Practices, Consumer and Contract Law* [5-015].

(6A) In determining for the purposes of this section whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:

- (a) whether the conduct was **materially facilitated** by the corporation's substantial degree of power in the market;
- (b) whether the corporation engaged in the conduct **in reliance on** its substantial degree of power in the market;
- (c) whether it is likely that the corporation **would have** engaged in the conduct if it did not have a substantial degree of power in the market;
- (d) whether the conduct is **otherwise related** to the corporation's substantial degree of power in the market.

This subsection does not limit the matters to which the court may have regard.

To consider the extent to which these tests depart from the test applied in New Zealand, it is worth looking briefly at the case law history from which they are derived.

### ***The "materially facilitated" test***

The 'materially facilitated' test is derived from the decision of the Australian High Court in *Melway Publishing v Hicks ("Melway")*.<sup>50</sup> Under this test it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power.<sup>51</sup> The Court accepted a submission made by the ACCC that:<sup>52</sup>

Dawson J's conclusion that BHP's refusal to supply ... was made possible only by the absence of competitive conditions **does not exclude the possibility that, in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power.** To that extent one may accept the submission made by the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had **made it easier for the corporation to act** for the proscribed purpose **than would otherwise be the case.**

It went on to say:<sup>53</sup>

Merkel J, and the majority in the Full Court, following the example given in *Queensland Wire* asked themselves whether, in a competitive environment, without its market power, Melway would have been compelled, in a practical sense, to supply to the respondent, and answered the question in the affirmative. [Kirby J agreed with this conclusion] ...

In particular, the appellant contends that the reasoning was based on an erroneous view of the assumptions s46 required to be made for the exercise. ... the hypothesis that Melway lacks a substantial degree of power in a market does not require the assumption that the distribution arrangements or practices of Melway are such that they are all commercially obliged to supply anyone who seeks to become a wholesaler, or that, at the wholesale level in the market, there exists perfect competition... It is one thing to compare what it has done with what it might be thought it would do if it lacked that power. **It is a different thing to compare what it has done with what it would do in circumstances that are completely divorced from the reality of the market.**

It can immediately be seen that this exposition of the test, in its use of the phrase "than would otherwise be the case" does not on its face preclude some consideration of what the firm with

<sup>50</sup> *Melway Publishing Pty Ltd v Robert Hicks Ltd* (2001) 205 CLR 1.

<sup>51</sup> *ibid* [51].

<sup>52</sup> *ibid* [51].

<sup>53</sup> *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 [54] - [58].

market power would not have found as easy, if it did not have market power, it simply sets the applicable causative link at an arguably lower level, ie the market power made it "easier to act" in the way it did, as opposed to requiring that the firm "could [not] have acted" as it did.

In *Rural Press Ltd v Australian Competition and Consumer Commission* ("**Rural Press**")<sup>54</sup> the High Court rejected the ACCC's criticism of the Full Federal Court for asking whether Rural Press and Bridge "could" engage in the same conduct in the absence of market power. The High Court determined that the Commission had failed to show that the conduct of Rural Press and Bridge was *materially facilitated by the market power*.<sup>55</sup>

Importantly, the High Court did not omit from its consideration how an entity without market power might have acted, it simply set an arguably higher threshold for the causal link between market power and conduct, by asking "could the respondent do this because, and only because, of its market power?" Note, too, that as applied in *Rural Press* the "materially facilitated" test did not set an obviously **lower** threshold than the standard "would/could [rationally]" test.

Next, in *NT Power Generation Pty Ltd v Power and Water Authority* ("**NT Power**")<sup>56</sup> the Federal Court found that to establish a contravention of s 46, it must be demonstrated that there was a sufficient causal connection between the market power and the proscribed purpose. Once that is appreciated the question is "What was it that *materially facilitated* the decision to deny access?"<sup>57</sup> Referring to the statement in *Melway* which described the quote below on p.14 (footnote 64) of this paper, the Federal Court continued:<sup>58</sup>

That statement does not say that unrealistic assumptions may not be made. The assumption on which the reasoning of four members of the Court in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* proceeded — that BHP lacked market power, and was operating in a competitive market — was highly unrealistic, but **no later case has held that it was wrong to make it**.

This case is again not a clear precedent for the rejection of a counterfactual analysis to determine the causal connection between market power and its misuse.

The key point to note is that both the "would/could[rationally]" and "materially facilitated" assessments require the postulation of a causation, the only dispute being what causation criteria are used. However, there does not seem to be any support for a non-scientific test. Therefore, all assessments must require a counterfactual analysis.

Finally, the Court in *Pacific National (ACT) Ltd v Queensland Rail*<sup>59</sup> followed *Rural Press* and *Melway*, in finding that it may be proper to conclude that a firm is taking advantage of market power where it does something that is *materially facilitated* by the existence of power.<sup>60</sup> What is involved in answering the question of whether a firm has taken advantage of market power is the sufficiency of the connection between the market power and the conduct complained of. In that context the Court found that it is relevant to ask *how it would have behaved if it lacked power* and whether it could have behaved in the way it did in a competitive market.<sup>61</sup> Again, it is clear that a counterfactual analysis was employed.

### **Is "direct observation" sufficient?**

In addition to the above, as the Commission outlined in its submissions before the Court of Appeal, there has been a suggestion that an alternative to the counterfactual test may be a "direct observation" approach. This proposition is based on the dicta of Deane J in *Queensland Wire*<sup>62</sup> and

<sup>54</sup> *Rural Press Ltd v Australian Competition and Consumer Commission* (2003) 216 CLR 53.

<sup>55</sup> *ibid* [51].

<sup>56</sup> *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90.

<sup>57</sup> *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90, 96.

<sup>58</sup> *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90, [145].

<sup>59</sup> *Pacific National (ACT) Ltd v Queensland Rail* [2006] FCA 91.

<sup>60</sup> *ibid* [1024].

<sup>61</sup> *Ibid*.

<sup>62</sup> *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, 191.

was picked up by the Court of Appeal in 0867.<sup>63</sup> In addition to the 'materially facilitated' test, above, the High Court in *Melway* also picked the 'direct observation' test up, after applying the traditional counterfactual test, observing:<sup>64</sup>

... **An absence of a substantial degree of market power does not mean the presence of an economist's theoretical model of perfect competition.** It only requires a sufficient level of competition to deny a substantial degree of power to any competitor in the market. ... **To ask how a firm would behave if it lacked a substantial degree of power in a market,** for the purpose of making a judgment as to whether it is taking advantage of its market power, involves a process of economic analysis, which, if it can be undertaken with sufficient cogency, is consistent with the purpose of s 46. But the cogency of the analysis may depend on the assumptions that are thought to be required by s 46... **In some cases a process of inference, based on economic analysis may be unnecessary. Direct observation may lead to the correct conclusion.** Deane J thought that *Queensland Wire* was such a case.

However, while the direct observation test has the appeal of simplicity, there is a risk that it lacks intellectual rigour. For example, it is unclear what direct observation will measure and by what means. There is a risk that an 'intuitive' approach could lead down the path that *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission ("Boral")*<sup>65</sup> and the Privy Council warned against (ie determining 'misuse' from 'purpose'). Indeed, when properly directed as to the causal link, a counterfactual analysis should replicate the intuitive approach anyway.

Ultimately the Court of Appeal in 0867, like the Courts in *Queensland Wire*<sup>66</sup> and *Melway* before it, applied and relied on a counterfactual analysis (in *Melway*, in both materially facilitated and direct observation tests) for the purpose of determining whether the necessary causative link was established. However, allegations of 'unreality' come from both sides and do not depend on which test is used.

### **The "reliance" test**

The inclusion of the term 'reliance' in s 46(6A)(b) raises interesting questions: does conduct relying upon market power involve a lesser connection between the conduct and the market power than courts have previously required? What degree of reliance is required?<sup>67</sup>

In *Queensland Wire*, Mason CJ and Wilson J considered that there must be a connection or causal link between the respondent's conduct and its market power, in the sense that it *relied* on its market power, or used its market power in order to give effect to the conduct.<sup>68</sup>

The Court held that the way to test this was to ask *whether BHP could have engaged in the conduct in a competitive market*. Under the formulation of the test outlined by Mason CJ and Wilson J, it is necessary to demonstrate that the conduct is *more likely* with market power, but not impossible without it (a lower threshold). Under the formulation of Dawson J, it is necessary to show that the conduct is *only possible because of the market power* - a high threshold.

Again, under either formulation of this test, some form of counterfactual analysis appears to be required.

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<sup>63</sup> See the discussion in *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 [52] – [55].

<sup>64</sup> *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 [52] - [53].

<sup>65</sup> *Boral Besser Masonry Ltd v ACCC* (2003) 195 ALR 609.

<sup>66</sup> See *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, 191; *Telecom Corporation of NZ Ltd v Commerce Commission* (2001) 10 TCLR 182 [17]; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 [52] - [53].

<sup>67</sup> Mallesons Stephen Jacques *Recent amendments made to misuse of market power* December 2008 <<http://www.mallesons.com/publications/update-combine.cfm?id=1565027>> (17 February 2010).

<sup>68</sup> *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 per Mason CJ and Wilson J, [24].

### **The "would [not] have engaged in the conduct" test**

The articulation of the counterfactual test set out in s 46(6A)(c) reflects the most common test set out in the case law. In particular, it was adopted by the majority of the Australian High Court in *Melway*,<sup>69</sup> which endorsed the High Court's approach in *Queensland Wire*, that the Court is to use the counterfactual test as a means of identifying whether or not a corporation has used its market power. If a firm's conduct is consistent with conduct it would have engaged in a competitive market, there can be no sense in which the firm has used or relied upon its substantial market power.

The commentaries refer to two formulations of this test. The first (higher threshold) approach requires proof that the conduct is *only possible because of the market power* held by the respondent. The question to be asked under this threshold is: "could" the respondent do this because, and only because, of its market power? This approach was adopted in *Melway* and *Rural Press*.<sup>70</sup>

The alternative (lower threshold) approach requires proof that market power contributed to why a company chose to act in a particular way. The question to be asked under this threshold is: "would" the conduct be more likely with market power?<sup>71</sup> Another way of expressing the lower threshold is: Did the existence of market power materially facilitate the conduct? This approach was approved in obiter by the majority of the High Court in *Melway* and subsequently applied by the Full Federal Court in *Safeway*.<sup>72</sup> This was the formulation adopted by Mason CJ and Wilson J in *Queensland Wire*<sup>73</sup> and endorsed by the majority in *NT Power*.

The two variants of the "could"/"would" test were most recently expressed by Allsop J in a composite form in *Baxter Healthcare*<sup>74</sup> as whether the conduct at issue:

... would not or could not be done in other circumstances where the substantial power did not exist.

Similarly, the Court of Appeal in the 0867 decision referred to the Privy Council's use of "would" in its *CHH* formulation of the counterfactual test and expressed the view that "would" means "could rationally".<sup>75</sup>

The application of this test by the Court of Appeal shows the degree of flexibility that is already available in the current New Zealand test.<sup>76</sup>

### **The "otherwise related" test**

Section 46 (6A)(d) refers to conduct 'otherwise related' to market power. The apparent breadth of this factor also raises questions regarding the necessary connection between the conduct and the market power.<sup>77</sup> This test is new. The Australian commentaries have asked, if the test implies some new connection of 'relatedness', what degree of 'relatedness' is required?<sup>78</sup>

At the very least the term 'otherwise related to' in (d) ought to be considered in the statutory context of the other elements (a), (b) and (c). In light of the High Court's warnings, for example, in *Rural Press*,<sup>79</sup> that the words "take advantage of" do not extend to merely any kind of connection between market power and the prohibited purposes described in s 46(1), presumably a court would conclude

<sup>69</sup> *Melway Publishing Pty Ltd v Robert Hicks Ltd* (2001) 205 CLR 1.

<sup>70</sup> CCH *Trade Practices, Consumer and Contract Law* [5-295].

<sup>71</sup> CCH *Trade Practices, Consumer and Contract Law* [5-295]. See also The twentieth Annual Workshop of The Competition Law & Policy Institute Inc, *The Trade Practices Legislation Amendment Act 2008 (Cth) and s 46 of the Trade Practices Act 1974 (Cth) - will anything really change?*, Presented by the Honourable Justice John Middleton, Justice of the Federal Court of Australia, (8 August 2009), p. 6, [28].

<sup>72</sup> *ACCC v Australian Safeway Stores Pty Ltd (No 2)* [2001] FCA 1861.

<sup>73</sup> *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177, 192.

<sup>74</sup> *ACCC v Baxter Healthcare Pty Ltd* (2005) ATPR ¶42-065 [582].

<sup>75</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 [75], [98].

<sup>76</sup> See observations to similar effect in respect of the application of the essential facilities doctrine in Berry, "Competition Law" [2006] NZ Law Review 599, at 607.

<sup>77</sup> CCH *Trade Practices, Consumer and Contract Law* [5-297].

<sup>78</sup> CCH *Trade Practices, Consumer and Contract Law* [5-297].

<sup>79</sup> *Rural Press Ltd v Australian Competition and Consumer Commission* (2003) 216 CLR 53, 76.

that a direct and material link between the conduct and the respondent's market power is required, rather than just any link, however indirect or tenuous.

### ***Is a legitimate business rationale sufficient?***

In *Boral*<sup>80</sup> the High Court emphasised that s 46 requires not only the existence of market power, but also a connection such that the firm whose conduct is in question can be said to be taking advantage of its power.<sup>81</sup> The High Court determined that it was dangerous to proceed too quickly from a finding about purpose to a conclusion about taking advantage of market power. It stated:<sup>82</sup>

Indeed, a process of reasoning that commences with a finding of a purpose of eliminating or damaging a competitor, and then draws the inference that a firm with that objective must have, and be exercising, a substantial degree of power in a market, is likely to be flawed.

The Court approved the idea that if impugned conduct has a business rationale, it is a factor which points against any finding that the conduct constitutes a taking advantage of market power. It went on to say that:<sup>83</sup>

**Where...a firm accused of contravening section 46 asserts** that it is operating in an intensely competitive market, and **that its price and behaviour is explained by its response to the competitive environment**, including the conduct of its customers, **an observation that it intends to damage its competitors**, and to do so to such a degree that one or more of them may leave the market, **is not helpful in deciding whether the firm has, and is taking advantage of, a substantial degree of market power.**

Similarly in *BOPE*, the New Zealand High Court considered a submission from BOPE that there was a legitimate business reason for its actions, and that this should prevent a finding that it breached s 36.<sup>84</sup> However, the Court commented that conduct which may be legitimate for a firm not in possession of market power can nevertheless be illegitimate if carried out by a firm with a substantial degree of market power, if for an illegitimate purpose.<sup>85</sup>

In the context of the Australian and New Zealand legislation, it therefore seems that a reference to the legitimacy of the business rationale - or intention to damage competitors - is more appropriately considered under the 'purpose' limb of the misuse of market power test.<sup>86</sup> The 'taking advantage' element is to be evaluated by the counterfactual test.

### **Other possible tests**

Other tests are applied in the US and EU which may bear some consideration. These tests apply to the whole monopolisation offence, rather than specifically to establish causation between market power and the conduct in question. These are discussed below.

### ***"Special responsibility" (EU)***

The way in which the EU law has developed has led the authorities to regard dominant undertakings as having a 'special responsibility' not to harm competition. The possible application of this test to New Zealand and some reasons it may appeal from a policy perspective were discussed in Ahdar "Escaping New Zealand's Monopolisation Quagmire" (2006) 34 ABLR 260, referred to by the Court of Appeal in 0867.<sup>87</sup>

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<sup>80</sup> *Boral Besser Masonry Ltd v ACCC* (2003) 195 ALR 609.

<sup>81</sup> *Ibid* [120].

<sup>82</sup> *ibid* [123].

<sup>83</sup> *ibid* [129].

<sup>84</sup> *Commerce Commission v Bay of Plenty Electricity Ltd* (13 December 2007) HC, Wellington, CIV-2001-485-917 [312].

<sup>85</sup> *ibid* [317].

<sup>86</sup> Ahdar "Escaping New Zealand's Monopolisation Quagmire" (2006) 34 ABLR 260 at p 275.

<sup>87</sup> 0867 [45].

While the test may have some merit from a policy perspective and, if legislative amendments are considered, it may be one to which New Zealand ultimately decides to move to,<sup>88</sup> the Privy Council in *CHH*<sup>89</sup> was clear that, on a statutory construction of the current s 36 test, European cases cannot be relied on as a sound guide to cases brought under s 36. The Privy Council stated:<sup>90</sup>

In the light of this description of the way Article 82 has been applied by the European Court, ... it is unsafe for any conclusions to be drawn in the context of section 36 of the 1986 Act as it must be applied in New Zealand from the decisions of that court in cases brought by the EC Commission under that Article.

It based this view on Advocate-General Lenz's commentary in *Akzo Chemie BV v EC Commission*:<sup>91</sup>

In particular, Article 86 does not require that the dominant undertaking in the market should have used its economic power to bring about the abuse...

As there is no need to show any relationship of cause and effect between market power and its use, the Privy Council held that the European law, including the 'special responsibility' approach, is not likely to clarify the 'taking advantage' test. Although the European law may continue to provide some general guidance as to the type of conduct which a firm with market power might engage in that has a negative effect on the competitive process, the specific tests developed under European law must be of less significance in terms of direct precedent, because of the difference in the statutory tests.

### ***The "effects balancing"/disproportionality tests (US and EU)***

In the DOJ Report, the DOJ expressed reservations about the effects balancing test, as it gave rise to a high degree of uncertainty and an organisation's inability to predict in advance whether its conduct would ultimately be legal or not. The disproportionality test, however, was ultimately on balance the DOJ's preference for a generic test (although its final recommendation was that conduct-specific tests be retained, consistent with the way in which the US Supreme Court jurisprudence has developed). The DOJ described the disproportionality test as requiring the Courts to consider whether the conduct:<sup>92</sup>

...results in "harm to competition" that is "disproportionate to consumer benefits (by providing a superior product, for example) and to the economic benefits to the defendant (aside from benefits that accrue from diminished competition)."

Similarly, the EU Guidance refers to an effects balancing approach, as it permits the dominant undertaking to demonstrate that likely efficiencies brought about by the conduct outweigh any likely negative effects on competition.

The appeal of this approach is that it evaluates the very question, of whether the competitive process is harmed, that is at the heart of every competition law inquiry. However, the applicability of this approach to New Zealand law must also be subject to the differences in tests, identified by the Privy Council, and its desirability from a policy perspective must be considered in light of the problems with the test identified by the US DOJ Report.

## **A FRAMEWORK FOR THE WAY FORWARD**

When considering whether use of a counterfactual analysis is appropriate and if so, how it is best employed, it is worth briefly returning to the underlying policy of competition law and of the Commerce Act in particular, as determined by the language of the statute.

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<sup>88</sup> If such a test were proposed to be incorporated in legislative amendments to s 36, there would also need to be further discussion as to whether it in fact has a 'chilling' effect on competition, which, from this author's experience practicing in that jurisdiction, it is obvious a number of practitioners in Europe believe it does.

<sup>89</sup> CHH [39], [63].

<sup>90</sup> CHH [65].

<sup>91</sup> *Akzo Chemie BV v E C Commission* [1993] CMLR 215, 238.

<sup>92</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 45 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

## Policy considerations

When considering the policy underlying s 36, and the Commerce Act as a whole, we return to the underlying social contract. There are many constructions of it, but the articulation by Andrew Carnegie is a helpful summary of the business person's perspective. It focuses on the law being sometimes hard for the individual, but "*best for the race, because it ensures the survival of the fittest in every department*". It is the competitive process that must be protected, where the best competitor wins. As the US DOJ Report summarises<sup>93</sup>:

Section 2 serves the same fundamental purpose as the other core provisions of US antitrust law: promoting a market-based economy that increases economic growth and maximises the wealth and prosperity of our society. As the Supreme Court has explained:

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. **It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress...**

Section 2 achieves this end by prohibiting conduct that results in the acquisition or maintenance of monopoly power, thereby preserving a competitive environment that gives firms incentives to spur economic growth. Competition spurs companies to reduce costs, improve the quality of their products, invent new products, educate consumers, and engage in a wide range of other activity that benefits consumer welfare. **It is the process by which more efficient firms win out and society's limited resources are allocated as efficiently as possible.**

Section 2 also advances its core purpose by ensuring that it does not prohibit aggressive competition. Competition is an inherently dynamic process. It works because firms strive to attract sales by innovating and otherwise seeking to please consumers, even if that means rivals will be less successful or never materialise at all. Failure - in the form of lost sales, reduced profits, and even going out of business - is a natural and indeed essential part of this competitive process. "Competition is a ruthless process. A firm that reduces cost and expands sales injures rivals - sometimes fatally." **While it may be tempting to try to protect competitors, such a policy would be antithetical to the free-market competitive process on which we depend for prosperity and growth.**

This narrative identifies the primary policy theme discernable internationally in respect of enforcement of misuse of market power provisions, namely that misuse of market power provisions are designed to allow for survival of the fittest, not necessarily the protection of individual competitors. This is captured in the DOJ Report, where it records:

The purpose of the [Sherman] Act," the Supreme Court instructs, "is not to protect businesses from the working of the market; it is to protect the public from the failure of the market".

Judge Hand's warning in *Alcoa* similarly highlights that competition law should not act as a barrier to reaping the rewards of success, otherwise it will act as a disincentive to investment and to vigorous competition.<sup>94</sup>

<sup>93</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 7 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

<sup>94</sup> Note, however, the difficulty in setting the appropriate parameters arising from the fact that the same conduct can be both legitimately competitive and exclusionary, so it is extremely difficult in this area to discern the difference between legitimate and illegal conduct. In *United States v Microsoft Corp*, 253 F 3d 34, 58 (DC Cir 2001) (en banc) (per curiam) cited Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 12, fn 69 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010):

Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad. The challenge for an antitrust court lies in stating a

The Privy Council also acknowledged this policy consideration in *Telecom v Clear*, in its often-cited passage:<sup>95</sup>

[A]s a competitor, Telecom will be seeking in one sense to "deter" Clear from competing successfully. **A monopolist is entitled, like everyone else, to compete with its competitors: if it is not permitted to do so it "would be holding an umbrella over inefficient competitors":** see *Olympia Equipment Leasing Co v Western Union Telegraph Co* 797 F 2d 370 (1986) per Posner J; *Union Shipping NZ Ltd v Port Nelson Ltd* at p 706; *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731 at p 761; *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 191 per Mason CJ and Wilson J.

However, different jurisdictions appear to place different weight on the preservation of competitors. For example, the view of many practitioners is that European law places greater weight on the protection of smaller competitors, through the imposition of a "special responsibility" on entities with market power. This appears to be reflected in the EU Guidance, which provides:<sup>96</sup>

However, **the Commission recognises that in certain circumstances a less efficient competitor may also exert a constraint** which should be taken into account when considering whether particular price-based conduct leads to anti-competitive foreclosure.

Compare this to the summary of the US law in respect of price-based conduct under s2 contained in the DOJ Report which describes:<sup>97</sup>

...the Supreme Court's predatory-pricing jurisprudence, under which a price is deemed predatory only if it is reasonably calculated to exclude a rival that is at least as efficient as the defendant. As Judge Posner explains, "It would be absurd to require the firm to hold a price umbrella over less efficient entrants... **[P]ractices that will exclude only less efficient firms**, such as the monopolists's dropping his price nearer to (but not below) his cost, **are not actionable, because we want to encourage efficiency**".

On this issue there is arguably a divide between the US and EU law, in that US law places emphasis on pricing behaviour that does not exclude an equally efficient rival, whereas EU firms must also consider possible allegations in respect of conduct that might foreclose only a less efficient rival. Such a restriction would in practice be expected to lead to more conservative conduct by EU-based firms with market power.

### Small economy considerations

Over-enforcement is recognised as having a chilling effect on competition as firms with market power structure their affairs to avoid breaching the Act. The DOJ Report observes:<sup>98</sup>

Importantly, rules that are overinclusive or unclear will sacrifice those benefits not only in markets in which enforcers or courts impose liability erroneously, but in other markets as well. **Firms with substantial market power typically attempt to structure their affairs so as to avoid either section 2 liability** or even having to

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general rule for distinguishing between exclusionary acts, which reduce social welfare, and competitive acts, which increase it.

<sup>95</sup> *Telecom Corporation of New Zealand v Clear Communications Ltd* [1995] 1 NZLR 385, 402.

<sup>96</sup> European Commission *Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* Official Journal of the European Union C 45/7 (24 February 2009) [24] <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>> (17 February 2010).

<sup>97</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 43 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

<sup>98</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 14-15 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

litigate a section 2 case because the costs associated with antitrust litigation can be extraordinarily large. These firms must base their business decisions on their understanding of the legal standards governing section 2, determining in advance whether a proposed course of action leaves their business open to antitrust liability or investigation and litigation. **If the lines are in the wrong place, or if there is uncertainty about where those lines are, firms will pull their competitive punches unnecessarily, thereby depriving consumers of the benefits of their efforts.** The Supreme Court has consistently emphasised the potential dangers of overdeterrence.

The chilling effect may be more significant in a small economy where markets are typically more highly concentrated, so a greater proportion of the market's operation relies on active competition by companies with higher market shares than are typically found in larger economies, and who may therefore consider themselves at risk of a finding that they have market power.<sup>99</sup>

In summary, the policy objectives of competition law enforcement, to the extent they are consistent across jurisdictions, appear to point to some form of counterfactual analysis by which the Court considers whether an equally efficient competitor would be excluded, at least in price-based exclusionary effects cases.<sup>100</sup>

### Integration of general and specific rules

Commission Chair Dr Mark Berry has, in other work, discussed the appropriate interaction between the overarching counterfactual test and more specific rules formulated by case law to deal with specific types of behaviour.<sup>101</sup> The article contains an excellent summary of the strong policy reasons why specific rules in many cases can (and arguably should) take precedence over general rules for s 36 conduct. Ultimately, this was the same conclusion reached by the DOJ Report, some three years later.

In principle, consistent also with the policy objectives of the Commerce Act, there can be no objection to use of conduct specific rules, as developed in the case law, in New Zealand, Australia and the US, to act as guides, or 'rules of thumb' indicating what a company with market power would, or would not, do if acting in a competitive market. For example, it might be said that if acting in a competitive market, a company would not, as a general rule, price below cost with no opportunity for recoupment, and it would not price above the level at which it would attract a competitor to enter ('ECPR'). In practice, the specific rules (for example, the Baumol-Willig rule - ECPR - in access pricing) have been developed in the cases through the application of the counterfactual test outlined above. Similarly, the counterfactual test, as it stands, has the ability to encompass internationally recognised concepts such as the essential facilities doctrine.<sup>102</sup>

Overly legalistic discussion about whether that pricing behaviour is 'materially facilitated' by market power, or whether it constitutes conduct 'in reliance' on market power, can often simply obscure the primary inquiry. If the 'would' test, with the flexibility that the Court of Appeal demonstrated in its application (by suggesting it equated to "could rationally") can capture the essential primary inquiry, which is to direct the Court to conduct that would not be engaged in if the firm did not have market

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<sup>99</sup> See, for example, Michal Gal, *Market Conditions Under the Magnifying Glass: Optimal Competition Policy for Small Economies*, Harvard University Press, 2003.

<sup>100</sup> European Commission *Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* Official Journal of the European Union C 45/7 (24 February 2009) [23] - [27] <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>> (17 February 2010). However, as noted above, see [24], that the EC Commission will also consider whether exclusion of less efficient competitors would be anti-competitive. The EU Guidance describes as the basic test for price-based exclusionary conduct the question whether a hypothetical competitor as efficient as the dominant undertaking would be likely to be foreclosed by the conduct in question. The US DOJ Report similarly considered as a possible generic test for all Sherman Act §2 offences, whether the conduct would exclude an equally efficient competitor and determined that consistent with US law, this test ought to at least apply in respect of price-based offences.

<sup>101</sup> Berry "Competition Law" [2005] New Zealand Law Review 267, 268.

<sup>102</sup> Berry, "Competition Law" [2006] NZ Law Review 599, at 607.

power, then it is not clear that adding further expressions, such as 'materially facilitated' or acting 'in reliance' is likely to assist the lower Courts in reaching the right outcomes in particular cases.

If the Supreme Court determines that the current counterfactual test, with its flexibility in application as demonstrated by the Court of Appeal's application of that test, serves a sufficiently useful purpose as an overarching test, it would be beneficial if it could also comment on the usefulness of the conduct-specific tests developed in New Zealand, Australian and US jurisprudence to facilitate the policy objectives of encouraging efficient investment and achieving a greater degree of legal certainty for businesses with high market shares.

### **Should New Zealand align with the new Australian approach?**

#### *Arguments for*

The Minister's address in the opening session to this conference flagged the government's preference for a single legal framework to guide the conduct of firms operating across both sides of the Tasman. There must be a strong presumption that New Zealand and Australian laws ought to align, at least in respect of s36 of the Commerce Act and s 46(1) of the Trade Practices Act, given the statutory language is in some respects the same, and in light of the general desirability for harmonisation of interpretation of laws where they are expressed in consistent terms.<sup>103</sup>

This was recognised by the Court of Appeal in 0867:<sup>104</sup>

...it would be particularly unfortunate in an Australian context, with the strictures to harmonise commercial law under the present CER regime, if Australian and New Zealand law were to be on different footings on this important issue. But if a change is to be made, it would seem to be appropriate that it be undertaken by the Supreme Court of New Zealand, if this is an appropriate case in which to undertake such an exercise.

Indeed, alignment would provide the opportunity to move away from, what some commentators have termed New Zealand's "rigid" counterfactual approach towards the less demanding Australian approach."<sup>105</sup>

An additional advantage of alignment is that the depth of precedent available through a greater number of cases being taken before Courts in Australia means that aligning our laws would be consistent with a desire for clear, administrable rules. It also recognises the phenomenon described in the DOJ report, which in the writers' experience applies equally to advisors to businesses that operate on a trans-Tasman basis:<sup>106</sup>

...an oft-repeated particular concern is that legal advisors to firms doing business globally may base their advice on the "lowest common denominator," that is, the rules of the most restrictive jurisdiction.

#### *Against adoption*

The pull towards harmonisation must be accompanied by a note of caution in one important respect. In one subtle way, the policy underlying the recent amendments to the TPA may depart from that underlying the Commerce Act. The ACCC has previously noted in submissions to the ICN that it

<sup>103</sup> *Taylor Bros Ltd v Taylors Group Ltd* [1988] 2 NZLR 1, 39.

<sup>104</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 [54].

<sup>105</sup> See Yvonne Van Roy, Associate Professor, Victoria University of Wellington, The twentieth Annual Workshop of The Competition Law & Policy Institute Inc, Commentary on *The Trade Practices Legislation Amendment Act 2008 (Cth) and s 46 of the Trade Practices Act 1974 (Cth) - will anything really change?*, Presented by the Honourable Justice John Middleton, Justice of the Federal Court of Australia, (8 August 2009), p. 2: "I have always been critical of the approach to that issue in New Zealand, encumbered as it has been with the rigid counterfactual approach mandated by the Privy Council in *Telecom v Clear* (which was affirmed by that court in the *Carter Holt* case), so would recommend strongly that New Zealand take the opportunity to adopt most of the Australian amendments."

<sup>106</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 168 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

does not consider the objective of protecting smaller and more vulnerable market participants from anti-competitive conduct to be incompatible with the goal of promoting competition.<sup>107</sup>

The ACCC Chair, Graeme Samuel, noted that the Senate Economics References Committee inquiry into the effectiveness of the TPA in protecting small business had accepted the ACCC's submission that s 46 had been interpreted too narrowly by the High Court, in cases such as *Boral*, and in its recommendations, had said:<sup>108</sup>

The Committee considers that the Act can **best protect competition** by **maintaining a range of competitors**, who should rise and fall in accordance with the results of competitive rather than anti-competitive conduct.

The protection of small business, and/or of a number of competitors, potentially at the cost of greater efficiencies that can be achieved by a larger, vertically integrated firm, must be recognised for the trade-off that it is in determining the proper parameters for conduct of a company with market power. As the DOJ observed in the context of discussing the 'equally efficient competitor' test:<sup>109</sup>

... "[a] defendant can rebut [the plaintiff's showing] by proving that although it is a monopolist and the challenged practice exclusionary, the practice is, on balance, efficient". This test is based on the rationale "that a firm should not be penalised for having lower costs than its rivals and pricing accordingly".

[However]... it is not clear whether a firm that produces a single product as efficiently as a defendant in a tying case would qualify as an equally efficient competitor if it does not produce the other product(s) involved in the tie.

A diversified firm may enjoy superior efficiencies in joint production and marketing, as compared to a firm that is arguably as efficient with respect to the one target product.

The High Court in *Melway*, in reaching the legal position that pre-dated the Birdsville amendments, referred to the comments of Senator Murphy on the second reading of the TPA, to the effect that s 46 did "not prevent normal competition by enterprises that are big by, for example, their taking advantage of economies of scale or making full use of such skills as they have".<sup>110</sup> However, the subsequent amendments to the TPA must put that policy statement in question.

As noted above, this may be a more important concern in New Zealand, where markets are more concentrated, even than in Australia. Firms with high market shares, and so potentially at risk of being subject to the s 36 prohibition, often include SOEs and organisations that historically had State-created monopolies. The Commerce Commission's submissions to the ICN recorded that, New Zealand, unlike in many jurisdictions, had chosen to rely often solely on competition law when privatising state trading entities:<sup>111</sup>

<sup>107</sup> International Competition Network *Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies* May 2007 21.

<sup>108</sup> Graeme Samuel "Taking a holistic approach to protecting small businesses" (Speech delivered at the National Small Business Summit, Sydney, 11 June 2008).

<<http://www.accc.gov.au/content/item.phtml?itemId=831231&nodeId=1d942ad9b7f9e954557a66da20d05bc5&fn=Taking%20a%20holistic%20approach%20to%20assisting%20small%20businesses.pdf>> (17 February 2010)

<sup>109</sup> Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, (September 2008) 43 <<http://www.justice.gov/atr/public/reports/236681.htm>> (17 February 2010).

<sup>110</sup> *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 [93].

<sup>111</sup> International Competition Law Network *Report on the Objectives of Unilateral Conducts Law, Assessment of Dominance/ Substantial Market Power, and State-Created Monopolies* (May 2007) 20. The Commission also described its view that the industry-specific regulation has a competition objective. However, the ICN's editorial comment on this submission was more circumspect, in that it queried whether that regulation ought to be regarded as effectively pursuing objectives beyond the protection of competition:

The New Zealand agency also describes specific markets, such as the markets for telecommunication services, raw milk, and shipping services, in which the goals of industry-specific regulation are consistent with the promotion of competition and/or efficiency. **However, the existence of a separate regulatory regime or even the mere provision of a specific enforcement process may also suggest that public interests other than competition are taken into consideration in these sectors.**

... New Zealand has been engaged in an extensive process of corporatisation and/or privatisation of its state trading activities during the 1980s and 1990s, with little associated regulation. Instead, New Zealand relied on the competition act to manage anticompetitive conduct based on the principle of competitive neutrality.

In this context, it is interesting to note that the ACCC and Commerce Commission, in outlining for the International Competition Network their respective countries' objectives of unilateral conduct laws, identified different criteria. While both identified 'ensuring a competitive process', 'promoting consumer welfare', 'maximising efficiency', and 'achieving market integration' (CER objectives), the ACCC also listed 'ensuring a level playing field for SMEs' which the Commission did not, and the Commission identified 'facilitating privatisation and market liberalisation', which the ACCC did not.<sup>112</sup>

A policy to preserve competition, even if the competitor, through its inability to diversify is less efficient, may indeed also be a feature of New Zealand policy underlying our Commerce Act, but if it is, then that policy objective has not been clearly expressed.

In the absence of a clear policy direction from Parliament that modifies our Commerce Act in a similar way to the TPA (if so, hopefully it would be done in a more coherent way), in the authors' view, the New Zealand approach should remain that competition law enforcement is not about protection of SMEs or less efficient competitors. Consistent with our more concentrated markets, we, even more than Australia, need to allow our firms with high market shares to compete effectively. The question whether the firm with market power was taking advantage of all available efficiencies, including those attributable to vertical integration, ought to prevail over a desire to preserve potentially more numerous rival firms which do not have the benefit of those efficiencies. If this leads to a market structure in which an efficient firm faces no meaningful competition in the same market, and there is no threat of new entry, this may fall to be considered against the expanded range of options available in Part 4.

#### **WHAT COULD THE SUPREME COURT DO?**

On the basis of the above analysis, without further statutory amendment, the Supreme Court could endorse the application of a counterfactual analysis in the application of the 'taking advantage' test under the Commerce Act. Whether it will also continue to articulate the counterfactual analysis as set out by the Pricy Council, or whether it will permit other formulations, such as the 'materially facilitated' test, is an open question. There is a possibility that the Supreme Court will be predisposed to dispatching the Privy Council test; however we trust that a knee-jerk reaction will not be entertained by the majority. As demonstrated above, as alternative tests have been applied in the cases, they have also involved some consideration of how the party with market power would or could have behaved without it.

The authors of this paper are not close enough to the facts of the 0867 case or any alleged errors in the economic modelling to consider in any detail how the Supreme Court might answer the second question it has granted leave for it to consider. However, as to the first question, whether the Court of Appeal erred in applying a counterfactual test, it is these authors' hope that the Supreme Court will:

- a) acknowledge some form of counterfactual analysis is required to establish the causation link between market power and the conduct in question;
- b) confirm that the purpose of such analysis is to encourage efficiency by allowing all companies, including those with high market shares, to compete based on superior efficiencies, including those arising from diversified operations; and
- c) confirm the application of conduct-specific tests as developed in the case law as the primary method of evaluating whether a company in the same position as the defendant but in a competitive market would (or could rationally) have behaved the way it did and/or

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<sup>112</sup> International Competition Law Network *Report on the Objectives of Unilateral Conducts Law, Assessment of Dominance/ Substantial Market Power, and State-Created Monopolies* (May 2007) Annex A.

whether that company's market power materially facilitated its behaviour, while allowing for further conduct-specific rules to be developed as those cases come before the Courts.

In particular, in these authors' view, it would be a pity indeed if the Supreme Court did not take the opportunity to comment on the way that conduct specific rules have developed within the framework of the counterfactual analysis. Although each case will depend on its facts, the way the cases have evolved, consistent with the policy of pursuing efficiency described above, is that it is appropriate when constructing the counterfactual, in most cases, to postulate the firm with market power (F1), in the same market, with the same structure of distribution, same financial resources, but with a shadow firm (F2) that looks exactly the same as the firm with market power, ready and available to make the investment necessary to serve the customer whose supply terms with F1 are in question.

Having postulated that type of counterfactual, the social policy objectives that underlie the Commerce Act 1986, as informed by an international comparative analysis of competition policy enforcement, support a sensible and coherent use of a counterfactual analysis to determine the causal link between market power and conduct.