IN THE SUPREME COURT OF NEW ZEALAND

SC 76/2009
[2010] NZSC 111

BETWEEN	THE COMMERCE COMMISSION Appellant
AND	TELECOM CORPORATION OF NEW ZEALAND LIMITED First Respondent
AND	TELECOM NEW ZEALAND LIMITED Second Respondent

Hearing:	21-24 June 2010
Court:	Elias CJ, Blanchard, Tipping, McGrath and Anderson JJ
Counsel:	J A Farmer QC, G M Coumbe, J S McHerron and C E Tingley for Appellant D Shavin QC, J E Hodder SC, P R Jagose and T D Smith for Respondents M S R Palmer, T G H Smith and K C Millard for the Attorney-General as Intervener
Judgment:	1 September 2010

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay the respondents costs of $50,000 plus disbursements to be fixed if necessary by the Registrar.

REASONS

(Given by Blanchard and Tipping JJ)

Introduction

[1] This appeal concerns the introduction by Telecom during 1999 of what was called its "0867" package. The appellant, the Commerce Commission, claimed that by introducing 0867 Telecom used its dominant position in the relevant markets for a proscribed purpose and thereby breached s 36 of the Commerce Act 1986.[1] The High Court rejected the Commission's contention.[2] And so did the Court of Appeal.[3] The Commission's appeal to this Court raises several issues, of which the most substantial concerns the question how to determine whether a dominant position has been "used" in terms of s 36. As the events in issue took place before the amendment to s 36 in 2001, the case must be considered according to the language of the section at that time. Section 36 then referred to use of a dominant position whereas from 2001 the section has referred to taking advantage of a substantial degree of market power. The change from dominance to substantial degree of power is of no present moment. As regards the change from use to taking advantage we conclude that the expressions "use" and "take advantage of" involve the same inquiry. The concept of use implicitly meant advantageous use. The discussion in these reasons of the concept of "use" of dominance therefore applies equally to the current version of the section enacted in 2001, where what is in issue is whether a firm with a substantial degree of power in a market has taken advantage of that power for a proscribed purpose.

Section 36

[2] It is convenient to set out immediately the relevant parts of s 36 as they stood in 1999, with bracketed additions to show the 2001 wording:

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1 The proscribed purpose alleged was that of preventing or deterring a person from engaging in competitive conduct (s 36(1)(b)).

2 *Commerce Commission v Telecom Corporation of New Zealand Ltd* (2008) 8 NZBLC 102,239 (HC), (2008) 12 TCLR 168 (HC) per Rodney Hansen J and M C Copeland.

3 *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338, (2009) 12 TCLR 457 per William Young P, Hammond and Robertson JJ.

36 Use of a dominant position in a market [Taking advantage of market power]

(1) No [A] person who [that] has a dominant position [substantial degree of power] in a market shall use that position [must not take advantage of that power] for the purpose of—

(a) restricting the entry of any [a] person into that or any other market; or

(b) preventing or deterring any [a] person from engaging in competitive conduct in that or in any other market; or

(c) eliminating any [a] person from that or any other market.

(2) For the purposes of this section, a person does not use a dominant position [take advantage of a substantial degree of power] in a market for any of the purposes specified in paragraphs (a) to (c) of subsection (1) of this section by reason only that that person seeks to enforce any statutory intellectual property right[,] within the meaning of section 45(2) of this Act[,] in New Zealand.

The circumstances in outline

[3] As the parties did not challenge its essential accuracy, we take the following summary of the circumstances giving rise to the litigation substantially from the reasons of the Court of Appeal given by Hammond J.[4] In 1987 the public telecommunications system in New Zealand, which had hitherto been run as a state monopoly, was incorporated as a State-owned enterprise under the name Telecom Corporation of New Zealand Ltd. That enterprise was privatised in 1990, after legal restrictions on entry into the telecommunications market had been removed.[5] The government sold its entire shareholding except for one share called the Kiwi Share which it kept in the name of the Minister of Finance to support obligations to residential customers contained in Telecom's Articles. The sale to the new owners included the nationwide copper-based wire network otherwise known as the public switched telephone network (PSTN). All other providers of fixed or mobile telephone services required access to this network. A new entrant could not economically replicate the PSTN network.

4 At [2]–[18].
5 On 1 April 1989.

[4] The government made no provision in the privatisation exercise for rights of access to Telecom's network; nor was any statutory guidance provided as to the terms on which Telecom might sell access to the network to another provider of telecommunications services. The first distinct rival to Telecom was Clear Communications Ltd. Substantial difficulties arose in the negotiations between Clear and Telecom as regards the terms on which Clear might have access to Telecom's network. These difficulties culminated in the decision of the Privy Council delivered on 19 October 1994 in *Telecom v Clear*.[6] This allowed Telecom, under an interconnection agreement (ICA) which was eventually signed in 1996, to charge Clear more than Clear had been hoping for.[7] Their Lordships held that in requiring such terms Telecom was not using its dominant position.

[5] One aspect of the ICA was the payment of what are called termination charges. When a customer of one provider made a call to another provider's network, the network of origin had to pay a per minute charge to the other network on which the call "terminated". The end result of the Privy Council decision was that the termination charges paid by Clear to Telecom were in aggregate distinctly greater than those paid by Telecom to Clear. This was in part because the per minute charge payable by Clear to Telecom was higher than that payable by Telecom to Clear, but mainly because most voice calls requiring interconnection were from the Clear network to the much more extensive Telecom network. Hence Clear was paying substantially more to Telecom than Telecom was paying to Clear. As the Court of Appeal put it, this was a particularly happy position for Telecom to be in.

[6] Into this arena came a substantial and unanticipated expansion of residential internet dial-up usage. This type of use quite quickly created major demands on Telecom's local access network. As internet calls were on average of much longer duration than voice calls, Telecom's network started to become congested. In addition it was essentially one-way traffic – from residential customers to Internet Service Providers (ISPs), with no traffic the other way. If the ISP was on Clear's

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6 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC).

7 On a basis which included the opportunity costs to Telecom of providing interconnection, together with a contribution to common costs and profits, including any monopoly profits denied to Telecom on account of business lost to Clear.

network and the customer was on Telecom's network (as nearly all were), Telecom had to pay termination charges on a per minute basis to Clear. Hence if Clear had successful ISPs on its network substantial termination charges became due to it from Telecom.

[7] This phenomenon developed to the point of tilting the balance of advantage under the interconnection agreement from Telecom to Clear. The consequence of this shift in the balance of advantage was that ISPs on Clear's network could keep ISP charges low or free, because Clear and the ISPs agreed to share the termination charges paid by Telecom. This tended to exacerbate Telecom's congestion problem because some customers were thereby encouraged to stay on the internet for longer than might otherwise have been the case. A further problem for Telecom was that under the Kiwi Share Obligation (the KSO) to the government, Telecom was required to supply residential customers with free and unlimited phone line access for local calls for a fixed monthly fee which could not be increased by more than the rate of inflation.

[8] Telecom's solution to these issues was to introduce the 0867 package. It considered that 0867 calls were outside the KSO and the ICAs, and thus did not incur termination charges. Telecom's residential customers were to be charged two cents per minute for all internet calls beyond 10 hours connection per month. However, if customers used a dial-up number with the prefix 0867 (or if their ISP was Xtra, an arm of Telecom, or another ISP hosted by Telecom) they would not be charged for their internet calls. Customers and ISPs thus had a substantial incentive to adopt the 0867 solution. The 0867 package was designed to encourage residential customers and ISPs based on Clear's network to "migrate" to Telecom and to encourage Clear to adopt the 0867 prefix for ISPs on its network, thereby reducing the termination costs payable by Telecom. It is also of moment that Telecom's introduction of 0867 enabled it to manage better the flow of voice traffic on the PSTN network when customers opted to use 0867. This reduced the need for further capital expenditure on that network.

[9] The Commerce Commission's contention, as summarised by the Court of Appeal, was that Telecom had introduced the 0867 package not only to stem the

outflow of payments for termination charges and to address network congestion issues, but also to make “life much more difficult” for its competitors.[8] The Commission contended that Telecom thereby used its dominant position for a proscribed purpose, contrary to s 36. The Commission accepted that Telecom could legitimately deal with the outflow and congestion problems but asserted that Telecom had choices how to proceed. It need not have addressed its problems in a manner that involved anticompetitive conduct. These issues will be examined in more detail below.

[10] The High Court held that Telecom was dominant in the retail but not the wholesale market. The Court of Appeal held that Telecom was dominant in both markets. But both Courts held that Telecom had not used its dominance. The High Court held that Telecom did not have a proscribed purpose. The Court of Appeal did not address that question.

Use of dominant position - authorities

[11] Against that background it is convenient to move straight to the primary legal question in the appeal: how does one determine whether use has been made of a dominant position in a market? In the discussion that follows we proceed on the assumption that Telecom had such a position. The High Court and the Court of Appeal directed themselves on the issue of use, as they were bound to do, in terms of two decisions of the Privy Council: namely *Telecom v Clear* and the later decision in *Carter Holt Harvey v Commerce Commission*.[9] The question whether a dominant position has been used for a proscribed purpose is a composite one involving both use and purpose, but it has become established that, for analytical purposes, the court must look separately at the requirements of use and purpose. A dominant firm may engage in competitive conduct, and may even have one of the proscribed purposes, provided it does not fall foul of s 36 by *using* its dominance for such a purpose. It is therefore necessary to distinguish between permissible competitive conduct by a dominant firm and use of a dominant position.

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8 At [19].

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

[12] In *Telecom v Clear* the Privy Council observed that the words of s 36 provided no explanation as to the distinction between conduct which does, and conduct which does not, constitute use of a dominant position.[10] Their Lordships said that both the High Court and the Court of Appeal had proceeded on a basis with which they agreed, namely that if the terms Telecom was seeking to extract were no higher than those which a hypothetical firm would seek in a "perfectly"[11] contestable market, Telecom was not using its dominant position. Their Lordships held that it was "legitimate and necessary to consider how the hypothetical seller would act in a competitive market".[12] For that purpose the hypothetical seller was in the same position vis-à-vis its competitors as Telecom, apart from the lack of a dominant position.

[13] The Privy Council thus saw the question whether there had been use of a dominant position as involving a comparison between the actions of the dominant firm in the actual market and what it, or its surrogate, would do in a hypothetically competitive market. This comparison became known as the counterfactual test, albeit the simpler idea of comparing actual with hypothetical is a more straightforward and illuminating description of the process. In summarising their conclusions of law, the Privy Council indicated that:[13]

> ... it cannot be said that a person in a dominant market position "uses" that position for the purposes of s 36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.[14]

[14] In *Carter Holt v Commerce Commission* the Privy Council, by a majority of 3:2, adopted and reinforced the reasoning in *Telecom v Clear* and also gave consideration to several decisions of the High Court of Australia.[15] Their Lordships

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10 At 403.
11 But see [22] below.
12 At 403.
13 Ibid.
14 The word "if", which we have bracketed, has been substituted for the word "unless", which their Lordships actually employed, because otherwise the test is the converse of what, in context, their Lordships were clearly intending to lay down. The context in which their Lordships' statement must be understood is that of a hypothetically competitive market in which no firm has a dominant position.
15 The application to the facts of the "counterfactual test" by the Privy Council in these two cases, particularly in *Carter Holt*, has proved controversial. We are not, however, called on to comment on that matter.

focussed on the concept of use as the link between dominance and conduct, describing it as a causal relationship.[16] It may also be of assistance to regard the connection as one of enablement. There will be use of dominance when the dominance enables the conduct to be undertaken and the purpose to be achieved. This is consistent with the view that if the dominant firm would have acted in the same way in a competitive market, its dominance has not been used because that dominance has not materially enabled or facilitated its conduct and thus the achievement of its purpose.

[15] In the course of affirming the test established by *Telecom v Clear*, the majority in *Carter Holt* emphasised that acting to achieve one of the proscribed purposes set out in s 36 does not constitute a breach unless the person concerned has used his dominant position to achieve that purpose.[17] They then examined the approach of the High Court of Australia in *Queensland Wire*,[18] *Melway*[19] and *Boral Besser*.[20] We will be discussing these cases below. In particular, the majority in *Carter Holt* cited, with approval, the observation of McHugh J in *Boral Besser* that there must be a "causal" connection between the dominant position and the conduct at issue.[21] That will not be so unless the conduct has given the dominant firm "some advantage"[22] that it would not have had in the absence of its dominance.

[16] In *Queensland Wire* Mason CJ and Wilson J held that it was only by virtue of its control of the market and the absence of other suppliers that BHP could afford, in a commercial sense, to withhold supply of Y-bar from Queensland Wire.[23] If BHP had lacked market power – in other words, if it had been operating in a competitive market – it was highly unlikely that it would have refused supply and allowed Queensland Wire to secure Y-bar from a competitor.[24] This is essentially the same comparison as that later adopted by the Privy Council. The comparison is between

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[16] At [51].
[17] At [23].
[18] *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177.
[19] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13, (2001) 205 CLR 1.
[20] *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* [2003] HCA 5, (2003) 215 CLR 374.
[21] At [67].
[22] An expression used by McHugh J and adopted by the majority in *Carter Holt*: see [59] and [67].
[23] At 192.
[24] Ibid.

the conduct of the firm in the actual market and that of the same firm in a hypothetically competitive market.

[17] In his judgment in *Queensland Wire* Deane J observed that BHP's anticompetitive purpose could only be, and had only been, achieved by virtue of BHP's power in the market.[25] This approach, albeit focussed on purpose, again implicitly involves a comparison between what BHP could achieve with dominance and what it could have achieved without dominance – the actual and the hypothetical. And Dawson J, agreeing generally with Deane J, was of the view, again based on the same implicit comparison, that BHP had used its market power in a manner made possible only by the absence of competitive conditions.[26] Indeed Dawson J was more specific when he added that BHP could not have refused supply if it had been subject to competition.

[18] The fifth Judge, Toohey J, agreed with the opinion of the Blunt Committee[27] that the words "take advantage of" simply meant "use".[28] We also agree with that view. On the question of how one establishes use, Toohey J adopted the comparison either expressly made or implicit in the reasoning of the other Judges when saying that the only reason BHP was able to refuse supply of Y-bar was that it had no other competitor who could supply that product.[29] The conduct engaged in by BHP was something in which it could not have engaged but for the absence of competitive restraint.

[19] We come next to the decision of the High Court in *Melway*. In their joint judgment Gleeson CJ, Gummow, Hayne and Callinan JJ first traversed the various judgments in *Queensland Wire* on the subject of taking advantage of market power. They emphasised, as had the Privy Council in *Telecom v Clear,* that it may be dangerous to proceed too quickly from a finding of anticompetitive purpose to a conclusion about taking advantage or use.[30] We take the same view.

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25 At 197–198.
26 At 202.
27 Trade Practices Consultative Committee *Small Business and the Trade Practices Act* (1979) vol 1 at [9.27].
28 At 213–214. See also Mason CJ and Wilson J at 191.
29 At 216.
30 At [31].

[20] Their Honours then stated that Dawson J's conclusion in *Queensland Wire* (that BHP's refusal to supply Y-bar was made possible *only* by the absence of competitive conditions) did not preclude the possibility that in a given case it may be proper to conclude that a firm is taking advantage of (using) 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.[31] To that extent their Honours said they could accept the submission of the ACCC that s 46[32] would be contravened if the market power a corporation possessed made it easier for the corporation to act for the proscribed purpose than would otherwise be the case.[33]

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

[22] Their Honours in *Melway* next observed that absence of dominance (or a substantial degree of market power) does not mean the presence of an economist's theoretical model of perfect competition. The necessary comparison requires only a sufficient level of competition to deny dominance to any competitor in the market.[34] This point is reinforced by the definition of competition in s 3(1) of our Commerce Act as "workable or effective competition".

[23] In *Melway* the authors of the joint judgment observed that to ask how a firm would behave if it lacked a substantial degree of power in a market involved a process of economic analysis, which, if it could be undertaken with sufficient

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31 At [51].
32 Of the Trade Practices Act 1974 (Cth), the equivalent of the New Zealand s 36.
33 At [51].
34 At [52].

cogency, was consistent with the purposes of the Australian s 46 (our s 36).[35] They also made the point that the necessary cogency depended on the assumptions thought to be required by s 46. While we agree that economic analysis is likely to be helpful in identifying the relevant features of the hypothetically competitive market, deciding what the firm in question would or would not have done in that market will often be best approached simply as a matter of practical business or commercial judgment. Once the comparator market is identified, what the firm otherwise possessing a substantial degree of market power would or would not have done in that market is a business or commercial question.

[24] Finally, in *Melway*, their Honours considered that in some cases a process of inference based on economic analysis might be unnecessary.[36] Direct observation may lead to the correct conclusion. But that articulation did not suggest abandonment of the comparative exercise to which their Honours had previously referred. This was made clear when their Honours said that the real question was whether, without its market power, Melway could have maintained its distributorship system.[37] The reference to direct observation was a reflection of the point that in some cases the comparison may be made without the necessity for economic analysis. *Melway* itself was that kind of case, there being direct evidence identifying what Melway, as the dominant firm, would have done without that dominance. It had acted in the same way as that impugned before it had acquired the dominance of which it was said to have taken advantage.

[25] We turn now to *Boral Besser* upon which the majority in the Privy Council also relied in *Carter Holt*. In their joint judgment Gleeson CJ and Callinan J followed *Melway* in holding that s 46 required not merely the co-existence of market power, conduct and proscribed purpose, but a connection such that the firm whose conduct is in question can be said to be taking advantage of (using) its power.[38] This is the causal or enabling connection to which reference has already been made. In their joint judgment Gaudron, Gummow and Hayne JJ said more than once that s 46 was designed to prevent damage to the competitive process rather than to individual

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35 Ibid.
36 At [53].
37 At [61]. See also [44] where the word "would" rather than "could" is used in the same context.
38 At [120].

competitors. It is therefore erroneous to reason backwards from damage to a competitor to find a breach of the section.[39] Only uses of market power that damage competition rather than competitors per se are caught by the section. Vigorous legitimate competition by a firm with dominance may damage competitors but, ex hypothesi, does not damage competition and is therefore not a breach of the section.

[26] Speaking of the necessary connection between market power and conduct or purpose, their Honours adopted a passage from the judgment of Heerey J in the Court below in *Boral Besser*.[40] His Honour captured the essence of the comparative exercise necessary to determine whether use had been made of market power in the following way:[41]

> If the impugned conduct has a business rationale, that is a factor pointing against any finding that conduct constitutes a taking advantage of market power. If a firm with no substantial degree of market power would engage in certain conduct as a matter of commercial judgment, it would ordinarily follow that a firm with market power which engages in the same conduct is not taking advantage of its power.

That, of course, is the comparative inquiry which has already been identified.

[27] In *Carter Holt* the Privy Council, as we have already mentioned, also referred to McHugh J's judgment in *Boral Besser*. In a passage not referred to by their Lordships, his Honour considered that the term "use" did not capture the full meaning of "take advantage of" and that this was demonstrated by the decision in *Melway*.[42] As earlier indicated, we are not persuaded that this is so; particularly when the word "use" is construed as meaning, as must implicitly be the case, "advantageously use". In context, "use" means "make use of", which clearly has the connotation of using to one's advantage. But we do agree with McHugh J's formulation, adopted by the Privy Council, that the firm's substantial degree of market power must have given it some advantage that it would not have had in the

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39 See [160] and [186]. See also [122]–[123] per Gleeson CJ and Callinan J.

40 At [170].

41 *Australian Competition and Consumer Commission v Boral Ltd* [1999] FCA 1318, (1999) 166 ALR 410 at [158].

42 At [279] and [321].

absence of that power.[43] As McHugh J noted, *Melway* could not have been decided as it was unless that proposition were correct.

[28] The next case which should be mentioned is the decision of the High Court in *Rural Press Ltd v ACCC*.[44] In that case Gummow, Hayne and Heydon JJ picked up the "materially facilitated" language from *Melway* but were also clearly using it within a comparative analysis. Their Honours said that the Commission had failed to show that the conduct in question was materially facilitated by the market power in giving the conduct a significance that it would not have had without it.[45] What gave the conduct its significance was something distinct from market power, namely the firm's material and organisational assets. Their Honours also referred to the judgment of French J in *Natwest Australia Bank v Boral Gerard Strapping Systems Ltd*[46] for His Honour's reference to the necessary connection between market power and conduct.[47] French J held that in many cases the necessary connection may be demonstrated by showing a reliance by the contravener upon its market power to insulate it from the sanctions that competition would ordinarily visit upon its conduct. This articulation again implicitly requires an examination of a hypothetical state of affairs, namely what the position would have been if competition had existed in the market.

[29] We mention finally the decision of the High Court in *NT Power*[48] which also applied a comparative analysis.[49] We do so to draw attention to the Court's explanation of the statement in *Melway* concerning the need for economic analysis of sufficient cogency showing how firms would behave in the hypothetical market; and the statement that the cogency of the analysis may depend on the assumptions thought to be required by s 46. In *NT Power* the Court said that these statements in *Melway* did not mean that unrealistic assumptions may not be made.[50] The

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43 At [279].
44 *Rural Press Ltd v Australian Competition and Consumer Commission* [2003] HCA 75, (2003) 216 CLR 53.
45 At [53].
46 *Natwest Australia Bank Ltd v Boral Gerrard Strapping Systems Pty Ltd* (1992) 111 ALR 631 (FCA) at 637.
47 At [56].
48 *NT Power Generation Pty Ltd v Power and Water Authority* [2004] HCA 48, (2004) 219 CLR 90.
49 At [148].
50 At [145].

assumption on which the reasoning of four members of the Court in *Queensland Wire* proceeded – that BHP lacked market power and was operating in a competitive market – was highly unrealistic, but no later case had held that it was wrong to make it. Their Honours considered that the statements in *Melway* were doing no more than urging the need for cogent analysis on the basis of the necessary assumptions. These assumptions are made for the purpose of identifying the features of the hypothetically competitive market and, ex hypothesi, will depart substantially from the realities of the actual market in which the firm in question is dominant.[51]

Use of dominance - conclusions

[30] It is now time to bring these threads together. In doing so we accept the tenor of the submissions made by Mr Hodder SC for Telecom. We cannot accept the Commerce Commission's argument to the extent it contended some of the language in the Australian authorities represented permissible alternative approaches to use of dominance which were divorced from, and independent of, making a comparison between the actual market and a hypothetical workably competitive market. It is important when addressing the statutory concept of use of market power to take an approach which gives firms and their advisers a reasonable basis for predicting in advance whether their proposed conduct falls foul of s 36 and risks a substantial financial penalty.[52] Having a range of tests, all potentially applying, depending on the circumstances and whether a comparative approach can "cogently" be adopted, would not assist predictability of outcome. Nor is such an approach consistent with the Australian cases when they are appropriately analysed.

[31] The survey we have undertaken of the principal authorities demonstrates a factor common to the reasoning of both the Privy Council and the High Court of Australia. It is important that the approach to the issue under consideration be broadly the same on both sides of the Tasman. Under agreements between the two countries competition law in New Zealand and Australia and associated enforcement provisions are increasingly being framed in a common way to address

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51 See [147].
52 See now s 80(2B) of the Commerce Act 1986.

anticompetitive practices affecting trans-Tasman trade.[53] All the relevant reasoning involves, either expressly or implicitly, consideration of what the dominant firm would have done in a competitive market; that is, in a market in which hypothetically it is not dominant. The essential point is that if the dominant firm would, as a matter of commercial judgment, have acted in the same way in a hypothetically competitive market, it cannot logically be said that its dominance has given it the advantage that is implied in the concepts of using or taking advantage of dominance or a substantial degree of market power. Conversely, if the dominant firm would not have acted in the same way in a hypothetically competitive market, it can logically be said that its dominance did give it the necessary advantage. This is because it can then reasonably be concluded that it was its dominance or substantial degree of market power that caused, enabled or facilitated its acting as it did in the actual market.

[32] The comparative exercise is designed to pose and answer the question whether the presence of competition in the hypothetical market would have restrained the alleged contravener from acting in that market in the same way as it acted in the actual market. If the answer is yes, the alleged contravener has taken advantage of its market power. If the answer is no, it has not done so, because the presence of that power gave it no material advantage. The need to make this comparison is inherent in the idea of "use" of dominance or substantial market power under s 36 whatever the conduct in issue may be, albeit the comparison may be more easily made in some cases than others. And the need to make this comparison is also supported by the concepts of dominance and market power themselves. It is helpful to bear in mind what those concepts involve when considering what s 36 envisages by its reference to their use.

[33] A firm has market power when it is not constrained in the way in which it would be constrained in a competitive market.[54] Any firm that is substantially

[53] For example s 36A of the Commerce Act 1986 (NZ) and s 46A of the Trade Practices Act 1974 (Cth), which give effect to obligations under art 4.4 of the Protocol to the Australia–New Zealand Closer Economic Relations Trade Agreement on acceleration of free trade in goods (signed 18 August 1988).

[54] See, for example, Dawson J in *Queensland Wire* at 200, the main judgment in *Melway* at [43] and [67], Gleeson CJ and Callinan J in *Boral Besser* at [121] and McHugh J in *Boral Besser* at [287].

unconstrained by competitive pressures has substantial market power. Market power gives some advantage if it makes easier – that is, materially facilitates – the conduct in issue. The question whether dominance or substantial market power exists implies a comparison between the position of the firm in the actual market and a firm in the same general circumstances but otherwise in a workably competitive market. The contrast inherent in the concepts of dominance or substantial degree of market power is the contrast between the actual market and a hypothetically competitive market. That same contrast is inherent in the inquiry into whether market power has been "used" within the meaning of s 36.

[34] A firm with a substantial degree of market power has the potential to use that power for a proscribed purpose. To breach s 36 it must actually use that power in seeking to achieve the proscribed purpose. Anyone asserting a breach of s 36 must establish there has been the necessary actual use (taking advantage) of market power. To do so it must be shown, on the balance of probabilities, that the firm in question would not have acted as it did in a workably competitive market; that is, if it had not been dominant. Translating that approach to the circumstances of the present case the Commerce Commission was obliged to show, on the balance of probabilities, that Telecom would not have introduced 0867 in a workably competitive market; in other words, that it would not have done so had it not been dominant in the markets involved. If that is shown, it follows that Telecom used its dominance in that its dominance gave it an advantage which caused, enabled or facilitated its introduction of 0867.

[35] The necessary assessment must be undertaken on the basis that the otherwise dominant firm will act in a commercially rational way in the hypothetically competitive market. The assessment is also likely to involve an examination of the factors that might constrain the firm from acting in the same way in the hypothetically competitive market. The Court is involved in making what is essentially a commercial judgment. That judgment must be made objectively and should be informed by all those factors that would influence rational business people in the hypothetical circumstances which the inquiry envisages. Economic analysis may be helpful in constructing the hypothetically competitive market and to point to those factors which would influence the firm in that market. But it must always be

remembered that the "use" question is a practical one, concerned with what the firm in question would or would not have done in the hypothetically competitive market. As the question is one of rational commercial judgment, the test should be what the otherwise dominant firm would, rather than could, do in the hypothetical market.

[36] It is also important to point out that for the comparative exercise to be effective in identifying when a dominant firm takes advantage of its dominance, the hypothetically competitive market must genuinely deny that firm all aspects of its dominance. The constraints acting upon the firm in the hypothetical market must neutralise the dominance in the actual market. The hypothetical market should, however, replicate the actual market, save for eliminating the dominance of the alleged contravener. The means of achieving that elimination is to posit in the hypothetical market as well as the alleged contravener (company X) at least one other firm (company Y) in effective competition with company X.

This case

[37] Although we heard argument for Telecom that the Court of Appeal erred in finding that it was dominant in the retail or wholesale markets, we will continue to proceed on the assumption that it was dominant. Whether Telecom used its (assumed) dominance in the retail market or in the wholesale market are in fact two distinct issues, but the answer in both cases can be established by the same analysis, which leads to the same conclusion. Thus although in what follows we refer only to the hypothetical competitive retail market, the outcome applies equally in a hypothetical wholesale market for terminating access. The two markets are inter-related: underneath every wholesale market by definition sits a retail market of customers. The behaviour of the ISPs and telecommunications providers in the hypothetical wholesale market would be driven by how the retail customers reacted to the introduction of the 0867 service.

[38] In order to produce a meaningful comparison between the market in which a company said to have used its dominance for an anticompetitive purpose was actually operating and a workably competitive hypothetical market in which the comparator company (the non-dominant Telecom, which we have called company

X) is posited as operating, it is necessary to attribute to the hypothetical market and to company X any special features which existed in the actual market other than those which gave rise to the dominance in the first place. This is done by stripping out or neutralising the features which gave rise to the dominance in the actual market.[55]

[39] In the present case Telecom's dominance arose from its ownership of the PSTN network because of the prohibitive cost for a competitor of replicating that network throughout New Zealand or even throughout the major cities. That feature can be neutralised by positing a market in which each competitor had its own PSTN network.[56] The point of the exercise is to have a situation in which company X cannot, in its dealings with its competitors, gain any advantage from its monopoly of the PSTN network. It is therefore to be assumed that there is in the hypothetical market at least one other non-dominant firm (company Y), effectively a stand in for Clear, with a PSTN network.

[40] On the other hand, a sensible comparison between the behaviour of Telecom and of company X cannot be made unless the essential features of the actual market which did *not* give rise to Telecom's dominance are included in the hypothetical model. In this case those features are the KSO and the particular aspect of the ICAs with Clear and other telecommunication providers to which Telecom was reacting.[57] As we have said, the KSO obliged Telecom to provide free local voice calls to its residential customers, together with certain service standards. The expert economists were agreed that company X would have to be subject to the same KSO and that in a competitive market, even if competitors were not similarly obligated to the government, they would necessarily have to match the terms of the service provided by company X in accordance with the KSO in order to attract or avoid losing residential customers.

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55 In undertaking the comparative exercise in this case, this Court has made a fresh assessment of the features of the hypothetical retail market. It does not differ, however, in any material respects from the circumstances of that market as described by the High Court at [77] (and taken up by the Court of Appeal at [80]).

56 Obviously that is not a realistic or practical assumption, but for the purposes of creating the hypothetical market unrealistic scenarios are permissible: see [29] above.

57 No breach of the ICA with Clear was pleaded or proved in relation to dial-up internet calls in the establishment of the 0867 service.

[41] The ICA between Telecom and Clear provided, as we have seen, for terminating charges. In the hypothetical market it is necessary to posit the existence of ICAs between the competitors providing for such charges rather than bill and keep arrangements.[58] It is also necessary to assume that each competitor will host some ISPs – that is, that each will have call sinks, attracting lucrative terminating payments – where calls originate from customers of another competitor with no reciprocal traffic generated. Of course, if the ISPs were evenly spread around the hypothetical competitors, it is likely there would be an equal spread of terminating charges. If that were so company X would not be troubled, as Telecom was, by a large adverse balance in the levels of terminating charges. That was the very problem which Telecom was plainly trying to overcome. In order to test whether its solution involved use of dominance, it is accordingly necessary to envisage that in the hypothetical competitive market a like asymmetry exists – that company Y is enjoying the benefit of hosting a disproportionate number of ISPs (or at least those receiving in aggregate a disproportionate number of calls) and thus gaining a disproportionate share of the terminating payments. That share must be taken to generate a sufficiently high level of profit to enable company Y to pass part of the payments on to the ISPs on its network.

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

[43] The Commission's argument was that in this hypothetically competitive market company X would have been at considerable risk of losing its valuable residential customers if it were to set up the same 0867 scheme and would therefore not have done so. That argument needed to establish two things: firstly, a real risk that company X would lose customers to competing networks and, secondly, that they were indeed valuable. The Commission argued that although a residential customer could have avoided paying for his or her dial-up internet calls (2 cents per minute after 10 hours per month) by choosing an ISP with an 0867 number, that

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[58] Where the supplier of the service bills its customers and does not account to the other network.

person's present ISP might have been on another network and not able or willing to make such a service available. The customer might not have been indifferent to its choice of ISP. In order to be able to retain a relationship with the same ISP, he or she might therefore have chosen to move to a network which did not require the use of an 0867 number. That other network would, it was said, be willing to match or better the terms offered by company X so as to attract the customer. It was accepted, as it had to be, that unless that were done, the customer might well change ISPs in order to continue to enjoy free unlimited dial-up internet calls.

[44] But, as Mr Shavin QC for Telecom pointed out, there is an immediate difficulty with this argument. It is that as soon as a customer moved to the network which hosted the customer's ISP – say, moved to company Y which hosted that ISP – then company Y would inherit the costs associated with the customer's business but would not be receiving terminating payments from company X. To match the KSO and the 0867 service it would have to provide free voice calling and a free dial-up internet calling option, as company X did. Yet it would get nothing in return. We indicated earlier that there must be at least one other non-dominant firm in the hypothetical market.[59] It is worth pointing out that, in this case, if there was a third non-dominant firm in that market (company W) it would be even worse for the company to which the customer moved, if the ISP were on a third network; for example if a customer of company X whose ISP was with company Y moved to company W. In that situation company W would be providing a free service but having to pay terminating charges to company Y. It follows that in the hypothetical market no competitor company would be willing to acquire company X's customers on terms acceptable to the customers, even if they were themselves desirous of relocating under the termination charges regime as it then stood. Moreover, those customers would not be attractive to an ISP on the competitor's network because there would no longer be terminating payments to be shared.

[45] When this was pointed out to Dr Bamberger, the Commission's expert economist, he appeared to recognise the force of the point. But he said that there

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[59] See [39].

were two other factors which meant that, notwithstanding, company X would still not want to run any risk of losing its residential customers. The first was that company X, like Telecom, would have been gaining substantial revenues from those customers by selling them additional services, not affected by the KSO. In the Commission's submissions in this Court references were made to charges for additional services such as telephone rental, wiring and maintenance, fixing faults, local calls (if customers had selected an optional tariff package as an alternative to the standard residential service), directory assistance, Smartphone services, "call minder", "call waiting" and so on. Counsel referred also to revenue from national tolls and international tolls where Telecom was the toll provider, the opportunity to sell innovative packages of services, such as integrated internet and voice offerings, interconnection revenues received from other carriers in relation to voice calls to Telecom's residential customers' premises, and potential revenues for new future products, for example, broadband. It was said that company X would not want to risk losing the revenues from these packages of additional services if customers shifted to another network. (It would also follow on this argument that company Y would gain those additional revenues if the shift occurred, which might provide some attraction counterbalancing the loss of terminating payments.) The second matter suggested by Dr Bamberger was that Telecom (or company X) might have been deriving substantial benefits from its large customer base because of economies of scale which it could lose if that base diminished significantly.

[46] Before addressing these two points, we should observe that, even if they could be established on the evidence, they would then have to be considered and balanced against the two adverse circumstances which Telecom was actually facing, which must also be taken to be a concern for company X in the comparison. They were the sizeable adverse balance in the termination charges being incurred, which it would reduce if it shed some of the customers, and the congestion and associated traffic management problems arising from the explosion in the volume of dial-up internet calling. That additional traffic, growing exponentially, would require substantial capital expenditure on the PSTN network. Much of the expenditure would, however, quite soon be of no ongoing utility once broadband replaced dial-up calling. Even at that time this was foreseen as likely in the next few years. The

additional network assets would then have become what were referred to as "stranded assets". Furthermore, in the meantime, Telecom would not have received a commercial return on the capital expended without a renegotiation of the KSO.

[47] The points made by Dr Bamberger – and the first of them particularly was heavily relied on by Mr Farmer QC in his submissions – may be theoretically sound. The difficulty with them for the Commission on this appeal is that the argument based upon them was not grounded in any evidence given in the High Court. The Commission had not, in formulating its case at trial, seen the necessity of relying on these matters. Consequently, when the Commission's comparative analysis was summarised in the reply argument of its counsel in this Court, Mr Farmer was obliged to say that it must be "assumed" that company X would have earned other substantial revenues (current and future) from residential customers. When questioned about this Mr Farmer admitted that there was no evidence supporting the proposition other than certain documentary material which had been before the High Court and to which reference was made in the Commission's written submissions. We have considered the material to which the Commission's written submissions contain reference but have been unable to discover in it any financial information which quantifies the "substantial revenues", and so makes it possible to make a balancing assessment against the level of terminating charges. The documents to which we have been referred either have no financial figures or are very generalised predictions (guesstimates) of potential future revenues. They were never apparently put to witnesses and in some cases the assessments were made several years before or after the time with which this case is concerned.

[48] Significantly, Dr Bamberger himself was never referred by Mr Farmer to any such evidence relating to additional revenues. And, as the High Court noted, no evidence was presented to support his contention on economies of scale.[60] The Commission's case appears not to have been put forward in the High Court with reference to these possibilities. It is quite unsatisfactory for the Commission on appeal to attempt to remake its case on what is really a speculative basis. Without

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[60] At [86].

supporting financial evidence it would be grossly unfair to Telecom to make assumptions about the significance of revenues from other services or the significance of economies of scale. As the loss of "other services" was not made part of the Commission's case against Telecom, it would not have believed that it had to adduce evidence or cross-examine on the subject. It is entirely possible that if the subject had assumed relevance at trial Telecom may have had a good deal that it could have said in response. Without financial evidence, it is not possible to assess how these factors may have impacted on a non-dominant Telecom (company X). The Commission's argument, that on any rational consideration the potential loss of customers would necessarily and inevitably have outweighed the other matters at issue, relies on speculation rather than evidence.

[49] Accordingly, the Commission failed to show that in a hypothetical workably competitive market, because of fear of losing retail customers, company X would not have introduced an 0867 service. What the foregoing analysis demonstrates is that, questions of additional revenue aside, the advent of dial-up internet had made the termination charges regime under the 1996 ICA unsustainable for a firm on the wrong side of the asymmetry. Any firm acting competitively, whether dominant or not, would have taken steps to mitigate the loss by introducing a scheme analogous to the 0867 package rather than continue to incur substantial losses. It has therefore not been proved that Telecom used its (assumed) dominant position in the relevant markets when introducing its 0867 service.

Result

[50] That being so, the Commission's appeal must fail. It is therefore unnecessary to consider the further arguments about dominance and purpose, which are factual in nature and relate to events which occurred over a decade ago. The respondents are entitled to costs of $50,000 plus reasonable disbursements to be fixed if necessary by the Registrar.

Solicitors:
Commerce Commission, Wellington for Appellant
Chapman Tripp, Wellington for Respondents