IN THE SUPREME COURT OF NEW ZEALAND SC 76/2009

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 J Tipping J McGrath J Anderson J
Appearances:	J A Farmer QC with G M Coumbe, J S McHerron and C E Tingley for the Appellant D Shavin with J E Hodder, P R Jagose and T D Smith for the Respondents M S R Palmer, T G H Smith and K C Millard on behalf of Attorney-General as Intervener

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CIVIL APPEAL

MR FARMER QC:

As Your Honours please, I appear with my learned friends Ms Coumbe, Mr McHerron and Mr Tingley.

ELIAS CJ:

Thank you Mr Farmer.

MR SHAVIN:

If Your Honours please, my name is Shavin I appear with Mr Farmer – I'm sorry, Mr Hodder, Mr Jagose and Mr Smith for the respondent.

ELIAS CJ:

Thank you Mr Shavin.

MR PALMER:

Tena kotou katoa. If it may please the Court, my name is Palmer. I appear for the Attorney-General. Appearing with me is Mr Smith and Ms Millard

ELIAS CJ:

Tena koe Mr Palmer.

MR FARMER QC:

One other matter, if Your Honour pleases, my learned instructed solicitor Mr Taylor from the Commission would like to sit behind us to instruct –

ELIAS CJ:

Yes, that's fine. Yes Mr Farmer?

MR FARMER QC:

Yes if the Court pleases, what I would like to do, because I think it will be helpful, is to give you some simple diagrams just to make sure that we all understand the basic way that a network operates particularly in relation to Internet service providers and the 0867 service. I've handed Madame Registrar copies of that.

ELIAS CJ:

Thank you. I think, unless you want to – they must have been left outside.

MR FARMER QC:

Well it's just a little difficult to explain a diagram if you don't have it.

ELIAS CJ:

All right, we'll wait for it. It's sometimes hard for the rest of us to follow diagrams, even when we do have them.

MR FARMER QC:

These are very simple because I can understand it and I'm sure you'll be able to.

ANDERSON J:

What might be helpful is a glossary of acronyms.

ELIAS CJ:

Yes, while we're waiting, PSTN, what's PSTN?

MR FARMER QC:

Public switch telephone network.

ANDERSON J:

Telecommunication words.

MR FARMER QC:

It's sometimes called the plain old telephone system.

ELIAS CJ:

All right.

MR FARMER QC:

It is the basic Telecom network that we're all familiar with, with the local loop calls, copper wire that runs from your home to the nearest exchange and then fibre optic cable from between exchanges generally.

ELIAS CJ:

Thank you. Madame Registrar do you have the diagrams?

UNKNOWN MALE SPEAKER:

Could I just check that these are them?

ELIAS CJ:

Do you have them all do you? Thank you.

MR FARMER QC:

So what this first diagram shows is the Telecom network in very simple form. With a telephone call from the left-hand side, from any one of those lines, into the nearest local exchange, calls are then taken, along with other calls, to a more central exchange. At that point this actually shows the link between Telecom and ClearNet where it will then go to what is sometimes called a point of interconnection or service delivery point, which is the SDP, where the call, if it's going into the ClearNet, if a Telecom caller is calling someone in the ClearNet where a call is handed over by – to the Clear and it's network and it's then transferred via usually another exchange ultimately to the end caller and you'll see that that, the term "terminating access" is indicating that Clear is providing a service to Telecom of terminating the Telecom subscriber's call and that's where the termination payment that you would have read about comes in. That the terminating network pays the calling network a termination payment under the interconnection agreement and the interconnection agreement

or ICA is the agreement that gives each network, one to the other, access to the other's network.

Now looking in the second diagram, this is dealing with Internet calls, so this is – we're not dealing with wireless calls, we're dealing with dial-up Internet access so that is to say a residential subscriber using his or her telephone line from home, simply calling a number which is the number of its Internet service provider, and the Internet service provider maybe for example Xtra which is Telecom's wholly owned subsidiary or it maybe some other kind of, some other independent ISP which has its own number. If it's an Auckland based ISP it will have an 09 number, if it's Wellington it'll have an 04 number. So the call, the Internet call, the dial-up, is made, it goes through the same process. This actually is not indicating, this is a single network so we'll say this is a Telecom network. The call goes, once again, through local exchanges and it will finally reach the ISP via dedicated lines to the ISP number and the ISP will then access the Internet for the subscriber. So the, each provider will pay its own ISP for that service and the ISP will be located on somebody's network, in this case Telecom's network, and will pay Telecom for the privilege, or Clear if it happens to be Clear's network.

The third diagram is very much the, this is showing once again two networks so again we have this point of interconnection or SDP, service delivery point, exactly the same with the voice calls, coming down to the SDP, being handed over by the caller network to the terminating network and if the ISP is located on the terminating network the call will be received by the ISP ultimately and access to the Internet from there.

Then finally 0867 calls, when 0867 came in, same basic system in terms of the transmission of calls. The difference is that if the call, if the ISP did not have an 0867 number, it was simply an 09 number, it would go through just in the same way that I've described. The difference was of course that under the 0867 scheme the residential subscriber would have to pay two cents a minute for an Internet call after the first 10 hours free hours per month. If the ISP had an 0867 prefix, the subscriber would ring 0867 followed by the ISP's six digit number. When it reached, when the call reached an exchange that was IN capable, meaning Internet, meaning intelligent network capable, the software would recognise that that 0867 number would identify it, would then translate it into an 09 number, the ordinary ISP 09 number and simply pass it on. If however, the network was congested at that point because it recognised it as an Internet number, it did have the facility for delaying the call while the congestion problem was addressed. Now part of Commission's case is that the intelligent network system could in fact, with a little bit more difficulty, identify any number as being an ISP number even if it didn't have 0867 and perform the same function if that was needed. There is a very, and I don't think you need to turn to it, but there's quite a good short description of how the 0867 intelligent network operated in volume 2 of the case on appeal at page 131. It's paragraph 54 of Mr Forsyth's brief and I'll just read it quickly to you, as I say you don't, I don't

think you really need to get it out. "The 0867 scheme," he said, "provided for an ISP dial-up telephone, dial-up telephone access number with an 0867 prefix, the call would still travel over the PSTN from a customer right to the ISP, the only difference was that the 0867 prefix would alert Telecom's intelligent network which is not actually a network but a traffic management system connected to Telecom's PSTN, it would alert it that the call was to an ISP. The intelligent network system would then perform the number translation from the 0867 to the local telephone number to which the ISP was connected. This would cause the PSTN to route the call to the actual local telephone number of the ISP. This is similar to the way calls to an 0800 is translated and directed to terminate on an actual local number. Other than this, a call using an 0867 call was no different from any other local call travelling over the PSTN."

And just as a further reference again, you don't need to look at it, if you want a slightly more complex diagram to look at and it's in colour, volume 18 at page 7639 has a diagram that Dr Milner who was an expert called by Telecom, in fact was a technical expert who worked for Telecom and he explains the system in a bit more detail diagrammatically. Now if Your Honours please, the primary issue in this litigation has been, and is, that the legality under section 36 of the Commerce Act of Telecom's conduct, in seeking to force rival carries to sign new Internet traffic agreements, which removed Internet calls from the ambit of existing interconnection agreements, referred to generally through the evidence as ICAs, by the device of imposing a two cent Internet dial-up charge called an IDC, just to just another acronym, with a so-called free calling 0867 option on residential customers using their landlines to make Internet calls. So we have the ICA, the interconnection agreement, entered into between Telecom and each of its rival carriers, carriers such as Clear Communications, Telstra, Saturn at the time, and Compass, which is an interconnection agreement that covers all calls. It covers local voice calls, covers toll calls, covers Internet calls, which are simply as we've seen at this time merely local landline calls. And so what 0867 was designed to do, was to remove Internet calls away out of the ICA coverage and to require the rival carriers to sign a new form of interconnection agreement, known as an ITA or an Internet traffic agreement and the means by which Telecom sought to persuade carriers to do that was through the 0867 scheme and in particular through the device of requiring residential subscribers to pay a two cent charge, two cent per minute charge for dialling up an Internet to their Internet service provider, and so you can see the pressure was put on residential customers, ISPs and ultimately on carriers, to go along with that because clearly residential subscribes were going to be very unhappy with having to pay for –

TIPPING J:

The stick was the two cents, the carrot was the 0867.

MR FARMER QC:

The pressure goes on first on the residential subscriber, he says, I don't want to pay this two cents, and he then turns to his Internet service provider and says, I'm not going to pay this, I understand you can keep the calls free if you get an 0867 number, the ISP then turns to its carrier and says, well get me an 0867 number, the carrier goes to Telecom and Telecom says, we'll give you one, but only if you agree to sign this Internet traffic agreement and remove Internet calls completely away out of the interconnection agreement that we have at the moment. So that was the –

ELIAS CJ:

And it's not suggested that there's any breach of the existing Internet connection agreement?

MR FARMER QC:

It's not part of our case that there either was or wasn't. There was certainly debate that went on as to whether – went on in fact internally within Telecom as to whether in fact the – it could be argued that Internet calls were not covered by the interconnection agreement. The fact of the matter is, they had been paying for quite some time, termination payments under it for all Internet calls, so – but one way or the other we don't mind, we don't have to argue that, because even if a party is not in breach of contract, the Commerce Act applies. The Commerce Act applies to situations where parties are simply exercising their contractual rights and I'll give you some authority on that.

TIPPING J:

Even if Telecom were right that it wasn't covered by the agreement, then you say they were still in breach of the Act?

MR FARMER QC:

That's so. My learned friends have continually suggested that we are trying to run a breach of contract case without pleading it. We are not. We don't care.

ELIAS CJ:

But you do have to address don't you, the impact of the contractual context in this matter?

MR FARMER QC:

Oh absolutely.

ELIAS CJ:

Yes.

MR FARMER QC:

And the contractual context is extremely important because the contractual context set the conditions under which competition takes place and I'm going to make that point fairly forcefully shortly.

ELIAS CJ:

Well we will have to enlarge on that.

MR FARMER QC:

Indeed I will.

ELIAS CJ:

Yes

MR FARMER QC:

And it's a very important part of our case. Now just a few general remarks about the ICAs, they were in similar terms for the four major rival carriers. There is Clear Communications, Saturn, Telstra and Compass. The focus in the case at trial was very much on Clear and on its ICA, but there was evidence particularly from the man from Compass which I'll refer to later. They were in similar terms the structure of the agreements was the same. The particular start dates differed a little and the length of the terms may have differed a little as well, but broadly speaking they were the same. So that when I refer to Clear's ICA as effectively I will, because as I say most of the evidence was directed to it, with respect one mustn't lose sight of the other, that the other carriers were in exactly the same position and other carriers were also dealing with ISPs in a similar way to that which Clear had been. So the Clear ICA, taking that, that was for a five year term entered into in 1996. Those agreements provided for interconnection, obviously between Telecom's network and the rival contracting network on the basis, as I've already indicated, that the network receiving a call, whatever kind of call it was, would be paid a termination charge per minute by the network from where the call had originated. Now at their inception, the ICA's were extremely favourable to Telecom because, for example, in respect of local calls, the level of termination charges paid to Telecom by the other network was much higher, in fact was twice the amount than the termination charges paid by Telecom to the other network for calls that it made into the other network. Now that particular differential did change over the life of the agreement, but it started out at twice the amount, and over the life of the agreement that differential reduced. But as I say, at the outset, very, very favourable to Telecom, and that has significance, and this we'll come to. Now –

ELIAS CJ:

I may be wholly astray in this, so please do correct me.

MR FARMER QC:

Sorry, certainly.

ELIAS CJ:

The agreement, the ICA was designed to reflect the opportunity cost to Telecom, was it not?

MR FARMER QC:

No.

ELIAS CJ:

It was not?

MR FARMER QC:

Not in the sense of Privy Council judgement in Telecom and Clear some years earlier. The Privy Council you remember had this –

ELIAS CJ:

Yes.

MR FARMER QC:

- ECPR opportunity cost regime.

ELIAS CJ:

Yes.

MR FARMER QC:

This was a commercially negotiated agreement, which had no principle underlying it. None whatsoever. It was a crude, commercial bargain and the outcome of it – in fact Clear had wanted what's called a bill and keep regime…

ELIAS CJ:

Yes.

MR FARMER QC:

Where there are no termination payments either way. You just make the call and you receive the call and the thing, the call, the charges are in effect netted out. There is no charge. But Telecom, no doubt using the market power and the commercial muscle that it had, because after all it was the ubiquitous network, it was the one that the rivals needed access to, rather

than the other way around, using its commercial muscle was able to extract this particular regime where they were paid twice the amount that the other carrier was paid.

BLANCHARD J:

You're not suggesting that Telecom was acting unlawfully at that point?

MR FARMER QC:

No, I'm not saying that, I'm saying they used their market power. I'm not saying they did so anti-competitively, I'm just saying they used their market power. That must be the case, because they, one normally doesn't, would not agree to such an unequal –

ELIAS CJ:

But if they used their market power, unless it was on some principled basis, it would be anti-competitive.

MR FARMER QC:

It may be, but it's not been part of our case so I –

ELIAS CJ:

Well except that isn't it the stratum against which your case has to be brought, the fact of the ICA which has never itself been challenged as anti-competitive?

MR FARMER QC:

Clear did challenge it itself and launch proceedings and said it was unlawful, but the commission is simply, the commission's case if focussed on 0867 and on nothing else, but what the commission does say about the ICA is that it, to use the sort of, the language that's sometimes used in this area, it created a playing field that was certainly not level and it created, to put it more neutrally, it created the conditions under which competition would take place in which the costs borne by Clear were certainly greater than the costs borne by Telecom so far as termination of calls were concerned, and I'm not taking it any further than that.

TIPPING J:

It's an important part of the background, if you like.

MR FARMER QC:

It is.

TIPPING J:

Or the second in which the 0867 came along, I mean, you can't, whether it's lawful or not – I take it your case is simply there it was?

MR FARMER QC:

Absolutely.

TIPPING J:

Yes.

MR FARMER QC:

Yes, yes. It's an important feature of the case, and, and, um, one of – I'm going to give you the reference, I may as well, you'll remember I'm sure, in QCMA what, the famous case of QCMA, what was said by the Australian Trade Practices Tribunal was judgement – usually attributed that had been written by Maureen Brunt was that the extent to which competition takes place is largely a matter, not entirely, but largely a matter of market structure, and there are the elements of market structure that are listed, including things like barriers to entry, but one of the features of market structure is contractual long-term stable contractual arrangements, and here we have a five year contractual arrangement structured in a particular way, very favourable to one of the rivals, namely Telecom, and therefore creating conditions under which each rivals must compete and what that then led to with the Internet explosion was those rivals obtaining an opportunity to turn the tables to some extent, and that's the story that we'll come to. So the conditions, the market conditions changed, but the contract remained the same.

ELIAS CJ:

But if it was a crude commercial bargain…

MR FARMER QC:

Yes.

ELIAS CJ:

Behind which you don't go to allege that it was anti-competitive, why is adjustment of this crude commercial bargain something that is necessarily anti-competitive, or that is, perhaps necessarily is a wrong…

MR FARMER QC:

Why is the adjustment on it?

ELIAS CJ:

Yes.

MR FARMER QC:

What Telecom was asking its rivals to do was to change that contract, or to enter into a new contract and were creating incentives, to use a rather neutral word, on subscribers to force through the process I've already outlined the other carriers to enter into new contractual arrangements…

ELIAS CJ:

To force a judgement, force adjustment to what proved to be an improvident bargain?

MR FARMER QC:

Improvident bargain ultimately for Telecom.

ELIAS CJ:

Yes.

MR FARMER QC:

Yes. Yes, not what we say is that, yes, there were changed competitive conditions that evolved in the market as the Internet explosion occurred. Telecom had various ways of dealing with that that were perfectly legitimate. It could compete more effectively, and we give examples of that, but what it couldn't do was use its market power to force its competitors to give up a particular competitive advantage that, as things had turned out, they had at that particular time. Now that was attacking the competitive ability of its competitors, which section 36 says you can't do. So, as I say, the story really is that as the Internet growth expanded dramatically in the late 1990s, an opportunity was seen by the rival carriers to use the particular contractual structure to their advantage, and what they did was they basically went out and got ISP's onto their network, attracted them for the network and one way that they did attract them to the network was to say, we will, if you stay on our network, we will share termination payments from Internet calls, the revenue from those calls with you. That will, in turn, enable you to lower your charges to your customers and you will thereby attract more Internet business yourselves from your customers, and we will both be winners in that situation. And that proved to be a very effective business model as it turned out, and indeed it had a number of effects, first of all it slowed completely the growth that Xtra, for example, had been experiencing, Xtra had 75 percent of the Internet residential market. It slowed the growth that it had been experiencing. It forced Xtra to reduce its costs as well but in fact the –

TIPPING J:

Costs or prices?

MR FARMER QC:

Prices I'm sorry. Prices. Prices as well and – but it nevertheless faced a real, it faced a situation where the ISPs on Clear's and the other carriers network were able to offer extremely attractive rates to their customers, indeed were able to, in some cases, to offer free Internet access and I'll come back to that as to how they were able to do that. so that what had previously been Telecom's wholly profitable and advantageous ICA, had in one area, in one area of its operation, namely the area that dealt with calls that were going to the Internet, had become very unprofitable because the termination payments that it was having to be made grew as the ISPs work, as the ISPs business on rival networks expanded. But it is important to note, just at this point, that in the other areas of the ICA, particularly the local voice calls, nothing changed. It was the Internet explosion, the Internet termination payments where the ICA became increasingly unprofitable for Telecom and it was that segment of the ICA, it was a selective attack only on the ICA, which Telecom sought to hive off into different contractual arrangements, or a different contractual regime, that would have the effect of removing the competitive advantage that its rivals had obtained through that particular business model.

So the issue that's really been at the heart of this litigation is whether, first of all as the Commission says, Telecom's conduct in introducing 0867 and the dial-up two cent charge was an illegitimate, anti-competitive measure constituting a use of its dominance or market power or whether, as Telecom says, the 0867 scheme was pro-competitive in the sense that it, as they put it, removed distortions and what Telecom call perverse incentives that were not the product, they say, of superior efficiencies but were mere opportunistic arbitrage and they've given the word arbitrage a rather, they say it's a rather nasty word and I want to come back shortly and say something about that.

Now the High Court, in terms of the, you know of course that s 36 prohibits the use of market power or at that time dominance, dominant position in a market, for an anti-competitive purpose and on the question of whether a firm has, with market power has used that market power, the High Court followed the direction of the Privy Council in *Telecom Corporation of NZ Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) and in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145 (PC), the majority in *Carter Holt* only, that the issue of whether a firm with market power has used that power in its competitive activities must be determined and can only be determined by the employment of a counterfactual analysis in which the conduct is tested by placing it in a hypothetical competitive market environment. So you accept that because the firm is dominant we don't have a competitive market, let's pretend we have one and let's see whether Telecom, or its equivalent, without market power could have, could rationally have successfully implemented 0867 in that competitive market and that was the counterfactual test. The conclusion by the High Court was that in the competitive market counterfactual Company X, which was a

Telecom equivalent, would have been able to implement 0867 successfully and therefore it could not in the factual be said to have used its market power in its implementation of 0867.

Now the Court of Appeal, as Your Honours will have seen, expressed reservations about the counterfactual in this case and that really, a lot of that relates or revolves around the size of the termination payments and the fact that the termination payments contained monopoly profits. So the Court of Appeal expressed reservations about the counterfactual but it also regarded itself, as it had to, as being bound by the Privy Council in restricting the determination of this issue of use of market value to a counterfactual analysis and did not feel, when doing that, constrained to disagree with the High Court's analysis of the counterfactual.

So the issue of public importance that is before this court is whether the Privy Council view that the counterfactual is a necessary test for determining whether a firm with market power has used that power, or whether other more factually based tests, as expounded by the High Court of Australia in a number of cases and by the minority of the Privy Council in *Carter Holt*, are appropriate, at least in some cases. So we're not saying the counterfactual can never be used. We're saying that each case really needs to be examined on its own merits as to which is the more appropriate method of assessing this issue. In fact it –

TIPPING J:

You don't have a suggested substitute test Mr Farmer, you are simply saying that the variety of approaches that have emerged in Australia is what we should be espousing, is that –

MR FARMER QC:

That is so Your Honour. We also say though that if we do apply a counterfactual test to this case, with respect the High Court got it wrong –

TIPPING J:

I understand that –

MR FARMER QC:

Yes.

TIPPING J:

– but you don't have a silver bullet. You just want the range of tests?

MR FARMER QC:

Want the range of tests, to the extent that we think one maybe more appropriate than the other in case, we think this is a case where the so-called materially facilitated test applied by the High Court, or recognised by the High Court of Australia rather than applied in *Melway*

Publishing Pty Ltd v Robert Hicks Pty Ltd (2001) 205 CLR 1 (HC of A) fits the case quite well. We also think that the minority, the approach by the minority in the Privy Council of – or assessment of the facts of the case, looking at all the evidence, and then coming to a judgment on the facts, which was, with respect, the sort of approach that Your Honour took in *Magic Millions* where Your Honour said it was a matter of fact and degree –

TIPPING J:

I knew far less then than I, in the sense that I think my approach might have been a little naïve in *Magic Millions* –

MR FARMER QC:

Well you were probably tutored in a rather misleading way.

TIPPING J:

Possibly Mr Farmer, yes. But in any event we would say, with respect, that what, the way Your Honour expounded in *Magic Millions* is actually very close to what the minority in *Carter Holt* said in Privy Council and very close indeed to the approach taken by the Court of Appeal in earlier cases, such as Telecom and Clear itself, these are mostly judgments of His Honour Gault J, *Carter Holt* at the Court of Appeal stage, *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) and also by the Court again the same Judge's judgment in *Electricity Company Ltd v Geotherm* [1992] 2 NZLR 641 (CA) and I will come back to one or two of those cases.

ELIAS CJ:

And you'll come back to explain why materiality isn't a species of counterfactual, a species of the counterfactual test?

MR FARMER QC:

Yes but I can say probably fairly shortly now it can't be because that test recognises that in the counterfactual it may well have been possible still for the term "stripped of its market power" to have done what it did so the counterfactual in that sense, test is met in terms of not establishing use of market power. But what it says is that nevertheless if the firm's market power made it easier for it to achieve that same result, well then there could be a breach of the section so it's, if you like it is a more, it's an approach that would lead to a greater readiness of fine liability than a strict counterfactual approach.

ELIAS CJ:

Is that because it concentrates on the actual effect?

MR FARMER QC:

No it – well it's really because it recognises that the reality is that firms with market power competing with firms without market power will always be more effective. They have greater advantage and the use of that market power if they are indeed seeking to achieve some particular anti-competitive purpose, they will be able to achieve it more readily. The problem with the counterfactual is that it leaves purpose to one side and it just says, we're going to look to see whether the firm has used its market power and we'll test that by putting it into this competitive market, hypothetical competitive market and if in the hypothetical competitive market the firm could still have done what it did in the factual, then it hasn't used its market power, therefore one of the elements of section 36, therefore we don't even have to worry about anti-competitive purpose, it could well have had an anti-competitive purpose, doesn't matter, because one of the elements is missing. Now what the materially facilitated test does is to really say, well the fact that it could've done it in a competitive market isn't really enough, it's if in fact it's been able to do it more easily because it had market power, then there's a breach.

TIPPING J:

Is it really that the market power gives you an advantage, if you'll forgive the word, in achieving what you're seeking to achieve?

MR FARMER QC:

Yes. And that's sort of, that kind of starts, putting it that way, starts to look a little bit like the approach that Deane J and Dawson J took in *Queensland Wire Industries Ptd Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177 (HC of A) where they said, "Let's start with the anti-competitive purpose, if we think there's an anti-competitive purpose, we'll then ask the question, could that purpose only be achieved if you had market power and if you used it?" And there you can see all three elements of section 36 have been integrated into the one exercise, and so that's a different approach again, even from materially facilitated, because materially facilitated is still leaving purpose out to one side, but it's just a more, it's an approach which as I say, would more readily lead to a liability. But the approach that Dean J and Dawson J took as I say integrates the three and if you take the minority in the *Carter Holt* approach where you just say, look, let's look at everything, let's look at the facts and are making an assessment and a judgment of what we think's happening here, well then everything is being looked at again at the same time, including purpose.

McGRATH J:

Is material facilitation partway between a test based on whether you could've done it and a test based on whether you would've done it?

MR FARMER QC:

There's a whole debate around could and would.

McGRATH J:

Yes.

MR FARMER QC:

Particularly in Australia and I think the – I think the way it's been reconciled to the extent that it has, is to say well could really means could rationally have done it, which makes it start to look a little like would, but not entirely.

McGRATH J:

So those two concepts emerging and material facilitation isn't a separate concept between –

MR FARMER QC:

Well I'm not sure, I'm not sure of the answer to that Your Honour to be quite frank.

McGRATH J:

If it's an uncertain – I don't want to get into it yet.

MR FARMER QC:

No, no, right. I do think this though, just going back to purpose, that it's somewhat, the problem with the counterfactual in its very pure form that has been so far adopted by the Privy Council, where purpose is left to one side and where you have this sort of what my learned friend's described as a "but for" test. Could the firm, if the firm could not have done this but for its market power, the problem with that in a way is that it really is, as I say, it's very much a hypothetical approach, because the better approach really is to look at the case as a whole, look at the purpose. Now if the purpose is simply to compete in the normal way of competition where one has a better product, a cheaper product, where one drives one's own costs down to be able to price more cheaply, all of that is fine and the competition can be extremely vigorous because when you go out to the market with a cheaper and better product, you are actually putting enormous pressure on your competitors and that's exactly what we would all like to see. But if on the other hand the competition is directed at attacking the ability of the competitors to compete, not by reference to your product, your better product, but rather by removing from them, pulling out from under them, particular advantages that they have, particular market positions they have, then one would suspect and think that that is really an anti-competitive purpose and of course if the firm has got market power, and if it has the ability to do that, well then, if you're just looking it at it in the round, you would say, well that certainly looks like a breach of section 36, but if you go off with the economist to the side and you have this little hot tub where we all have a hypothetical debate, and we enjoy it,

my learned friends and I love it, but is it really, is it really getting you to the right answer? In some cases it will. But in many cases the level of abstraction and the level of unrealism, just becomes counter-productive. In any event I –

ELIAS CJ:

As you say, an anti-competitive purpose can't be a competitive purpose –

MR FARMER QC:

No.

ELIAS CJ:

So what, in a nutshell do you say was the anti-competitive purpose here?

MR FARMER QC:

It was – in the market as it existed, under the contract.

ELIAS CJ:

Under the contract.

MR FARMER QC:

As it existed, termination payments were being made at a certain rate and a business model had been adopted by the rival carriers with their ISP clients, that was making them extremely competitive, that was enabling them to drive Internet prices down, that was enabling them to rapidly build up their customer basis and put pressure back onto Xtra. So that the anti-competitive purpose was in the way that 0867 operated was depriving, forcing the carriers and their ISP clients to change the conditions of competition by entering into the new ITAs and by agreeing, necessarily agreeing that no longer termination payments be made under the interconnection agreements, but where instead, the whole Internet access regime would be dealt with under a new contractual regime which had no termination payments at all in it.

ELIAS CJ:

Well is that saying that any attempt to change the terms of the ICA, would necessarily have been anti-competitive?

MR FARMER QC:

No, they could have – Telecom could gone to them and said, we want to renegotiate the ICA.

ELIAS CJ:

Any change –

MR FARMER QC:

Forced.

ELIAS CJ:

Not achieved by agreement?

MR FARMER QC:

Yes.

ELIAS CJ:

Thank you.

BLANCHARD J:

If there hadn't been an ICA, would it have been anti-competitive behaviour?

MR FARMER QC:

If there hadn't been an ICA we would never have had the problem, because Telecom could never have had the problem, because there would've been no termination payments.

BLANCHARD J:

Would it have been anti-competitive for Telecom to have suggested such an arrangement, the new arrangement, in the absence of an ICA?

MR FARMER QC:

No, one can always suggested any contractual -

BLANCHARD J:

So the anti-competitive element was the forcing of their hands out of the contract?

MR FARMER QC:

Yes.

BLANCHARD J:

If I may mix my metaphors.

MR FARMER QC:

Yes, yes without – the reality is, and indeed Clear in particular had – I did say that they, first of all they said that the 1996 ICA was itself anti-competitive, but they also sought to renegotiate the ICA, at least early in its history.

BLANCHARD J:

So the anti-competitive purpose was forcing them to give up a contractual advantage?

MR FARMER QC:

A competitive advantage that arose out of a particular contractual situation.

BLANCHARD J:

Well it was a contractual advantage.

MR FARMER QC:

Which gave rise to a competitive advantage.

BLANCHARD J:

Yes.

ELIAS CJ:

Even though the contract didn't prevent, it didn't seek to prevent that, and was only for a term of five years.

MR FARMER QC:

It was only for a term of five years and that's an important point that is relevant to the counterfactual analysis that I'll come to, in other words the contract, and the time 0867 was introduced it only had 18 months to run and that's relevant to how the cost and benefit analysis that was done by the High Court in relation to the counterfactual but I'll come back to that if I could.

BLANCHARD J:

But I think what the Chief Justice is really getting at is if they didn't have a contractual advantage, where's the anti-competitive purpose?

MR FARMER QC:

If they didn't – if they didn't have a contractual advantage I have to say – which gave rise to a competitive advantage?

ELIAS CJ:

Yes.

BLANCHARD J:

Yes.

MR FARMER QC:

Then this case would not, we would not be here.

BLANCHARD J:

Well you were saying earlier that you're not alleging any breach of contract?

MR FARMER QC:

No I'm not. I'm not.

BLANCHARD J:

So where was the contractual advantage?

MR FARMER QC:

The contractual advantage was the right to receive termination payments –

BLANCHARD J:

But there was no right in relation to Internet dial-up.

MR FARMER QC:

Yes there was. Yes there was.

BLANCHARD J:

Well –

MR FARMER QC:

They, Telecom –

BLANCHARD J:

– how could there have been in the absence of any allegation of breach of contract?

MR FARMER QC:

Telecom had paid termination payments for Internet calls from the beginning of that contract.

BLANCHARD J:

Yes, but it didn't have to.

MR FARMER QC:

Yes it did. Why would it – if it didn't believe that it was obliged to –

BLANCHARD J:

Well we often do things under contracts and then think well wait a minute, I don't have to do that.

MR FARMER QC:

I'm sorry, I've never done that.

BLANCHARD J:

Come on Mr Farmer, it's common practice for people to think they are bound to do something under a contract and then having thought about it more realised that they're not. Half the contract cases that come to Court arise out of that situation.

MR FARMER QC:

Okay. So what is Your Honour putting to me exactly?

BLANCHARD J:

I'm putting to you that in the absence of any breach there is no contractual advantage. It was non-existent. Telecom may have thought it was there.

MR FARMER QC:

Sorry I don't quite –

TIPPING J:

I wonder if it would help you Mr Farmer if you put it to us that what they were trying to do was to get out of a contractual disadvantage as it developed?

BLANCHARD J:

Well it's not a contractual disadvantage if you're not bound to it.

ANDERSON J:

Well it was at least moot, wasn't it, whether the parties were arguing about it?

MR FARMER QC:

The parties weren't arguing about that particular issue. They weren't arguing about that particular issue.

TIPPING J:

I thought under this ICA the way things turned out they were haemorrhaging money instead of coining it.

MR FARMER QC:

That's right because, because at the beginning of the ICA all local calls, and a local call is the picking up the telephone and ringing a number, and it doesn't matter whether you speak at that point or whether the call is going through your computer and going out to the Internet, it is a local call, and the ICA did not distinguish between those two calls. All local calls went down the same line, same copper wire, out to the exchange and from there out to the number that the ISP had and then the ISP at that point sent it off out into the ether. So there was no distinction drawn in the contract between the purpose of a call and whether someone spoke into a telephone or whether one typed on a computer.

BLANCHARD J:

You've conceded that the competitive advantage came out of the contract.

MR FARMER QC:

Came out of the termination payments made under the contract, yes.

BLANCHARD J:

If the contract did not in fact bind Telecom in that respect then there was no competitive advantage.

MR FARMER QC:

If Telecom was not bound by the contract it would've have just simply stopped making termination payments. It wouldn't have done 0867 –

BLANCHARD J:

So you are alleging breach of contract?

MR FARMER QC:

No I'm not. I'm saying it doesn't matter whether it's breach of contract or not –

BLANCHARD J:

Well I'm having difficulty understanding that.

MR FARMER QC:

But if – Your Honour, with the greatest of respect, if Telecom had truly believed that there was no obligation on it to make termination payments under that contract for Internet calls, it would simply have stopped making them. It wouldn't have come up with this very convoluted

scheme, the 0867 scheme, with the two cent dial-up charge. Even under 0867 there were still going to be calls –

BLANCHARD J:

So you are –

MR FARMER QC:

– made where termination –

BLANCHARD J:

So you are arguing that they were bound to do that?

MR FARMER QC:

Well they certainly thought they were.

BLANCHARD J:

Which way are you arguing it?

MR FARMER QC:

I'm saying that Telecom made payments under – for Internet calls, under that contract in exactly the same way as voice calls.

BLANCHARD J:

Which they may or may not have had to make?

MR FARMER QC:

Well if they thought they didn't have to make it, my point is, why didn't they just stop making those payments?

ELIAS CJ:

Well effectively they did, they readjusted it. They may well have thought –

MR FARMER QC:

No, with respect Your Honour, what they did was that they said to this – to their own residential subscribers, you can keep making these calls but we're going to charge you two cents.

ELIAS CJ:

Yes.

MR FARMER QC:

And if they, if the residential subscriber had done that, then Telecom would still have made the termination payments but the whole point of the two cents was to force the residential subscriber, in the way I've described, to go down to its ISP, the ISP to the carrier to say, put us on an 0867 number which is a free calling option. And the free calling option, to get an 0867 number Telecom said to the carrier, if you want one of these numbers, you have to agree, enter into a new agreement which has no termination payments in it. Now with respect Your Honour I can't see how it could possibly be argued by Telecom that it went through all that process because it believed it didn't have to make termination payments for Internet calls because if it believed that it would just simply have stopped making them.

ELIAS CJ:

But is it not essential to your argument that the conditions of competition, departure from which was anti-competitive and in abuse of dominance, the conditions of competition were those settled in the –

MR FARMER QC:

In the ICA.

ELIAS CJ:

– in the ICA for it's that aspect that I'm struggling a little bit with. You might want to come back to it.

MR FARMER QC:

No well I'm moving onto it actually now I think I believe. I've given the *QCMA* reference and the whole arbitrage I think it becomes clear when we look at that. So I think where I got to was in saying that the, it is important to note that the ICA's governed all traffic passed on between the networks not just local traffic and it's important also to appreciate the strength of the Telecom network. It was the only ubiquitous network in the country, 99 percent of telecommunication users were subscribers to it. Now the Commission says that the terms of the 1996 ICA is an in particular the what we – what was referred to as the asymmetric charging regime in respect of all services, that Telecom insisted upon against Clear's preference for bill and keep, had two, so that had two principal effects. First, it was the product, I've dealt with this point, we say that Telecom, the ICA can be seen as the outcome of Telecom's huge market power. They – the carriers, the rivals needed Telecom, Telecom didn't need them and so in that situation Telecom had the commercial leverage to extract very favourable terms and I'm not putting it any higher than that. as I said earlier I'm not saying

that that was or was not a breach of section 36, that's never been the case that we've run, although it certainly was a case – a view that Clear had.

Now secondly it set the framework within, that is to say the ICA, set the framework within, and the conditions under which competition would necessarily take place for the life of that contract and in terms of effects beyond it and I gave the QCMA reference, I won't take you to it but it's in, I'll tell you where it is, it's in Telecom's bundle of authorities at tab 70 and at page 516 of the judgment it was said, "That whether firms compete is very much a matter of the structure of the markets in which they operate and the elements of market structure include," and then one of the five elements that is listed is the existence and the nature of any formal, stable and fundamental arrangements between firms and the ICA was a fundamental arrangement between Telecom and its competitors. The Commission, however, says that as the market conditions for Internet growth changed, they did create an opportunity that we've referred to for Clear to endeavour to level the playing field. Now, that opportunity has been disparagingly described by Telecom as an arbitrage that exploited perverse incentives, and it says that exploiting and arbitrage opportunity is not "competition on the merits", and I'll just give you the reference, their submissions, paragraph 5.69. That, of course, conveniently ignores the fact that the terms under which competition take place are the terms that they created in the 1996 ICA, so any accusation about arbitrage and arbitrage not being competition on the merits necessarily needs to be put in the context of the ICA itself. That was a point that Dr Bamberger who was the expert economist called by the Commission said, and again, I'll just give the reference without taking you to it. In his reply brief, paragraph 22 volume 4 of the case on appeal at page 1414, he said, "The economic incentives to which Clear responded were created by Telecom, and weren't negotiated in the 1996 ICA." Now, other than under a model of perfect competition, a characteristic of markets, in our submission, is that they are replete with so-called arbitrage and other transitory opportunities. Indeed, they feed into the competitive process in a very positive way. Firms that are selected –

ELIAS CJ:

I don't think you need to develop this, particularly.

MR FARMER QC:

Well, it's through my learned friend's submissions.

ELIAS CJ:

But isn't it rather what's the cause? It is the – and it's the point that was being put to you earlier, is this a contractual problem, or is it a competition problem?

MR FARMER QC:

It's a competition problem.

TIPPING J:

It's a contractual problem to which they have to give a response, which is kosher in competition law terms.

ELIAS CJ:

Yes.

MR FARMER QC:

The way that I've put it is, the conditions of competition, under which competition takes place, were created by the contract.

TIPPING J:

But the problem was contractual, wasn't it? At least, in their perception.

MR FARMER QC:

In Telecom's perception?

TIPPING J:

Yes. And they had various things they could do about it. You say, contrary to what they say, that they chose the very one that was the worst.

MR FARMER QC:

That's right.

TIPPING J:

And they say they chose one which was perfectly all right. Isn't that the nub of the case?

MR FARMER QC:

It is, it is. Indeed. But what they also say is that the way in which Clear outsized the clients of the other ISP clients, the way that they responded to the contractual provisions was not competition on the merits. So that it's like saying, well, it's competition on the merits for us to have a contract where we get twice the termination payments of our rivals, but when they come up with a business model that actually gives them a competitive advantage over us in respect of Internet traffic, that's not competition on the merits. It's mere arbitrage. What I did want to give you, this submission, and give you one reference, one case law reference, is that it has been recognised that so-called arbitrage opportunities are, in fact, can, in fact, be very pro-competitive in the sense that they do, indeed, promote competition and certainly should not be regarded – and, indeed, further than that, a monopolist or an incumbent firm which

employs its market power to prevent firms from exploiting arbitrage opportunities may well breach competition or anti-trust law, and we actually have an example of that, which, again, I handed up this morning, because I only came across it in the last few days.

ELIAS CJ:

I think Mr Palmer may well have it, then.

MR FARMER QC:

It's an American case called *Metro Services v Qwest.* The judgment of the 9th Circuit. Just very briefly, what had happened was that the Court had found anti-trust liability in respect of – it's a telecommunications case – in respect of a – the Court had found anti-trust liability in respect of a monopoly or an incumbent local telephone company which had taken action to prevent resellers of its services re-selling its product. What the facts are set out, actually, you'll see on 13849, where the incumbent firm had offered cheaper prices for any business with 20 or fewer – with 20 telephone lines, 20 or more telephone lines, and what MetraNet, which was a reseller of telecommunications service did, was that they purchased that service from Qwest, but then re-sold the telephone services to small businesses which had fewer than 20 lines, and what Qwest then did was to change its pricing structure to require that customers have 20 lines or 21 lines at the same location in order to receive the volume discount. And the Court had found that that attempt to prevent the reseller taking the arbitrage opportunity was a breach of the anti-trust law. The Supreme Court referred it back. It referred it back for a different reason altogether, which was to do with the fact that the Telecommunications Act had a regulatory framework, which the Court thought did, in fact, provide an adequate remedy, and that's arising out of this, the famous *Verizon Communications v Law Offices of Curtis V Trinko* LLP 540 US 398 (2004) which my learned friends have raised in different ways in this case. But what I do refer Your Honours to on page 13863, where there's a section, elimination of arbitrage, and looking at the second paragraph on that page, and this has to be obiter, because the Court, in fact, went on to say that the regulatory framework did, indeed, as the Supreme Court had indicated, provide the remedy, and there was no need to resort to anti-trust law, but in that second paragraph, what was said was, "With regard to the benefits of anti-trust intervention, we recognise that in posing anti-trust liability on sellers who unilaterally attempt to eliminate resellers can deter attempts to eliminate arbitrage that is beneficial to consumer welfare." So the arbitrage was seen as being beneficial to consumer welfare. "A reseller," the Court said, "can engage in arbitrage when a seller price discriminates among its customers, its consumers, in particular, if a seller charges a higher price to some consumers, called the disfavoured consumers, and a lower price to others, called the favoured consumers, a reseller can take advantage of this price differential by buying the product or service at the lower price intended for the favoured consumers and reselling it to the disfavoured consumers at a price below the price the seller charges the disfavoured consumers". And it goes on to say, "prohibiting sellers from

eliminating arbitrage thus can enhance consumer welfare under certain conditions", and it goes on to develop that point. Now –

ELIAS CJ:

Sorry, can I ask you one more question, and then I'll try to simply listen. But it is helping me understand. If the – if Telecom had imposed a two cent charge on its subscribers and offered the 0867 option, if that's as far as it went, would that – that isn't the anti-competitive behaviour that you're complaining about, you're complaining that that was done in order to force a renegotiation of the contract, the ICA, is that right?

MR FARMER QC:

It was done – it wasn't even done for that purpose. It was done in order to – ah, well, yes, renegotiate in the sense of forcing the rivals to come off the ICA and go into a new contract on the Internet.

ELIAS CJ:

Yes, thank you.

MR FARMER QC:

Now, the Commission says that that business model, the contractual arrangements that the rival carriers entered into with their ISPs were actually very pro-competitive. The so-called arbitrage was a pro-competitive measure that they took. It was a business model that actually intensified competition to the benefit of consumers, in the form of lower, even free, Internet access pricing by ISPs. Now, that was possible because the termination charges under the ICA were above cost. That was acknowledged, that was common ground in the case. Even the termination charges paid to Clear, even though they were half the rate of the Telecom charges, they were still considerably above cost. No-one is quite sure how much above cost, but they were above cost. And because they were above cost, there was a margin which could be shared with the ISPs clients of those competitors. So one of the points, indeed, that is made by Telecom is that Clear was a monopolist. It was Clear that was the monopolist because it was receiving termination payments above cost. Now, to the extent that that can be categorised in that way, nevertheless, the fact is if that was true of Clear, it was even more true of Telecom, because Telecom was receiving twice the amount of twice the payment. But the important point to note, with respect, is that the contractual arrangements which Clear entered into with its ISP clients distributed those monopoly profits, if that's what they are, or those profit margins, to retail Internet users in the form of lower Internet access prices, and thereby, in that sense, were consistent with the primary objective of the Commerce Act of

increasing consumer benefit through the process of rivalry. So with the greatest of respect, Telecom's attack on Clear and its ISP clients and on the other carriers and their ISP clients as somehow indulging in competition that wasn't on the merits simply can't be made out. Indeed, the absolute reverse is the case, because, as I say, those margins that were available under the ICA were redistributed back to the consumer in the form of lower prices.

TIPPING J:

Mr Farmer, let's say that what's said is true, and I'm not accepting it, that there was something naughty going on here. It doesn't give them the licence to be naughty in return, does it?

MR FARMER QC:

Give who?

TIPPING J:

Telecom.

MR FARMER QC:

No, no, absolutely not.

TIPPING J:

I mean, I'm –

MR FARMER QC:

Well, the case they make is to say we were not acting anti-competitively. We were simply taking steps to remove a distortion in the market, that's one phrase they have. We were taking steps to deal with a situation where competition was not taking place on the merits. We were taking steps to remove the arbitrage opportunity. We were taking steps to remove the perverse incentives. It's the sort of case that they make.

TIPPING J:

Yes, I understand that. But what about anti –

MR FARMER QC:

Now, apart from the fact that the Internet users who are subscribers to ISPs on rival networks receive very low prices for Internet access, indeed, in some cases, they didn't pay at all, those lower prices put competitive pressure back on Xtra, and Xtra was forced to lower its prices. So everyone was a winner, except maybe Xtra and Telecom. Now, we – so just to deal with,

and I've already dealt with it in summary just now, but to deal with what Telecom says about this, we say it's no answer for Telecom to make a number of points. The first point they make is they say, well, yes, we may have had market power, although we dispute that, but we were entitled to compete and respond vigorously to the inroads that were being made on our profitability. We have a duty to our shareholders. Now, the issue is not of the entitlement to compete, we say, but the issue is whether what they did and the way they did it falls foul of section 36, and, again, if I can refer to Dr Bamberger in his reply brief, paragraph 24 volume 4, 1415, he says, well, the key issue in this litigation is not whether Telecom chose to respond to the change in the conditions that come about, but whether its choice of how to respond was use of its dominance for an anti-competitive purpose. That's the issue. It's not that they didn't have a right to respond. Of course they did. Now, the second point Telecom makes is that – and I've just indicated again – 0867 removed a market distortion created by the sharing of termination revenues, and we say, well, if there was a distortion in the market, the distortion actually arose much earlier. It was the distortion of the asymmetry of termination charges in the ICA, and it was that asymmetry which, in fact, handicapped all Telecom's rivals, and the investment choices and options that they had, could make in competing with Telecom. So that the business model that they came up with, we say, is that it was a perfectly rational and legitimate means of competing with Telecom in market conditions which Telecom itself had created.

McGRATH J:

Are you really saying that the nature of the arbitrage opportunity that was used by Clear and others isn't relevant to the key issue, which is how Telecom responded?

MR FARMER QC:

Yes. That's so. And really, Telecom have arranged a bit of a smokescreen here, a sort of attack is the best means of defence. And so what they're really seeking to do is to justify their actions by attacking, by saying that we were addressing was the fact that there was not competition on the merits occurring. And what I'm saying is – well, I'm saying two things, the same thing at different levels. I'm saying first of all that what Clear and their other rivals were doing was pro-competitive, and to consumer benefit in the way I've just described, and secondly, I'm saying that Telecom was not entitled to remove the ability of those rivals to compete in a way that was, in fact, benefitting consumers.

McGRATH J:

If they are able to answer your first prong of the argument, that what was done by Clear and others was pro-competitive, you still stand by the second, though, do you not?

MR FARMER QC:

Yes, I do.

McGRATH J:
That the way they did it was wrong?

MR FARMER QC:
Yes.

McGRATH J:
And is that really the main focus of enquiry, on your submission?

MR FARMER QC:
Yes, I am happy to adopt that.

ANDERSON J:
Mr Farmer, this may be an elementary enquiry. If a Clear ISP elects an 0867 number, does that involve that ISP going onto Telecom's network?

MR FARMER QC:
It involves it going to a network which has entered into an Internet traffic agreement with Telecom, in other words, the ISP can't get an 0867 number from a carrier which hasn't entered into an ITA with Telecom. And so all the rivals had stayed off, stayed away from ITAs, none of them would sign them, then the ISP would have, in effect, no option but to go to Telecom at that point. But it could go to any carrier who'd entered into an ITA and given up, therefore, its right to receive termination payments.

Now, a third point, another point that is made by Telecom about the business model is they say that the business model was, or created inefficiencies. They also say it was of no lasting value to the ISPs and their customers because it was unlikely to survive the expiry of the current ICAs, which in Clear's case had about another 18 months to run at the time that the 0867 was introduced. Now the evidence is, though, that the ISPs – although the receipt of the termination payments was the platform from which they were able to establish a very rapid customer increase in their customer base, or basis, the evidence was that they, in the longer term that they saw considerable value arising from, at least starting out in this way using, being able to use the termination payments to trigger growth, and growth not only in the form of attracting customers from Xtra or other networks or other ISPs, but also generally growth in Internet traffic users. Because of course if Internet access became free or very cheap then people who previously hadn't used the Internet would be much more inclined to sign up for it, or people who did use it but used it sparingly because of the cost of it would use

it more often, much more often if the act, the use of it was either free or very cheap. And so the ISPs business models, in fact, went beyond just simply looking at where they were with sharing of termination payments and the ability to provide free or very low cost Internet services and that was explained, for example, in the evidence given first of all by one of the Internet service providers and also by one of the other carriers, and I'll give you this reference, I perhaps would ask you to look at this evidence, you'll find it, it's the evidence of Mr Malcolm Dick, who was the managing director of CallPlus. CallPlus was an ISP that charged customers, but which developed a free ISP called i4Free, which is entirely appropriate, and his evidence is to be found in volume 2 of the case on appeal, both in his original brief and then he was cross-examined at some length. So if you do have volume 2 there, he, first of all at page – sorry Your Honours, I thought I had this, here you go, in his brief at page 490 he describes how they set up i4Free. At paragraph 44 he said, "The key assumptions in our planning of free Internet service were, first, it should at least break even, not taking into account advertising revenue." Now, advertising revenue was an important benefit that was seen from ISPs. "It would result," he said, "in Internet users switching from their existing ISPs, slow the growth of existing ISPs and the introduction of new ISPs. It could be discontinued if terminating revenue was discontinued or significantly reduced at the end of 2000, which we knew was a strong chance, so that was when the ICAs came up for renegotiation. Existing users could then be transferred to other paid ISP services. Alternatively, there may have been sufficient advertising revenue to maintain the free ISP. I believed that terminating revenue would continue, even if at a much lower rate. It would be capable of growing at a rate of 10,000 customers per month, which is huge. In the long term, we aim to exit the venture by way of a public listing or sale." And over the page at 46, "We did considerable research into the offering of free Internet access, prepared a projection at the beginning of February 2000," which was then refined, so that's in evidence, I won't take you to it.

And then at 52, paragraph 52 he says, "Although the user would receive free access to the Internet, our free ISP would obtain revenue from advertising, commission on sales on affiliate programmers with e-commerce sites, direct marketing of products to the customer base, sale and value added products which are charged for, for example web hosting, domain name hosting, filtering products for families concerned about violence, pornography on the Internet, et cetera. Revenue from Clear under the agreement with Clear for terminating dial-up Internet traffic received from Clear's network." So you'll see that the termination payments were one and an important source of revenue that certainly enabled them to get off the ground, but in the medium to longer term, they had these other sources of revenue very much in mind, and if you go over to 55, he said, "The free Internet business was designed to encourage through a wide advertising campaign a significant number of customers to sign up for free Internet access and a free email service with i4Free."

So it was building the base, building the customer base and then going on to develop other revenue sources, and what he also went on to say in his evidence was that, over time what actually happened, which with the end of the termination payment regime was they moved the customers off the i4Free base back onto a CallPlus lower priced base, and I can give you the references for that, that's ready – I won't read it to you, but he deals with that at pages 559, when he was cross-examined, 560, 560 at about line 5 he says, "In the end what happened was i4Free is we set up a low cost pay ISP, which was Slingshot, which of course is one of the major ISPs even today. It's all well known today. We transitioned a number of those customers onto Slingshot so it still had a reasonable outcome."

And at line 19 he was asked, "Is it your evidence that, had Telecom not cut off service or the 0867 number at the beginning of April, you could've built a viable free Internet business?" "Yes." I won't go into detail that what actually happened was that after 0867 came in, i4Free came up with this, what they call a call re-address scheme where they were able to redirect calls around, even though there was an 0867 number, and still get the calls and at that point Telecom said enough was enough, they cut them off, i4Free went to Court, got an interim injunction and then ultimately later the whole matter got, ended up being settled, and he said, in fact, at the top of page 561 that was actually quite damaging to the people, lost confidence in their system because they'd been cut off by Telecom, but as he went on to say in 561 at line 9, "However, having converted it to a pay ISP and growing that base, growing that base the return was fine in the end."

So there was the, as I say, the broader, longer-term business plan not in the longer-term dependent totally at all on continuation of termination payments, but that initial period, that 18 months it was still to run was quite critical in helping them to grow the customer base to begin with, and he also went on to say elsewhere in the cross-examination that the free Internet service was what he called a "differentiated brand" and he referred to similar models that had been used, and were still being used, both in the UK and in the United States. Does Your Honour take a break at –

ELIAS CJ:

Yes, we'll take the break now thank you.

COURT ADJOURNS: 11:29 AM

COURT RESUMES: 11:51 AM

ELIAS CJ:

Thank You. Yes Mr Farmer.

MR FARMER QC:

Just before the break I had just taken you to Mr Malcolm Dick's evidence relating to the setting up the buy for free and the fact that it had a longer term, longer term objectives based on the ability to grow a customer base very rapidly through free Internet service, making use, of course, of the sharing of termination payments with Clear at the beginning. Now I wanted to refer you next to evidence from the managing director of Compass. Compass is a very interesting company –

ELIAS CJ:

Mr Farmer, why are you taking us to this?

MR FARMER QC:

Because I want to –

ELIAS CJ:

I just want to know a map of where we're going.

MR FARMER QC:

Okay. I'm really dealing with the point that the, so-called arbitrage opportunity in fact was, had a longer term life than simply the mere arbitrage that arose –

BLANCHARD J:

It was a springboard.

MR FARMER QC:

It was a springboard, yes.

BLANCHARD J:

it's as simple as that, isn't it?

MR FARMER QC:

Absolutely, yes, that's right. And I won't dwell on it, I'll just give you the reference if I could?

ELIAS CJ:

Yes.

MR FARMER QC:

And just tell you in summary form what Mr Hussona, the nature of his evidence, he – Compass started life as a business customer toll service provider, initially fax communications

sent through the toll – sent long distance fax communications. It developed to the point where it became a carrier in its own right. it formed interconnection agreements both with Telecom and with Clear and it expanded its business fairly rapidly and it established a company called FreeNet which was an Internet free service Internet service provider but the important point about that was that it actually targeted – two points about it. One it targeted its existing business customers, toll customers, providing them with a free Internet service and it used that, a second point, it used that as a base for, once again for, as Your Honour puts it, as a springboard for developing right through into other telecommunication services including local calls, voice calls, et cetera. Now the references I give you, and as I say you won't need to go to them, but he was cross-examined, volume 3 at page 619, 620, my learned friend put to him that even without, even if the termination payments were discontinued at some point in the future, would there still be a valid business model, answer yes, definitely and in fact the business model was set out at some length in an internal document which you'll find, and it is worth a read, I won't take time on it now, but it's in volume 13, it begins at page 5470 and it indicates that FreeNet was to be offered as a bundled service, that is to say free Internet service provided that customers also spent $50 or more on traditional toll services. So it's an example of a telecommunications company bundling the services and using the free Internet service as part of that. now we'll come back to bundling later because it's part of Telecom's case that, when we look at the counterfactual, that in fact telecommunications companies do not bundle their services and we say well indeed they do and here in fact is a very good example of it and you'll see, if you read through the report, that just as we saw with Mr Dick, you'll find the additional sources of revenue advertising online purchases et cetera and using this, once again, as a springboard for selling and moving into other traditional telephone services such as local voice calls and the like.

Now this, what I've been saying so far under that heading that Telecom says well this is all, these arbitrage opportunities did not create efficiencies in the market and we do want to make this point, that whether what we're looking at here created an optimum efficiency in a market, in the telecommunications market, is completely beside the point because the underlying assumption of the Commerce Act, and of anti-trust law everywhere, is that competition is the process which will drive greater efficiencies in the form of lower costs to achieve more competitive prices and product offerings, and it's, in particular it's not for an incumbent such as Telecom to assume the role of regulator and to determine that its competition model is more efficient than that which emerges in the market by the actions of all firms.

ELIAS CJ:

Mr Farmer I wonder really whether it's necessary for you to develop this. speaking for myself I'm perfectly happy to accept the points that you're making subject to any response that Telecom might make and it may be that you can respond in reply rather than –

MR FARMER QC:

I'm happy to do that. The response is in their submissions of course –

ELIAS CJ:

Yes.

MR FARMER QC:

And I perhaps –

ELIAS CJ:

Yes and you're seeking to respond to that which usually is quite convenient but –

MR FARMER QC:

Yes and it would have the effect, of course, of limiting the reply, hopefully, but I'm in Your Honours hands on that. What we do say though is that the – it is important to understand that there is no such thing as a perfect model of competition, markets don't operate like that. Markets are in fact full – there is no ideal competitive environment and I'll just give you the reference without taking you to it, but the matter was addressed by the High Court of Australia in the case of *NT Power Generation Pty Ltd v Power and Water Authority* (2004) 219 CLR 90 (HC of A), generally referred to as PAWA, and you'll find that case which we'll come back to for other purposes, in our casebook, tab 7, where PAWA, which was a natural monopoly, had declined access to a competitor to its, in effect, network on the grounds that a better competitive environment could be devised by regulation and that was something that was being contemplated at the time and so it was far better to wait for that than to provide access to a new entrant who might well create competition in a way that was far from "ideal" and the High Court of Australia said it's not for you to decide that, it's for the process of competition to decide an outcome through the process of rivalry and so that was, that concept was knocked on the head and indeed in this country we have *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1989] 3 NZLR 158 (CA) as well which is a case I'll come back to, where the same sort of thing happened, where the Apple and Pear Marketing Board decided that it would be more efficient to have a levy system or to extract levies from growers, new growers and existing growers, in order to limit production of apples and the Court of Appeal judgment by Sir Robin Cook said, "Well that's not actually how competition works, it's not for you to determine in that way, use your market power to determine the conditions of competition. Competition will take its course and the efficiencies should follow." That's obiter because that case went off on another point altogether which was as to whether the Commerce Act actually applied to the Apple and Pear Marketing Board. You'll find *Apple Fields* by the way in tab 23 of volume 3 of our casebook and the passage, the relevant passage that I've just referred to is at page 162.

McGRATH J:

Have you got – have you got a paragraph reference in the *Northern Territory Power* case?

MR FARMER QC:

Yes I have. Paragraph 141, at pages 141 to 142. Now if we turn to look perhaps at what the alternatives were available, the alternatives that were available to Telecom and to contrast those with what they actually did with 0867 in order to address the issue, or the problem as it saw it, that it faced in relation to the growth in Internet revenue payments being made by it to its competitors, we say it actually had number of options that would not have breached section 36, so in other words that were not anti-competitive in the sense contained in the Act. The first of them was that it could use its ISP subsidiary Xtra which, as I said earlier, already held 75 percent of the retail Internet market to offer a better and a cheaper service and Mr Parkes who is a principal Telecom witness, acknowledged that that was definitely an option that they could pursue. I'll give you the reference in the interests of saving time, volume 4 in the case on appeal at page 1117, and you'll find the relevant evidence in the transcript page which is at 1117, is page 766, lines 7 to 13.

TIPPING J:

Was he asked why they hadn't adopted that method, that approach?

MR FARMER QC:

Let me just take you to it. It's –

ELIAS CJ

Which volume is it?

MR FARMER QC:

Volume 4 of the case on appeal at page 1117, and it would be worth getting out, and I was going to move onto this next in any event, it would be worth getting out – I'll deal with this at this stage, I'll come to that. No, it is worth getting out volume 10 as well. Because volume 10 is a report that Mr Parkes had made to Dr Deane who was then the CEO of Telecom and that report is in volume 10 at page 3675, and you'll see it's dated 9th of April 1998 and it concerned in particular, a situation that had arisen with Ihug, Ihug was the second largest ISP at the time and Ihug was, which was threatening to move to the Clear network to join with the other ISPs on that network and it was seeking to persuade Telecom as an incentive not to do that, to give it carrier status by entering into an interconnection agreement with it and you'll see that the – so that's what is being directed, the topic that's being directed in this report and the purpose of the memorandum is said to be against the possibility of arbitraging the Clear ICA, Ihug has requested direct interconnect status, this note assesses the options available to Telecom in response and recommends an approach to deal with the short-term problem

without compromising longer term interconnect strategy which necessarily involves renegotiation of the Clear and other existing ICAs, so that's interesting that at that stage they saw that in the longer term they would have to renegotiate them, the recommended approach they say, would incentivise Clear and other interconnect customers to renegotiate ICAs. Now then they went on to say in the recommendation, they recognised Xtra does need to compete more vigorously for customers with Ihug and other ISPs active in the New Zealand market and then there are a whole lot of options, which I won't take you through, but if you go to the end of it, 3679 right at the end of the report, "Ihug may also be reminded that most arbitrage opportunities once exploited, tend to be short-lived."

So that was the Telecom view of it and really what was being addressed in this report was the comparison in monetary terms or value terms, of doing some sort of deal with Ihug as opposed to letting them go to Clear. Now when Mr Parkes was cross-examined about this, if you go to page 1116, that report that I've just shown you was put before him, he was asked questions about it and what was drawn to his attention at the top of page 1117 was the fact, was the statement that Xtra needed to compete more vigorously for customers, that was the first option and line 7, "Wasn't that in fact always an option available to Telecom that through Xtra it should just simply become more competitive offer better service, better rates and put pressure back on Ihug and its other competitors in that way?" And he said, "Yes absolutely, that would be the case at any point of time."

And then really he was questioned about the 0867 option and about the fact that, if you look at the top of page 1118, Mr Parkes in his report, I haven't shown it to you, but he said, "Given Telecom's dominance in the PSTN market and its presence in the ISP market, charging only for PSTN connectivity to ISP's terminating and other networks would expose Telecom to risk of breach of section 36 of the Commerce Act, therefore must be rejected." So Mr Parkes himself saw there was an issue because if Xtra calls could still be made to Xtra that were free, but calls made to Xtra's competitors were not, then he was concerned there might be a breach of section 36 arising out of and he was questioned about that and he expanded on that at lines 15 to 22 and really that's where the questioning went as I remember it. But on 1119 at line 10 it was put to him that, "Section 36 case was based on what you said was Telecom's dominance in the PSTN market." He says, "Yes that's what I wrote." So when you wrote it then you felt dominant, even though you've told us earlier you didn't, when you otherwise worked at Telecom field, he said, "I must have been feeling dominant that day." It was quite an interesting – I remember the exchange quite well, it was – he's a nice man Mr Parkes.

So that's really about as far as that goes, but what I wanted to do was to contrast that with another report that was sent at almost exactly the same time, in fact it was sent – I beg your pardon, that was I think 1998, that was really the origins of 0867 when it arose out of this

concern about Ihug, a very substantial ISP moving across to Clear and joining what was happening there, and 0867 really, as I say, developed out of that and the following March there were two reports which went to Dr Deane and one of them was from Mr Parkes where he put forward a positive recommendation for – to introduce 0867, and the other one was a report from Rachael Knight and you'll find that, if you wouldn't mind looking in at volume 11, at 4263, and she was addressing specifically this issue of Internet termination payments, at 4263 under the heading "Interconnect transition strategy" an update on interconnect with proposals for simplified interconnection agreement sand revised organisation structure to support the changing role, you'll see the recommendations, the second paragraph, "The paper recommends that work be done to simplify interconnect agreements and restrict them to pure interconnection services. These new interconnection agreements and proposed associated pricing structure, if successfully implemented, would reduce current prices, but reduce Telecom's exposure to arbitrage." So the recognition was if, let's renegotiate the ICA, the cost to that will be that everything will be up for grabs, everything will be up for renegotiation, so current access prices will come down, but at least we'll thereby get rid of the arbitrage problem and you'll see that that point's developed I don't need to take you through it, but it's developed on 4264 and the middle of that page, proposed solution, second bullet point, renegotiate the existing interconnect agreements to remove the problem. Now Mr Parkes was asked about that, as to why didn't you go down that track? And if you've still got volume 4 there at page 1131, at line 4, the question was put to him, "The reason you didn't want to go down this route" he's referred to the report I have just referred to –

ELIAS CJ:

Sorry, 11?

MR FARMER QC:

31.

ELIAS CJ:

Thank you.

MR FARMER QC:

So he was referred to what I've just shown you, and he said, and he was asked, "The reason you didn't want to go down this route which was being suggested, was because that would've involved giving up, or at least reducing significantly the very advantageous interconnection revenue position that Clear had been complaining about that Telecom had?" Answer, "It would've meant we would've had to have given a large amount of value away, a very large amount." So that's why they didn't want to renegotiate the whole of the interconnection agreement, because if they'd gone back and said, look let's talk about termination payments, the other carriers would've said, fine I could talk about them because we think they're too high

anyway, right across the board, not just those that relate to Internet. And that really goes back to that point that I tried to make earlier that the interconnection agreements did not distinguish, they did not mention the word, as far as I remember, the word Internet, they did not distinguish between a local call that was a voice call and one that was an Internet call, because the calls, whatever they were, were going along the same lines to an 09 number or an 04 number as the case may be and what clearly Telecom wanted was to draw a distinction between those calls and to have a different regime for Internet and from voice.

Now a second, if we're looking at purpose and justification for 0867, the second justification other than the fact that this is costing us an awful lot of money, paying out these termination payments that Telecom had for 0867, was that the continued growth of Internet traffic would cause congestion on the PSTN and in particular there was reference to expected expenditure of the sum of 205 million dollars that would have to be made at some point to upgrade the PSTN network to deal with the increased growth. Now of course that was a situation that would only – I should say there was a lot of debate at the High Court as to whether or not that 205 million dollars was a true figure and in fact Dr Milner for Telecom under cross-examination, agreed to – or said that he thought the figure was more like 7.5 million, there was no finding made by the High Court as such, but it perhaps the real point to note is that in fact had Telecom renegotiated the interconnection agreements in a way that would have enabled it better to deal with the situation that had arisen, or had it in fact competed more effectively through Xtra, then either way the situation, the expenditure, the expected expenditure would either have not occurred or could have – would have been significantly lower than the amounts claimed, but in addition to that, there were also other technical options that were available to Telecom which the High Court found did exist, and said were in many ways, preferable, which Telecom did not pursue and those – in fact the High Court's ruling on that, if I can give it to you, was that there were other technical options which the High Court said may even have been preferable to 0867 and that's said in paragraph 98 of the High Court's judgment.

Now those options were, and there were three of them, first, using the intelligent network software in a not too dissimilar way from how it was used under 0867, but instead of intelligent network picking up an 0867 prefix as it came through and then converting it back into the local number, the 09 or the 04 number of the ISP, it simply would recognise the number as being a number that was an ISP's number and after all there weren't that many ISPs and it was quite readily able to be identified as a number to which a large number of calls went, Internet calls, and Dr Milner agreed, and Mr Benson more particularly agree, Mr Benson again, who I think was Dr Milner's boss, agreed on cross-examination that ISP identification was readily possible without the use of the 0867 prefix and we've given the references, I won't take you to them, but we've given the references to the cross-examination of both witnesses in our submissions in footnote 19. And the point, the whole point of the ISP

identification, whether it be by 0867 or whether it simply be by some other process within the software, was to deal with situations as and when they arose and they did arise from time to time, at particular times of the day or night, that if there was an issue about possible congestion because of heavy Internet usage in particular, then the intelligent network software was able to deal with that problem by deferring or delaying the Internet calls, managing them in a way that they didn't in fact stop voice calls being made, so voice calls got priority. So that was one solution and it was really the same solution as 0867, just a little bit more complicated from a technical point of view.

The second solution was accelerating the rollout of ADSL. The ADSL broadband service, which had already been trialled successfully as at the time 0867 was introduced and which was a complete solution to any network management problem because ADSL traffic was carried on a different platform from the PSTN. It was carried over what's called the ATN platform so it was a data platform and it was the, as I say a complete solution. The case made by Telecom at trial was that ADSL was still in its infancy. It was still software that hadn't been given necessary standard specifications and the like, the evidence really was that it had been trialled successfully and a rollout of it had begun and indeed, as we say, I think in a footnote somewhere in our submissions, and you may or may not be able to take account of this, but in the subsequent litigation between Telecom and the Commission in the so-called "*Data Tails*" case the Court found that at this time ADSL had indeed been rolled out.

That was a solution, the third solution was the use of something called IP net which again was a technical solution that avoided the use of the PSTN and which according to Dr Milner would have been the ideal solution. You'll see that referred to in our submissions at paragraph 208 and in particular footnote 20 and Dr Milner also said at that time that the trouble with IP net at the time was that the commercial people at Telecom were being, were trying to charge too much for it and it basically hadn't got off the ground at that point but it could have been pursued as a solution to –

TIPPING J:
That ideal solution was presumably a solution to the congestion problem?

MR FARMER QC:
Yes.

TIPPING J:
Not more widely than that?

MR FARMER QC:
No, no, I'm just dealing with congestion.

TIPPING J:

Yes.

MR FARMER QC:

Yes that's right, that's right. But to the extent that it's claim, and it is claimed by Telecom that the legitimate – one of the two legitimate business reasons for 0867 was the need to deal with congestion and we say these three things which the High Court itself described as being, may even have been preferable to 0867, really is an adequate response to that.

Now finally before I really, I'm going to turn next to the counterfactual after this but there's one final topic to deal with which will help, I think ,the discussion on – definitely help in the discussion on the counterfactual is this issue of Clear's market power and in particular the issue of the fact that the termination payments that were being made were above cost. Now Professor Hausman who gave evidence from MIT who gave evidence for Telecom at the trial made much of the fact that in the – terminate, what he called the terminating access market, Clear had market power and he in fact identified or said there was a separate market for terminating access, as opposed to a broader wholesale access market which was originating and terminating access. In other words just interconnection generally between the different telecommunications companies where each provides, as a wholesale service, access to the other and is, fees or revenues from that service and what Professor Hausman said was, well no you've got to break it down and there's this sort of rather more specific terminating access market and if you do that then you'll find that Clear in that market has got market power and the reason he said that was because there was a bottleneck to Clear's network. You couldn't get into Clear's network, you couldn't get access to it. Telecom couldn't get access to Clear's network and therefore Clear was able, as it were, to extract monopoly rents for the termination charges that it's paid and so he said, Clear was earning monopoly profits in that market because the termination payments made to it were above its costs, and they were. Now why, this is evidence led, why does Telecom rely on it, as it does in its submissions, and the answer seems to be found in Telecom's submissions, paragraph 2.18, and I'll just read the extract, the quote, they say, "Thus 0867 was in fact Telecom's innovation to escape Clear's exercise of market power." It's an extraordinary statement, with respect, and the statement or the submission is presumably made to divert attention away from the fact that this case is actually about the exercise of Telecom's market power.

TIPPING J:

What was the reference again Mr Farmer?

MR FARMER QC:

2.18 and the Hausman evidence is volume 5 in the case on appeal at 1772 and particular the transcript page there is 1174 lines 18 to 26. So this bottleneck to Clear's network is said to be the source of Clear's market power –

TIPPING J:

Is this submission simply that when the balance of advantage under the contract turned the other way the market power was now being used against Telecom? Is that the broad effect of it?

MR FARMER QC:

I – no I think, I think if one goes back to Hausman, Professor Hausman said, he was defining market power in conventional economist terms of, if price is above cost, if there's a margin, then that's a monopoly –

TIPPING J:

But was the market he was speaking of wasn't the market as ultimately found, was it?

MR FARMER QC:

No. His market was the terminating access market and he's saying in that market Clear is charging and is able to charge above cost and therefore it has market power. Now of course it was able to charge above cost because that's what the contract that Telecom had negotiated provided and more significantly Telecom, if Clear was charging above cost, which it was, Telecom was charging twice above cost.

TIPPING J:

Well that was rather what I was getting at. It seems a bit uneven.

MR FARMER QC:

Indeed, indeed. And if one then starts to think about level playing fields and so on then that comparison is a perfectly valid one to make. So in any event that is what he said, that as a business justification for 0867 was that Telecom's innovation, so innovation is fine if it's doing it but not perhaps if its rivals are doing it, to escape Clear's exercise of market power. Now Professor Bamberger – Dr Bamberger I'm sorry, put his finger on it and said well the source of Clear's market power, if one's going to analyse it that way, is in fact the contract that Telecom set up and you'll find that reference in his first brief, paragraphs 90 to 91, which is 4 case on appeal at 1383. Now the difference between the two networks of course was that Clear's network was ubiquitous and I made the point earlier that – sorry Telecom's

network was ubiquitous, I made the point earlier that everyone needed Telecom, Telecom didn't necessarily need them.

Now then on this question of price over cost. In its submissions to this Court, and the reference I'm going to give you is paragraph 5.22 of Telecom's submissions, Telecom does in fact acknowledge that, and I quote, "In a workably competitive market, contract prices and payment terms may well be above marginal cost in order to capture a contribution to fixed and common costs." Absolutely right, we couldn't agree more because telecommunications is an industry that is characterised by high fixed costs. The bulk of a telecommunication's company's costs are the fixed network costs establishing and maintaining the network, and so charging at marginal cost, which is simply the cost of a call, is that all you charged at, you'd go broke because you need to cover your fixed costs. So if we're looking at this question of whether Clear has market power and we're looking at the question of just what is the margin over cost, then in a workably competitive market, which is, encompasses markets where firms do have high fixed costs, typically infrastructure type markets, if we're looking at that then we have to readily agree that the firm, when it prices anything, should be able to obtain a contribution to its fixed costs, and so there's no dispute between us on that, although somewhat paradoxically, the Court of Appeal did accuse us as it were of arguing in a counterfactual house that the competitive market should be market in which there was perfect competition, where price equalled marginal costs, and we've never argued that. I mean I wouldn't argue that, I've been in these telecommunications cases for as long as I can remember and high fixed costs are a characteristic of these markets.

So I'll perhaps come back to that if I need to, but to the extent that Clear did receive a margin and it's made out Clear's prices, termination prices had a margin and it would seem likely that the margin as above the contribution that it needed for its fixed costs, because if it hadn't been, it wouldn't have been able to share the revenues with its ISP customers. But, the points that can be made about that are, first point I made earlier first of all, that those profits, those if you like excess profits, monopoly profits, whatever you might want to call them, were redistributed into the market for the benefit of consumers by sharing them with ISPs, who passed them onto Internet users in the form of lower prices. The second point of course is the obvious one that we've just discussed, Telecom obtained twice the margin, and not just in relation to Internet traffic but in relation to, but from all traffic where there were termination payments being made under the ICA, which includes voice calls. Telecom, however, did not redistribute that margin for the benefit of consumers, so it certainly was acting as a true monopolist, that is to say retaining the profits, the monopoly of profits that had made and we say that –

TIPPING J:

Do we have any findings of Clear making monopoly profits?

MR FARMER QC:

Only, the only – no specific finding. There was no empirical evidence of their costs and things except that what was agreed, I think, by I think Mr Parkes was that Clear's costs of terminating a call were unlikely to be any higher or lower than Telecom's, they were likely to be very similar costs and the actual of terminating a call is pretty low and as I say, I think the finding that, the obvious finding that must be able to be made is that there was a margin being earned over and above the contribution to fixed and common cost, because otherwise there wouldn't have been anything to share.

TIPPING J:

Share, yes…

MR FARMER QC:

And –

TIPPING J:

It was a purely factual inquiry –

MR FARMER QC:

Yes, that's right, I understand.

TIPPING J:

- Mr Farmer as to whether there was anything to…

MR FARMER QC:

Yes, I understand, Your Honour. And then the fourth point I make is that the source of that entire situation in any event and of the fact that both Telecom and Clear it would seem were earning supernormal profits but in different proportions was of course the ICA itself. Now, it's - so having dealt with all of those points, many of them which are factually based, I think I can probably now move on to the counterfactual and I want to deal with that in two ways. First I'd like to deal with it by looking at the case law and looking in particular at the Australian High Courts approach, and then I want to sort of test, try and test that against the counterfactual analysis that actually took place in this particular case, and about that we'll say two things, really, we'll say, well, this was a type of case which the Court of Appeal already recognised right at the end of the judgment when they said, well, I'll give you the reference now. It's paragraph 100, right at the end of the – there's earlier references as well, but volume 1, page 106, paragraph 100 of the judgment the Court of Appeal said under a heading, "Some Concluding Comments; this case exposes the realities of the difficulty of counterfactual

analysis and that it is not always of utility in the context of a case such as the present. 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," that threat of regulation is a different point, which we'll have to deal with, we will deal with later. "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." Now there is the heart of the problem because in a competitive market, this counterfactual market, by all means let's say the competitive market has to be one that's workably competitive. In other words, let's say that this is a market where we recognise that competitions taking place between firms, you'll have high fixed costs and therefore when they price they will be pricing above marginal costs. They will be pricing to obtain to recover a contribution that will cover their fixed cost. Let's accept all that. But, as the Court of Appeal recognises in this paragraph, this is a case where the firm, the rival, not even the monopolist, but the rival, is actually recovering more than that. It's recovering monopoly profits, and then it's distributing them back again. So in a counterfactual you have to have that feature, otherwise it's unreal, and that's the problem with the counterfactual, and I'll come back and develop that point. But that's a good starting point with respect for considering this whole question of the counterfactual.

So there are a number of issues that arise in respect of the counterfactual, the first is whether as the Privy Council ruled initially and Telecom and Clear, although without much analysis or reasoning on that point, and the second by the majority in Carter Holt where the issue was debated much more vigorously as between the majority and the minority. The issue is whether the employment of the counterfactual as a tool for determining whether Telecom had used its dominance in implementing 0867 is a, to use the word the Court used, necessary - Privy Council word, necessary analytical tool and therefore whether it's not open to the Court to find use of dominance by some other means by reference to some other form of evidence. Now both the High Court and the Court of Appeal in the present case rightly regarded themselves as bound by the Privy Council and therefore they restricted themselves to a counterfactual analysis, most of that we saw was in that paragraph 100 of the Court of Appeal just raising some doubts and giving a bit of a hint, I think, that we should come up here and see what Your Honours thought about it.

The Court of Appeal, as I say, did express those reservations about the utility of the technique in the case such as this one, because of the irreconcilable tension between postulating and an absence of market power in a counterfactual and the fact that the issue in the case concerned the deployment of monopoly rents, not by the monopolist actually, but by the other firm, the rival –

TIPPING J:

Is that the issue or is that just a dimension of the case?

MR FARMER QC:

It's a dimension. Yes the issue is clearly Telecom's conduct, but the dimension that's so difficult to replicate –

TIPPING J:

Which would be hard to replicate?

MR FARMER QC:

Yes that's right. And of course the Privy Council has said that when you construct a counterfactual, you establish it is a competitive market, but it's a competitive market which is supposed to have the same features otherwise, other than the fact that it's a competitive market, the same features as the real market and of course the features here are the ICA and the structure of the ICA and the monopoly rents that are earned –

ELIAS CJ:

Well why is it so difficult though, I mean, that is the background that you're working within, it is the market in terminating calls only that you're looking at, isn't the issue the distribution of monopoly rents, isn't that really what the ICA's about?

MR FARMER QC:

Well, we with respect, we don't, first of all we don't agree that the market is as narrow as just terminating access, in fact the way the case has been, the wholesale access market that was considered –

ELIAS CJ:

Yes.

MR FARMER QC:

In both the High Court, Court of Appeal is the broader market, which includes all access, not just terminating access.

ELIAS CJ:

Yes.

MR FARMER QC:

So I'm sorry, I got distracted by that, I've lost the part of Your Honour's question.

ELIAS CJ:

Well isn't that just a feature of the issues here, that effectively if you're talking about the ICA and adjustment to it through abusive dominant position –

MR FARMER QC:

Yes.

ELIAS CJ:

You are talking about access to monopoly profits?

MR FARMER QC:

That's what the Court of Appeal are saying, that yes you have – if you don't have those monopoly profits in there –

ELIAS CJ:

Yes.

MR FARMER QC:

It doesn't make sense.

ELIAS CJ:

Yes. So what's the problem? I mean you do have to factor it in.

MR FARMER QC:

The problem is that the counterfactual didn't, that was used in this case, did not factor it in.

ELIAS CJ:

Oh, I see, yes thank you.

MR FARMER QC:

Now –

TIPPING J:

I've always found it very difficult Mr Farmer in these, well it's going back a long way now, but the – but of course we didn't have counterfactuals to bug us in Magic Millions, well perhaps they were there, hovering around and not recognised, but when you were eliminating the concept of market power from the hypothetical –

MR FARMER QC:

Yes.

TIPPING J:

How much of that do you have to eliminate, and how far does the reach of eliminating those ingredients actually extend into the hypothetical market, that seems to me to be a very difficult issue when constructing the hypothetical as a matter of theory, not necessarily in this particular case.

MR FARMER QC:

The hype that the counterfactual would say that you must eliminate market power. No firm has market power.

TIPPING J:

Presumably you must eliminate anything that is related to market power, must you?

MR FARMER QC:

Anything that is a source of market power, yes, yes.

TIPPING J:

Yes.

MR FARMER QC:

And that's of course, in this case you start to run into problems because you say, the Court said, well there will be an ICA, but it's an ICA that somehow has got stripped out of it. Any monopoly profits, either by Telecom or by Clear and when you strip those out, you have in effect, defined away the problem, or the issue, because the issue is that Clear and the other rivals are earning monopoly profits out of the termination payments which are then using in a particular way, which creates a problem for Telecom which then comes back and has an 0867 response. So it's sort of – there's an internal inconsistency there.

TIPPING J:

The problem is derived from a factor that apparently you've got to eliminate in the hypothetical.

MR FARMER QC:

But when you eliminate it you –

TIPPING J:

You are eliminating the problem.

MR FARMER QC:

Exactly, and that's what we submitted, defined away the problem. Anyway we'll come back to that perhaps, we will come back to that and when we perhaps get into the counterfactual analysis that was actually done. Now –

TIPPING J:

Isn't this, arguably anyway, a very good example of how the counterfactual won't necessarily be an adequate or appropriate tool?

MR FARMER QC:

With respect, absolutely, and that's why this is such a wonderful case to bring to this Court.

BLANCHARD J:

Well the problem, the problem Mr Farmer would have been a wonderful case to bring to the Court, is that it involves Telecom which is the very company that the Privy Council made its ruling on originally, saying you had to use a counterfactual and secondly, it's a very old case and nine years ago, New Zealand Parliament adopted a different test. So that makes it a difficult case to argue, that this Court should depart from the Privy Council.

MR FARMER QC:

Well I think Your Honour's referring perhaps to – you're referring to the amendment that was made to remove –

BLANCHARD J:

Yes.

MR FARMER QC:

To replace dominance with substantial market power?

BLANCHARD J:

No, take advantage of.

MR FARMER QC:

Take advantage, well that, with respect, has been, I don't think there's any ruling that says that take advantage of is any different from use, and because of course the Australian –

BLANCHARD J:

Well what was parliament doing then if it wasn't making a change?

MR FARMER QC:

What parliament was doing was adopting the Australian language, but in *Queensland Wire* –

BLANCHARD J:

Adopting the Australian language in light of the Australian case law which included *Melway*.

MR FARMER QC:

But with respect Your Honour, in *Queensland Wire*, what the High Court said was that take advantage equals use. We had use, they had take advantage, and in –

BLANCHARD J:

Well why were they doing it if it meant the same thing?

MR FARMER QC:

Because there was a strange view about CER, represent that we've got to be the same as Australia, not perhaps in every respect, but somehow –

BLANCHARD J:

But surely they were doing it Mr Farmer, against the materials, some of which we can look at, was to get away from the Privy Council.

MR FARMER QC:

I know my learned friend Dr Palmer is going to – the Crown has filed a submission that sort of goes in -

TIPPING J:

Well Telecom's much the same, but they say Parliament's given a clear signal here and what's more this is a penal context and you can't penalise us retrospectively on a different test, which would be a point that I would need early addressing –

BLANCHARD J:

Particularly when we as a company have been told what the test was by the Privy Council.

MR FARMER QC:

We are going to address this issue.

BLANCHARD J:

Yes, well that seems to be a real difficulty for you, but I wouldn't take a lot of persuading that the New Zealand Parliament changed the law in 2001.

MR FARMER QC:

Well it's a question of in what respects they changed the law. Did they –

BLANCHARD J:

Well, surely they brought in *Melway*?

MR FARMER QC:

Well if they brought in *Melway*, that's terrific.

BLANCHARD J:

Yes.

TIPPING J:

Yes, but they didn't bring it in at the time when this set of circumstances occurred.

BLANCHARD J:

Yes, they didn't bring it in retrospectively.

MR FARMER QC:

No. No, that's right.

TIPPING J:

If I was Telecom, I'd feel a bit, you know, you guard yourself by the Privy Council and then what is it, how many years later? Ten, 11, you're told, oh that was all wrong, and you're liable to a five million dollar fine. But maybe that's something for after lunch Mr Farmer.

MR FARMER QC:

It is.

TIPPING J:

No I don't mean –

MR FARMER QC:

It's been very benevolent towards Telecom in terms of – there were certainly, I mean I know my learned friend will say much the same, but there's certainly no evidence that –

TIPPING J:

But there are two difficulties I see, if I can just add my weight to what my brother has said. There is the fact to have someone find on a different law from that was in force at the time they did it, it is anxious making, and the second dimension is that on the face of it, parliament has fixed it in 2001.

MR FARMER QC:

By changing –

TIPPING J:

Yes.

MR FARMER QC:

– use to –

TIPPING J:

Take advantage of against the what we know and I think are entitled to take account of the purpose of the change but you – I think the sooner you come to those two difficulties for this particular case, I would have thought the more helpful it'll be.

MR FARMER QC:

Okay.

McGRATH J:

There's another element I suppose you'll no doubt address Mr Farmer and that is if this Court were to change the law in relation to the term "use" it would be doing it, as far as one can see, for only one case, this case. There is no public interest of a future kind that would be involved, such as the Court saw, for example, in the *Couch* case.

MR FARMER QC:

Well it would, at the moment – unless Your Honours are right, that the amendment that was made has introduced *Melway*.

BLANCHARD J:

Well if we say it we're right.

MR FARMER QC:

Well exactly, and if you say it and you are right –

BLANCHARD J:

Unless Parliament chooses to say we were wrong.

MR FARMER QC:

But if you do say that then, fine we have, counterfactual is gone as –

BLANCHARD J:

Well it hasn't gone.

MR FARMER QC:

No, it's gone as a necessary and exclusive test.

BLANCHARD J:

Yes.

MR FARMER QC:

Yes, that's what I mean. But if you're not right on that then the issue is still a live issue.

TIPPING J:

Has anyone held, in the High Court or the Court of Appeal, that the 2001 legislation has not changed the law?

MR FARMER QC:

I don't think – well my learned friend, there are two – yes. The cases, it's in both cases actually, it's only my memory – but in the *Bay of Plenty Electricity* case that issue is expressly addressed and the High Court held that those, that amendment did not change the law and in the second case which was the other case I referred to earlier, the so called "*Data Tails*" case, the same issue was addressed there too.

BLANCHARD J:

How far up have those cases got?

MR FARMER QC:

The Bay of Plenty Electricity, I acted for Bay of Plenty Electricity, the Commerce Commission appealed, not necessarily on that point but they made an appeal but they later withdrew the appeal. In the "*Data Tails*" case which the Commission was successful on Telecom has filed an appeal and there's some interlocutory skirmishing going on at the moment but it has not yet got a fixture in the Court of Appeal.

TIPPING J:

Well Telecom was wanting to – Telecom's position in that case presumably is to try and support the High Court.

MR FARMER QC:

The High Court – on that issue?

TIPPING J:

On that issue, yes.

MR FARMER QC:

Well I, I don't know whether –

TIPPING J:

Well perhaps that's not something that is appropriate to go into Mr Farmer.

MR FARMER QC:

No I don't think we've kind of got to that level on the finding.

TIPPING J:

No. Well it may not need to.

ELIAS CJ:

But may need to fast.

MR FARMER QC:

Now – well thank you for that indication of where we need to, what we need to address sooner rather than later. So what I did was raise the issue of principle arising out of the Privy Council's judgments, and that's what we're been talking about. The second issue is whether the counterfactual analysis that was used in this case was appropriate and whether it gave rise to the correct conclusion. And the conclusion was that Company X, the Telecom equivalent in the counterfactual, would be indifferent to giving out residential customers and all their telecommunications business, to another network, if they sought to impose the two cent charge. They wouldn't care if they lost customers who weren't willing to pay that charge because at last if that happened Telecom would make the saving of not having to make termination payments in respect of it, that was basically the conclusion that was drawn. Now it will be submitted that – in other words there was a neutrality or an equality between the losses that were made on the customers revenues, if the customer goes to another network because it doesn't want to pay a two cent charge on the one hand and the savings that will be made because that customer has taken its Internet business away somewhere else and therefore there are no termination payments that are going to have to be made any longer.

We would submit, with respect, that that is in fact an overly simplistic and incorrect assessment of the position for a number of reasons, there are a number of dimensions to it, and I'll come back to this. But one if them is that the saving and termination charges is an important one. The saving and termination charges is for a relatively finite period only. It's the 18 months that the ICA has still got to run. After that clearly there's going to be a renegotiation and one can be pretty sure that Telecom's position in that renegotiation will be rather different than what it had been in 1996. Whereas on the other side of the coin, what is being lost when the customer takes its business off the Telecom network is, is all that customer's revenues. Revenues – that is to say not just what they might be paying for Internet service but also what they're paying for their other telecommunication services that they are getting from Telecom, local calls, toll calls if their toll calls are with Telecom, mobile calls maybe and so what you have to compare, the savings that are made of not serving that customer are the termination payments that are no longer being made for that customers Internet calls plus whatever savings there is in not having to serve that customer, which is a marginal cost only, but what is being lost are all the revenues including within those revenues that customers contribution to the fixed common costs of Telecom so that – and what is also being lost, in all probability, is that customer for what may be an indefinite period of time, perhaps even permanent period of time.

TIPPING J:

And it's not just confined to the two cents.

MR FARMER QC:

No.

TIPPING J:

That's the nub of the argument?

MR FARMER QC:

Yes, that's right. Well it's not confined – yes it's not confined just to the – because the High Court equated the two cents with the termination payment.

TIPPING J:

Yes.

MR FARMER QC:

And what we say is no, the loss is much larger and therefore that's why Company X wouldn't be indifferent at all about losing its customers, far from it, and because it wouldn't be indifferent to losing its customers it would not be able to – 0867 is not something it would contemplate even trying to do in a competitive market. Now there is a third issue which arises

and that relates to the wholesale market for network access. What – it has a little bit of a chequered history because what actually happened in the High Court is the High Court focused on the residential market –

ELIAS CJ:

I'm sorry, just thinking about what you were saying there, that X wouldn't be indifferent to a loss of its residential customers. Was not the 0867 option in fact attractive to those residential customers?

MR FARMER QC:

Ah –

ELIAS CJ:

I mean were they really at risk through the 0867 strategy of losing those customers?

MR FARMER QC:

Well the customers, the customers faced the two cent charge in the competitive market. Let's assume would go to their ISP and say, look, we don't want to pay this charge and the ISP would, the option would then exist though for the ISP and the carrier, the ISP business to say to the residential customer, come to us. What we're assuming here are three networks –

ELIAS CJ:

Yes.

MR FARMER QC:

– that are ubiquitous unlike the Clear market which was not ubiquitous so you've got three ubiquitous markets, X, Y and Z or W, X, Y, I can't remember what they were. So the customer has a different option that it has in the real world. It has the option of moving its business to another network whereas in the real world it doesn't.

ELIAS CJ:

Would that be a convenient time or do you want to say the third point?

MR FARMER QC:

Well perhaps I'll just deal with the point quickly. That what – so in the High Court focused on the residential market and it dealt with the counterfactual in there. It also found that Telecom was not dominant. It found Telecom was dominant in the residential market but it also found that Telecom was not dominant in the wholesale market for network access and because of that finding it didn't do the counterfactual analysis on that market because the dominance threshold hadn't been established in its view. In the Court of Appeal however, the Court of

Appeal reversed that finding and said, no we think Telecom was dominant in the wholesale access market but then unfortunately the Court of Appeal didn't go on to address that market with a counterfactual analysis and then more importantly perhaps than that was that as a result it didn't look at the two markets together, which are inter-related, on a counterfactual basis and so we have a sort of rather unsatisfactory situation which we now have to unfortunately bring to this Court on that and what we do submit is that if you combine the retail and the wholesale counterfactuals together that does lead to a conclusion that Company X would not have introduced 0867 because of the high risk of losing both residential customers in the residential market and wholesale customers in the wholesale access market and I'll just give you the references in our submissions, you've read them and know where they are, but we've dealt with this topic really from, in our submissions, from paragraph 5.15 through to 5.19 and I've also added, if I could, Dr Bamberger's reply brief where he says that two essential features of a counterfactual should be that the non-dominant firm should not only face the asymmetric traffic problem but the second feature he said was that the firm shall be non-dominant in both markets in which Telecom was dominant and that reference is his reply brief, paragraph 29, volume 4, case on appeal at page 1416.

ELIAS CJ:

We'll take the lunch adjournment now thank you.

COURT ADJOURNS: 1.03 PM

COURT RESUMES: 2.15 PM

MR FARMER QC:

So what I wanted to do next if Your Honours pleases, is to relate the counterfactual tests to the structure and scope of section 36 and to ask the question whether the counterfactual illuminates section 36 or whether it obscures or whether perhaps putting it another way, whether it may, in some cases, have the effect, and this maybe one of those cases where it may have the effect of limiting the scope of section 36, so it's perhaps that concern about limiting the scope of section 36 which has driven the High Court of Australia in Melway and subsequent cases, to searching for alternative tests that perhaps better reflect the true intent of parliament in enacting section 36 and indeed that's what the minority in the Privy Council in *Carter Holt* were really saying, that the real question is the statutory question, the statutory test of section 36 itself imposes, rather than some kind of judicial hypothetical gloss that you put on that. So the – thinking of section 36 then, it does of course, the prohibition in it, is against firms with substantial market power, or at the time that we're looking, firms with dominance, using that power for an anti-competitive purpose, the purpose of section 36 is not to prevent firms with market power from competing, but by that one has to understand the

term competing meaning competing in the way that competition exists, firms using their greater efficiencies, their superior products, their cheaper products or whatever, to obtain advantage in the market, as opposed to firms that use their market power to attack the process of competition itself and to damage the ability of their competitors to compete against them.

Now just in that respect I wonder if I could deal with one point. Telecom's mantra and you'll see it in paragraph 4.4 of their submissions, is that competition more is concerned only with competition and not with the fate of competitors. And in that respect they refer to – I don't need to take you to it – but to the joint judgment of Mason CJ and of Wilson J in *Queensland Wire* where there are such phrases uses as "competition is a ruthless process", "competition does injure competitors", it's intended to injure them in the sense that the firm with the superior product will win the battle, and similar statements to the same effect by Posner J in *Olympia Equipment* 797F 2d 370 (1986). Now the problem with that very simple statement, is that in fact the way that competition as a process is often damaged, is by in fact injuring competitors in the sense, not injuring in the sense of having a better product, or a cheaper product, but injuring them in the sense of depriving them, or damaging their ability to compete and that's a very important distinction and that's the very distinction that's in the very words of section 36 itself.

ELIAS CJ:

Yes, because in its turn, section 36 is concerned with competitors.

MR FARMER QC:

Deterring competitors.

ELIAS CJ:

Yes.

MR FARMER QC:

From competing.

ELIAS CJ:

Yes.

MR FARMER QC:

Exactly. And so it is that deterrence of competitors engaging in competition which is the damage to competition and –

TIPPING J:

Is one way of looking at this, to ask whether what is being done, is or is not to the benefit of consumers generally?

MR FARMER QC:

Ah.

TIPPING J:

It may be a little simplistic and I'm not suggesting it is the absolute mantra, but that must get close mustn't it?

MR FARMER QC:

Well in the sense, Your Honour's right with respect in the sense that – I'll just get the Act, just a moment. Your Honour is right in the sense that as you will know the purpose of the Act, and this was another one of those amendments that was made in 2001, the purpose of the Act is to promote competition in markets for the long-term benefit of consumers within New Zealand. So that is the underlying purpose of the Act.

ELIAS CJ:

You said that was introduced in 2001 as well. What was the purpose at the time?

MR FARMER QC:

The purpose, the reference to the long-term benefit of consumers is the new bit to it, and I can't remember the precise wording of what it was before. But the change was intended, certainly, to emphasise the consumer benefit consequence of competition. That's what competition is designed to achieve.

TIPPING J:

If you're competing in a way that is beneficial for consumers generally, you'd have thought you were on the right side of the line. If you're competing in a way that is not beneficial to consumers generally, you would have thought you were on the wrong side of the line.

MR FARMER QC:

Yes, and if one applies that to this case, I emphasise the fact that the benefit to consumers of what Clear and the other carriers were doing with the ISPs was that it drove prices down. The effect of 0867 was to change back again, as it were, or not to change that structure in a way which removed the ability to benefit consumers in that way. Now, another – you'll find, I'll give you the reference in Telecom's submission, paragraphs 4.5 to 4.7 and again later at 4.72 to 4.74, you'll find the heavy reliance on what was said by Posner J about the right of monopolists to compete vigorously, not to pull their punches, not to give rivals a helping hand, not to put an umbrella over the rival, et cetera, and the statements by Mason CJ and Wilson J

about more general, simply stated to be competition is vigorous. Now, interestingly, Telecom, in their submissions, does seem at paragraph 4.8 to retreat a little bit, perhaps inconsistently, from that position by acknowledging the force of the judgment in *Eastman Kodak Co v Image Technical Services Inc* 540 US 451 (1992). The *Eastman Kodak* case is in the casebook, one of the casebooks. What His Honour said in that case was that the conduct of a firm with substantial market power must be examined through what he called a special lens, and that behaviour that might otherwise not be of concern to the anti-trust laws can take on exclusionary connotations when it's practiced by a monopolist, or by a firm with substantial market power. There was quite a nice way that Professor Ahdar puts it, which I'll perhaps come to, I'll give you the reference, where he says, well, both a rottweiler and a chihuahua can bite, but the bite of the first dog is a bit more serious than the bite of the second one. And so that's really recognising that, yes, everyone's in there competing, but the firms with market power is potentially of greater concern, because they have the ability to engage in conduct which is exclusionary, which excludes firms from competing effectively, and that's why the special lens approach. So that's acknowledged fairly by Telecom in their written submissions, and we would submit that's something that always needs to be kept in mind.

Now, looking at the monopolist, or the firm with substantial market power, yes, it's fair to say that they don't have to pull their competitive punches if they are acting competitively, and yes, it is fair to say they don't have to give their rivals a helping hand. The traditional problem, of course, has always been seen in this kind of cases as determining when they are competing legitimately and when they are competing illegitimately, that is to say, in breach of section 36. That distinction, that problem of where do you draw the line and how do you classify one conduct in one way as against another way is recognised or is referred to by Dawson J, again, I don't need to take you to it, but it's tab 12 at page 202. And Your Honour Tipping J in *Magic Millions* made the same reference, and we've given that reference, in fact, in our submissions at paragraph 4.6. *Magic Millions* is in tab 36 of volume 2 of the Crown's bundle of authorities. The point of that, though, is this. The broad language of section 36, and it is broad language, far from, in our submission, forcing the enquiry into some narrow counterfactual straitjacket does require a factual evaluative approach of the kind that the minority in *Carter Holt v Privy Council* and of the kind that Your Honour Tipping J in *Magic Millions* was alluding to, and that gives the Court far greater flexibility and ability, generally, to drill in and find and determine whether or not the conduct is on one side of the line or the other.

ELIAS CJ:

You will explain to us why such flexibility is a good thing, in terms of the purposes of the Act, because that was one of the reasons why the Privy Council came up with the counterfactual, that it was a test that anyone could apply, whereas if you're striding into a test that gives flexibility to the Judge, that's contrary to that policy.

MR FARMER QC:

By flexibility, I don't mean discretion. I don't mean discretion. By flexibility, what I mean is an ability to evaluate the evidence as a whole.

ELIAS CJ:

Well, an evaluation isn't usually a discretion in that sense at all.

MR FARMER QC:

And that's why I'm saying, I'm not trying to say discretion, I'm trying to say an evaluation on the evidence as a whole, rather than being driven into what I've called a narrow straitjacket of some sort of economic hypothetical counterfactual analysis, which may be appropriate in some cases, but in many will not be. And, of course, I mentioned this earlier, one of the vices of it – vice is too strong a word. A problem with it is that it excludes purpose as part of the analysis. With respect, the Court of Appeal in this case got it right in *Geotherm*, and it's in volume 2 of the bundle of authorities at tab 15. Judgment of Sir Robin Cook, and it was Gault J who gave the judgment. This was a case where ECNZ, the electricity corporation, were allegedly, through various devices, seeking to keep Geotherm out of the market, making threatening statements using rights of objection under Resource Management Acts and that kind of thing. What was alleged by Electricity Corp on a strike-out application was that this sort of conduct could never come within section 36, and the Court of Appeal said, well, no, it could. But on the particular point I want to focus on, page 649, with respect, this gives a very helpful answer to the question of how you distinguish between vigorous, legitimate competition on the one hand by a firm with market power, and on the other hand, conduct that contravenes section 36. You'll see at 649, line 12, it says, "the interpretation of section 46" – which is the Australian equivalent, of course – "adopted by the High Court of Australia indicates a similar approach to that dictated by the New Zealand section 36, the distinction between vigorous legitimate competition by a corporation with substantial market power and conduct that contravenes the section is in the purpose of the conduct". It's in the purpose of the conduct. Market power can be exercised legitimately or illegitimately, and from there I can perhaps take you to – they in fact go on in the judgment, I won't take you through this, to consider the specific acts of conduct that were complained of and then if we go over – and along the way they, the fact that a firm might be exercising its statutory rights, in this case, the right to object under a statute, to some proposed development or activity which said not to put the Commerce Act beyond the pale. But, if you go over to 652, at the top of the page, first of all what was said here, it was said was that the reference to the policy to exclude competitors, "Whether this amounts to a use of market dominance will be a matter for evidence," and then a little further down, about line 20, just after the reference to the New Zealand Bill of Rights, it's said, "However, for the purpose of the present application," so the Bill of Rights had been raised but they said let's put that to the side for the moment and said in sentence 10, "We

prefer to concentrate on the words of s 36 and to conclude that it will be a matter of fact in each case, whether the exercise of the rights to objection and the manner of the exercise, in all the circumstances may be set to constitute a use of a dominant position." And across the page at 653, letter 10, "Whether Electrocorp has used its market position and its alleged activities as a question of fact, we are satisfied it is possible in appropriate circumstances for statements, such as those relied upon, to amount to use in the sense of invoking a dominant position," and then they went into the particular conduct that had been complained of.

TIPPING J:

Another passage, Mr Farmer, which attracted my attention, was back on 649.

MR FARMER QC:

Yes.

TIPPING J:

Where it seemed to me at least that a valuable point was being made at about line 46, 45, "It was not the conduct itself that amounted to a use of market power for a prohibited purpose, but the conduct in the market context for the particular anti-competitive firm."

MR FARMER QC:

Yes, thank you Your Honour. I've highlighted that as well. The next sentence, "This illustrates the difficulty in separating the use of market dominance and purpose and that's –

TIPPING J:

Yes, people tend to come at this on the basis that use and purpose were two unconnected boxes.

MR FARMER QC:

Exactly, exactly, with respect, that's exactly the point that I'm really trying to make and –

ELIAS CJ:

Well it comes from not concentrating on the text of section 36 –

MR FARMER QC:

Yes.

ELIAS CJ:

– which is really the point that Gault J is making isn't it?

MR FARMER QC:

Yes, and the same point is actually made by Kirby J, and I'll give you that reference, I was coming to it very soon anyway, because what happened in *Carter Holt* was that the majority criticised Williams J, he was the High Court Judge, for considering section 36 as a whole and then for not actually separating out the different components and treating them each in turn. And, it's interesting, Kirby J, without referring to *Carter Holt* in *Melway*. If you get volume 1 –

ANDERSON J:

Well he couldn't could he?

TIPPING J:

What?

ANDERSON J:

He couldn't could he, it hadn't been decided.

MR FARMER QC:

At tab 6. Now Kirby J dissented in *Melway*, generally on the result, but in a very thoughtful judgment, described as thoughtful actually by my learned friend in an article, it's a paper he gave at a conference I believe, which –

BLANCHARD J:

I wondered when you'd get to that.

MR FARMER QC:

Well they put one of my articles in their casebook.

TIPPING J:

So it's 1-all.

MR FARMER QC:

And I read what I had allegedly written and I thought I don't remember writing that. There must be someone else with the same name –

ELIAS CJ:

You must have changed your mind.

MR FARMER QC:

– who's writing this inferior stuff but my learned friend's paper is excellent I think. In any event, if you go to tab 6 and over to paragraph 103, which is on page 41, there's a reference

first of all to the ACCC intervening in the case and they said that they, "Helpfully drew attention to a second textual consideration supportive of the view that the phrase 'take advantage of' did not import any unduly stringent test." This was that, in context, the words 'taken advantage of' must be read with what immediately follows. "The use involved in the notion of taking advantage must be for one of the purposes proscribed. It is a mistake to dissect s 46 of the Act into single words, or even separated phrases. The normal unit of communication in the English language is the sentence. Thus, reading the relevant sentence in s 46 as a whole, there is no necessity to force on to the expression 'take advantage of' notions of misuse or wrongful use of market power, to the extent that such notions exist in the section, they may be found in the classification of the purpose of the corporation concerned. It is in identifying that purpose and not in characterising the acts as taking advantage that the debate is about prescribed or permissible conduct by a dominant market player, arise."

So he's saying really that starting at the wrong end and in a way that's also the approach that Deane J and Dawson J in *Queensland Wire* were suggesting, and if I can just show you that. That's volume 2, if you still have that there, at tab 12 in the volume, at page 197, at the foot of the page. "Its," meaning BHP's, "refusal to supply wire bar to Queensland Wire, otherwise at an unrealistic price was for the purpose of preventing Queensland Wire from becoming a manufacturer or wholesaler of star pickets. That purpose could only be, and has only been achieved, by such a refusal of supply by virtue of BHP's substantial power in all sections of the Australian steel market as the dominant supplier of steel and steel products."

And this is the sentence really that follows that, "In refusing supply in order to achieve that purpose, BHP has clearly taken advantage of that substantial power in that market." And then it says, "If that purpose be one of those specified in the section, BHP's conduct costs you for the contravention of that subsection." So, that's the judgment of Deane J, and you'll see towards the foot of the page, Dawson J ends his judgment by saying, "I agree generally with the reasons for judgment of Deane J," and then he adds some following comments.

Now, that particular integrated approach to the section was proved in *Melway,* so still looking at volume 1, which I think is at tab 6, and paragraphs 27 and 28. That passage from Deane J, they note Dawson J agreed, is there set out. The passage that I've just read to you, and then interestingly, going over the page while I'm here, page 18, paragraph 31 they did say this. "As the Privy Council observed in relation to corresponding New Zealand legislation and *Telecom v Clear*, there are cases in which it is dangerous to proceed too quickly from a finding about purpose to a conclusion about taking advantage." Now, that's true but, that's not to say that a finding of purpose, if it can be established, may not indeed be highly relevant in the way at least described by Deane J in the way referred to in *Geotherm* can be highly relevant to the question of abuse of market power.

And then one can also look in the same volume at tab 7, which is the *NT Power (PAWA)* case, which I referred to earlier, and in particular going to page 145, which is the majority judgment of the Judges referred to at the top of the page. They say, "Finkelstein J," and it's in the case before them, "Adopted what he saw as an alternative approach that had Deane J in *Queensland Wire*. In *Melway* that approach was described without disapproval in the following way," and then they set out the same quote, and at paragraph 150, "That reasoning is applicable here. PAWA's decision to refuse access to infrastructure had the purpose of excluding NT Power from the market, and that purpose could not have been achieved by its refusal access to infrastructure, had it not been for PAWA's market power. It was a decision," said the trial Judge, "made in the appreciation of the existence of that market power and of the capacity to exercise that market power to decline access to its infrastructure. PAWA did not direct any argument against that part of Finkelstein J's reasoning and it is sound."

And really that approach needs to be contrasted with the strict "but for" kind of analysis which, of causal connection between dominance and use alone, and which takes no account of purpose, which Telecom argues for in the present case.

TIPPING J:

Mr Farmer, you're raising the "but for" causal, it provokes me to ask, it is said in a lot of the literature that "use" is the link or the connection –

MR FARMER QC:

Yes.

TIPPING J:

Between dominance and conduct?

MR FARMER QC:

Yes.

TIPPING J:

Yes. I wonder whether causal connection is quite the right concept. I wonder whether it's not more the enabling connection?

MR FARMER QC:

Yes, yes, yes there's a link but I, with respect, I'd agree it's not causal connection. The problem, a problem that I face with that is that the minority of the Privy Council, which took a more different approach to the counterfactual, did use that same phrase of causal connection, I think -

TIPPING J:

Yes.

MR FARMER QC:

I need to acknowledge that. But that's not a term that's to be found in these other cases –

TIPPING J:

If the market power contributes in some appreciable way, and I don't think –

MR FARMER QC:

Yes.

TIPPING J:

– this is very far away from materially facilitates –

MR FARMER QC:

Exactly, yes.

TIPPING J:

But contributes in some significant way to the firm's ability to undertake its proscribed purpose, then one would have thought that was "use"?

MR FARMER QC:

Absolutely, with respect Your Honour, and that's really what, why *Melway*, either Their Honours were expressing concerns about the counterfactual in saying we need something that's really getting more to the heart of the issue that we're looking at.

TIPPING J:

"But for" has too much dominance, if I can be forgiven. It has the link too high, it could be argued.

MR FARMER QC:

Yes, yes.

TIPPING J:

The link, the appropriate link in policy terms should be at an appreciable level, so it is not just de minimis, but to have it at "but for" level is –

MR FARMER QC:

Yes.

TIPPING J:

– a very high requirement.

MR FARMER QC:

It is, and it's, and again if I can hark back to what Scalia J in *Eastman Kodak* when he said that behaviour can take on exclusionary connotations if it's a monopolist that's engaging it, and you can see, though, the comparison that can be made with materially facilitated and with the way that Your Honour's putting it to me.

TIPPING J:

Because I've always thought the "but for" has too much emphasis on causation –

MR FARMER QC:

Yes.

TIPPING J:

– as opposed to facilitation or –

MR FARMER QC:

If it's -

TIPPING J:

– enabling.

MR FARMER QC:

That's right, that's right. And it is facilitation or enabling that we're looking at here when we talk about a mark, a firm with market power, what is it able to do by virtue of that market power. So that's, with respect I would agree with that and adopt that.

Now the, I referred to the minority in *Carter Holt*. Their suggested approach was what they called a straight forward factual assessment of all the evidence of whether the firm had used its dominant position, which Their Lordships described as the statutory question, what is the question that the statue asks, and the question the statute asked is did the firm use its dominant position or its market power for an anti-competitive purpose, and even if you do put purpose to one side that's still the question, and it is basically a question of fact. It is, as they put it, a straight forward factual assessment on all the evidence and…

TIPPING J:

Slightly repenting of what I said in *Magic Millions* I just wonder whether that isn't somewhat unhelpful, Mr Farmer.

MR FARMER QC:

No, no, with respect it's extremely helpful –

BLANCHARD J:

Magic Millions has come down to be magic thousands.

TIPPING J:

Well, it's all very well to say it's a matter of fact, what might be magic hundreds by now, but it's all very well to say it's all a matter of fact on the evidence, but you've got to be pretty jolly clear what you're looking for.

MR FARMER QC:

The factual issue has got to be determined and isolated, and then you've got to –

TIPPING J:

Yes.

MR FARMER QC:

– examine all the evidence to see whether…

TIPPING J:

Doesn't that really mean, involve what you mean by "use", it's a simplistic word, it's a difficult word. You've got to have a very clear idea of what "use" means, or take advantage of may be slightly easier, I don't know.

MR FARMER QC:

Well…

TIPPING J:

But we're not into that.

MR FARMER QC:

I might use a gun if I was out hunting, if I happened to shoot someone I might've used it for the purpose of killing him or I might not have. I just thought it was a good example, not –

TIPPING J:

I don't find that particularly helpful Mr Farmer.

MR FARMER QC:
No, no I don't know what made me say that, but…

ELIAS CJ:
You're using it either way.

MR FARMER QC:
But, no, but why I give that example –

TIPPING J:
It's time for thoughts, that example.

MR FARMER QC:
- is that I'm bringing purpose back into it.

TIPPING J:
Yes.

MR FARMER QC:
And saying, well, that if you're asking questions about the use of a gun, why are you asking that question, I mean you're asking a question because you want to know why you used it as well as did you use it, and the critical question is why did you use it in that example and we would say in this case why you did what you did is a very important part of the inquiry.

ELIAS CJ:
Well, it's a – as you said before, effectively it's a composite provision.

MR FARMER QC:
Yes.

ELIAS CJ:
It's use of a dominant position for one –

MR FARMER QC:
A purpose.

ELIAS CJ:
– of the proscribed purposes.

MR FARMER QC:

Right.

TIPPING J:

I would've thought, if you had a proscribed purpose it might possibly be on an evidentiary basis at least, over to you to demonstrate that you weren't using your dominance for that purpose?

MR FARMER QC:

Yes, I have to acknowledge…

TIPPING J:

It sounds a bit revolutionary, I know, but –

MR FARMER QC:

Well I have to acknowledge the Privy Council I mentioned a short -

TIPPING J:

Yes.

MR FARMER QC:

– while ago, the Privy Council in *Telecom v Clear* did say you shouldn't jump immediately from purpose to use –

TIPPING J:

No.

MR FARMER QC:

– of market power, but it's, if you do say it, there's an integrated inquiry here, well then certainly Deane J, Dawson J, our Court of Appeal in *Geotherm*, our Court of Appeal in all these other cases that Gault J certainly gave judgments in, including *Carter Holt* at the Court of Appeal stage, including *Telecom v Clear* at the Court of Appeal stage, those cases were all cases where the Court was insisting on purpose being part of the inquiry, a relevant, highly relevant part of the inquiry into whether there had been use in market power. It's interesting – no, perhaps I'll leave that point.

Now one point, a bit of evidence that might help here is that if one does look at this as a matter of straightforward factual assessment, our submissions that Telecom did use its market power, when introducing 0867 to remove the competitive advantage that the rival carriers and the ISPs competing with Xtra had achieved, and they were Telecom was

successful enforcing change through 0867. Interestingly Clear faced, perhaps not too dissimilar situation in respect of toll calls that arose under the same interconnection agreement and actually this matter, is it was a matter of factual evidence given by Mr O'Brien but the best summary of it actually is Dr Bamberger's reply brief where he actually sets out the evidence, so volume 4 describes what happened, volume 4 of the case on appeal at page 1419 and what he was examining was a situation where Clear, as a non-dominant firm, faced re the same situation, only this time it was Telecom that was extracting very large termination payments by virtue of the way in which it chose to market its toll service, so you have toll calls with termination payments made on a permanent basis, and so if you look at page 1419, paragraph 36, this is how Dr Bamberger described it, "The empirical evidence" he says, "contains an example of a non-dominant firm in a similar situation, in particular Clear was faced with a similar problem in the market for long distance service, when flat-rate toll call deals became widespread".

In his brief of evidence Raymond O'Brien who was from Clear, explains. "The permanent structure of the interconnect charges under the ICA, combined with the high level of the charges, meant that Clear struggled to compete in the market with the retail packages being offered by Telecom, in particular from the mid-1990s Telecom promoted some flat-rate toll call deals, the $5 weekend". I remember my mother used to ring my aunt every - who lived in Levin – every weekend and they'd talk all weekend on the phone for $5. She'd wait until Sunday to do it. So they might've been Sunday calls. In any event he then continues, "Mr O'Brien also explains that because Clear was required to pay Telecom up to 2.8 cents per minute charge for terminating and originating toll calls, and up to 3 cents per minute for terminating calls from its own local customers, it was exposed if it offered flat-rate deals to compete with Telecom's flat-rate deals, each call would generate only a fixed flat fee, for example $5 per weekend, encouraging customers to talk for longer, but Clear would be exposed to charges that kept increasing for the duration of the call. The situation can be compared with that faced by Telecom with respect to Internet calls. If Clear offered flat fee long distance service to compete with Telecom, it would receive revenues that were fixed with respect to minutes, but would incur per minute costs, that is termination payments, to Telecom. Furthermore consumers faced a zero marginal cost for this service and so would have an incentive to increase the use of it. Mr O'Brien reports that Clear initiated discussions with Telecom about whether Telecom would be willing to renegotiate the per minute for toll bypass. Clear proposed that it pay a percentage or cap, rather than a per minute charge. Telecom refused and referred Clear to the terms of the 1996 ICA. Thus when economic conditions changed, making part of the 1996 ICA unattractive to Clear in a similar matter to that later faced by Telecom, Clear, a non-dominant firm, asked to renegotiate, Telecom refused, and Clear was, in effect, stuck with the bargain it had struck. Unlike Telecom, when economic conditions changed because of the rise of call sink",, a call sink being the rule the

calls go one way as they do with Internet, "Clear was not able to take unilateral actions to undo the unexpected harmful consequences of the 1996 ICA."

So that's quite a nice example that shows the difference that Telecom's market power gave it, that both firms, one in the case of tolls with the local call, the local loop connection with a termination payment, and the other with the Internet, and it does show, with respect, how that market power makes a difference and how it can be used, and can be used only because the firm has market power, and in a competitive market could not be used.

Now I did want to comment to you, I won't take you to it, except to give you the references to Professor Ahdar's two articles that he's written. One of them is in volume 3 of the bundle of authorities at tab 25, between pages 293 and 295, where he deals with the problems of counterfactual and the effect it has on limiting the scope of section 36. He refers to Scalia J in *Eastman Kodak* and he also refers to the fact that Telecom, that may or may not be relevant here, but Telecom did not acquire its market power through any superior efficiencies, rather it acquired its market power because it was the incumbent firm that was established out of what had been a monopoly in the days of the Post Office as a government department, then created as an SOE and also in that same article, he – is the passage where he says, "A rottweiler and a chihuahua can both bite, but the injury would be decidedly more troubling in the former instance," and that's supporting the point that he makes, that the fact that conduct engaged in by both dominant and non-dominant firms may have dramatically different effects upon competition, on the process of competition. And Hammond J in fact cites the Ahdar paper and makes somewhat similar comments in fact in his judgment at paragraphs 89 – sorry pages 89 to 90 of volume 1 of the case on appeal, paragraphs 43 to 45 of His Honour's judgment. So that's the first point that – these are points made by Ahdar in particular, that the effects on competition on the process of competition may be quite different according to whether we're looking at a dominant firm or a non-dominant firm. The second point he makes, which we would submit this case as an illustration, is that it's very difficult to apply and of course in Melway that's what the High Court of Australia said, there will be cases where it's difficult to apply. And the third point is that, which is a point really that the Court of Appeal in the present case, was alluding to, that it requires Courts to engage in hypothetical comparisons that are wholly unreal and the way Professor Ahdar puts it at pages 271 to 272, he says, "It's hardly sensible for the legality of a real firm's actual conduct to be predicated upon a speculative answer to an imaginary firm's hypothetical conduct," and Kirby J in *Rural Press Ltd v ACCC* (2003) 216 CLR 53 (HC of A), said something similar really and *Rural Press* is volume 2, tab 17 if you still have that handy, and he has a section, this is at paragraphs 138 to 139 on page 105, he has this heading, "A trilogy" what he calls a trilogy, which is the three High Court of Australia cases, *Melway*, *Boral Besser Masonry Ltd v ACCC* 215 CLR 374 (HC of A) and now *Rural Press*, "A trilogy and the doctrine of innocent coincidence", and in paragraph 139 he says, "In my view, the approach taken by the majority

is insufficiently attentive to the object of the Act to protect and uphold market competition. It is unduly protective of the depredations of the corporations concerned. It is unrealistic, bordering on ethereal, when the corporate conduct is viewed in its commercial and practical setting. The outcome cripples the effectiveness of s 46 of the Act. It undermines this Courts earlier and more realistic decision in *Queensland Wire*. The victims are Australian consumers and the competitors who seek to engage in competitive conduct in a naive faith in the protection of the act. Section 46 might just as well have not been an Act if the cases like these, where its operation is sorely needed to achieve the purpose of the Act."

Judicial lightning strikes thrice, a novel doctrine of innocent coincidence prevails. Effective anti-competitive threats can be made without the redress which s 46 appears to promise. It dissents, because on the facts of that particular case the High Court of Australia held that what had happened in the facts of that case, which I won't go into, did not amount to any abuse of a common market position.

TIPPING J:
That dissent wasn't really focussed directly on the counterfactual was it? It was just a plea, an unrealistic approach to the whole ethos, if you like, of the section.

MR FARMER QC:
Yes. He was saying – I think what he was really saying was that the whole proper purpose and ambit of s 36 had really been undermined by what he called ethereal or unrealistic approaches to it, and we would submit the counterfactual –

TIPPING J:
Was one of them.

MR FARMER QC:
– was one of that, an important aspect of that.

Now, in the Court of Appeal, just dealing with that. We made a submission that the facts of the present case tested the very limitations of the counterfactual technique, and in that respect we submitted, and we submit here, that sight should not be lost to the fact that the counterfactual has got a tool for analysis and is not an end in itself. So that if the counterfactual that is defined creates more confusion than light and is unduly unreal in comparison with the factual world, then its use will be counterproductive, and we made that submission.

My learned friends have kindly reproduced it in their casebook, our submissions on that and volume 3 of their casebook at page 356 of the transcript, lines 14-22 and page 614, lines 22-

32, and that same kind of concern of course, is one that rose in respect of market definition. And you'll recall that particularly in the earlier cases under this Act and in Australia, there was an enormous attention paid to defining markets and arguing about markets and about how narrow they were or how wide they were, and often, depending on the answer to how the market was defined, that would resolve the case. It was that famous case in Queensland, *Ira Bourke***,** where they defined the market as being the market for the retail sale of Nissan motor cars in some suburb in Brisbane. Really, if you define a market that narrowly, you know what the answer is going to be in terms of the conduct of that firm. And there's been very much a reaction away from that, an acknowledgement in the case. It's like, I don't need to take you through them, but acknowledgement in the case is that market definition is an instrumental tool for examining what is in issue in the case, and what is in issue in the case is the conduct of a firm.

I just need to give you I think, two or three references, in New Zealand cases where that has been recognised, recent New Zealand cases following authorities overseas. *Brambles New Zealand Limited v Commerce Commission* (2003) 10 TCLR 868 and particularly at paragraph 137 in the judgment of O'Regan J and Kieran Vautier as lay member, and then *Telecom Corporation of New Zealand Limited v Commerce Commission* (1991) 4 TCLR 473 at 499 to 500, and *Commerce Commission v New Zealand Bus Ltd* (2006) 11 TCLR 679 at paragraph 123. So it's the same thing, don't – this is not an end in itself, it's a technique, a tool, an analytical tool, if it's not working we shouldn't get too bound to it.

So if I can – having dealt with that section of the submissions that leaves me really to deal with, as far as the counterfactual is concerned, with issues around the counterfactual in the present case because we do come to this Court submitting that even if the Court takes a view that the counterfactual test is it, we say that the High Court got it wrong and because it got it wrong therefore the appeal should be allowed on that ground alone which doesn't, that that – in other words, we say there is an error and we want the error corrected.

ELIAS CJ:

The High Court got it wrong and the Court of Appeal didn't correct it?

MR FARMER QC:

Yes.

ELIAS CJ:

And the outcome would be, if you're successful remission to the High Court?

MR FARMER QC:

Not – we would submit that wouldn't be necessary because we say the material is there for this Court to be able to say that on the, on a counterfactual analysis it's plain that Telecom, and this is the critical finding about the counterfactual, that Telecom would not have been indifferent to losing customers and therefore would not have been able to introduce 0867 in a competitive market. We will submit that that can be demonstrated very clearly on the evidence and that is what I'm going to proceed to try and do now.

Now as I mentioned earlier, the starting point of this perhaps is that Telecom says that 0867 was Telecom's innovation to escape Clear's exercise of market power. That Clear had an exercise monopoly control over access to ISPs on its network and that is based on Professor Hausman's view that Clear was earning what he called, I'm sure he called "supra-normal profits" although it's transcribed as super-normal profits, and was sharing them with the ISPs. Now what we say is that accepting that Clear had, whether one describes it as market power or whether one simply says Clear was clearly, was earning profits over and above its costs including, within the term costs, a contribution to fixed and common costs and accepting that Clear in attracting ISPs to its network had a competitive advantage, in respect of Internet, and we say that nevertheless that advantage, to the extent that it was based on the termination payment regime, to the extent that it was based on that, that advantage was relatively short-lived, was going to be a short-lived one, because of the relatively imminent expiry of the ICA, it had about 18 months to run at the time 0867 was introduced, and that's an important fact that the Courts below, we submit, failed to factor into their consideration of the question, the key question, whether in the counterfactual Telecom would have been indifferent to losing customers and the loss of a customer is potentially a long-term or even a permanent loss. I mean people don't easily switch, they don't switch unless they've got a good reason and they don't switch backwards and forwards, maybe some do but by and large people stay put. And if they have a good reason for switching, because Telecom has annoyed them to the point where they are prepared to switch, it could generally be assumed they are unlikely to switch back again in the near future, so that the reasonable conclusion that can be drawn is that a loss of customer is likely to be, looking at the customer loss as a whole, is likely to be something that would go beyond the relatively short term that the ICA still had to run. So the point about that is that therefore in looking at the benefits to Telecom of 0867 of losing customers who are costing them money because of termination payments, and comparing that with the losses to Telecom of the lost revenues from those customers, the first point that needs to be taken account of is the time dimension.

The second point that needs to be taken account of, is just what are the revenues that are being lost and as I suggested earlier, the revenues that are being lost are likely to be far more than just the revenues that are earned by Telecom from the local rentals that are paid monthly for local calls. I say that for two reasons. First, because it is very likely that a Telecom subscriber in most instances will probably be taking other Telecom services as well.

They may well be taking, probably will be taking toll call services, which earn very significant revenues for a telecommunications company. They were also likely to be taking in many instances value added services, which are highly profitable to a firm, and by value added services I would instance things like call readdress where the call is diverted from the local line to a mobile phone for example. Call-waiting and those kinds of services which are highly profitable and which firms use as optional services that they can build on to some basic service that they are providing to a customer. It's a little bit like buying a basic Starbucks coffee and then you can, value added the optional extras things like some sort of essence being added to it, which is just a few drops of something out of a bottle –

BLANCHARD J:

Isn't it bad enough in its basic form.

MR FARMER QC:

Why I'm giving this example is because there's a wonderful book which I bought in an airport which is called The Undercover Economist and it shows the amateur level of my economics, but what they did do was give the Starbucks example which is Starbucks have techniques for working out customers who are price sensitive and those who are price insensitive. And the ones who are price sensitive will just buy the basic coffee and the ones who don't really care too much about the price will say, oh I see they've got vanilla essence, if I pay another 75 cents, and the cost of that vanilla essence is like one cent, and that's where the real profit comes in. So they –

ELIAS CJ:

People who don't know what they want, sounds like.

MR FARMER QC:

Pardon?

ELIAS CJ:

They make their money from people who don't know what they want.

MR FARMER QC:

They make their money from, yes, from people who don't know what they want, who have at least got enough money to not care how much they pay for something and I actually tested this when I was in London and because they said, well if you go into Boots the Chemist they will have their very expensive brand products and then they will have their own in-house products which are the no-frills products, which are very much cheaper, but they put the no-frills products at the very bottom shelf and I went and I tested it, and looking at shaving cream, and what I found was that the no-frills product was not only on the bottom shelf but it

was – the bottom shelf was actually built in a little further in, so you couldn't see it unless you got down on your hands and knees and so they are – sorry this is digressing but it's actually quite a wonderful book.

ELIAS CJ:

I'm just feeling very sorry for you having to buy shaving cream at Boots when there were so many wonderful places –

MR FARMER QC:

No, they sell the expensive products, they do, but the point being that in terms of optional extras, the optional extras are where the profit is made and test it with motor cars. You can go in and buy a standard motor car, but the minute you start buying a few fancy extras on it the price goes up very dramatically, compared with the cost of providing that optional extra.

TIPPING J:

Your expertise in this field is mind blowing Mr Farmer.

ELIAS CJ:

Now why are you taking us here? I am totally lost.

MR FARMER QC:

Why I'm telling you this is because in terms of looking at Telecom's indifference to losing customers, those value added services are, the call-waiting et cetera, the toll services, the high profit toll services et cetera, they are the things. Not the basic telephone line rental, the monthly rental, not that so much but those other things, and so it's the package that Telecom loses when the customer goes. Now Telecom I think recognise this issue as being a problem for them, because in their submissions at paragraph 5.36, they refer to some evidence from Professor Hausman who says, "Telecommunication services cannot be treated as a bundle and it's always open to a consumer to shop around and buy its tolls from one carrier and its local calls from another." Well yes, that's true and firms like Clear and Compass do target, do sell toll services, and they'll sell them separately, but those firms tend to focus on the business end of the market and if we're looking here, talking here mostly about residential uses of the Internet, the bundled service is still one that is extremely valuable and it is promoted and sold. We saw an example even with the evidence I took you to of Mr Hussona with Compass and the free net business plan which was linked in with tolls. "We will give you free Internet services provided you pay $50 a month," or whatever the period was, "for tolls."

TIPPING J:

What did the High Court make of this argument Mr Farmer? What did the High Court make of this argument, because it's –

MR FARMER QC:

The High Court equated the savings with the costs, so they said –

TIPPING J:

I realise that, but did they actually traverse this argument and say why it didn't work that way?

MR FARMER QC:

No. They – what they, with the greatest of respect, I suspect it may have been the lay member who wrote this part of the judgment because it was written very much in economic sort of assumptions about this cost equals that cost and capital investment savings.

TIPPING J:

What about the Court of Appeal what did they make of this argument? I mean we've been asked to try it for the third time, if you like -

MR FARMER QC:

Yes.

TIPPING J:

On the facts.

MR FARMER QC:

Yes, yes.

TIPPING J:

What the other Courts made of this, well I mean are you saying in effect they didn't really address it?

MR FARMER QC:

I'm saying they didn't get it right.

TIPPING J:

Didn't get it right.

BLANCHARD J:

Did they have the evidence?

MR FARMER QC:

The evidence is there, the evidence is there, and –

BLANCHARD J:

On lack of bundling or –

MR FARMER QC:

On what sorry?

BLANCHARD J:

On lack of bundling, or bundling.

MR FARMER QC:

What this – I don't recall, and I stand to be corrected, I don't recall anything being – any reference being made to Professor Hausman's claim that telecommunications services cannot, be treated as a bundle and I stand to be corrected on that, I don't remember that point being made. My learned friends will correct in due course, they always do, but I don't recall that being a feature of what was said here, but in any event we would say it's clearly wrong and we've got the Hussona evidence as an example, but we've also got what is clearly, and indeed it's a matter that one way or another Dr Bamberger certainly addressed and was cross-examined on.

TIPPING J:

And it's paragraphs 5.7 to 5.9 inclusive of your written material is it Mr Farmer? I'm not trying to be – that's – it's the potential loss of residential customers is the heading?

MR FARMER QC:

Yes, I certainly address in our written submissions.

TIPPING J:

Yes, just like having a cross-reference.

MR FARMER QC:

Yes, that's it and in fact we're giving quite a number of references in the footnotes you'll see there. The second lines I forgot to mention that and particularly actually with Internet, I mean the second line is that people get because they want to be able to use the phone rather than having their teenage children on it all the time, but there are also the second lines that people were in fact buying for fax and for Internet itself, and that was a source, a very profitable source of revenue for Telecom and you'll see in fact that, I haven't – I'm not taking you

through all this, but you'll see, we've tried to summarise it very briefly that the second line revenue alone was predicting 22 million dollars in revenue within five years and Mr Parkes was cross-examined on that. He said that there was definitely an opportunity to earn substantial from second lines –

TIPPING J:

Is the punch line of this argument towards the bottom of page 34? "Company X would not rationally have risked losing these customers."

MR FARMER QC:

Absolutely, yes. That is it and we've given a reference in the footnote to the fact that Professor –

TIPPING J:

The only reason that Telecom could was that it was dominant?

MR FARMER QC:

Yes. So those pages from 31 to 34 of our submissions are, with respect, important. They are the heart of our case about the counterfactual analysis and we also have given, as I say in the footnotes which are quite extensive, references to all the evidence that had been, that was relevant to this analysis including me of Telecom's own internal documents which indicated the revenue sources that were available to them including references to what, for example looking at footnote 167, bandwidth hungry families, things like that.

Now by contrast, just looking at the bottom of page 32, the High Court assumed that lost revenue would exactly match the cost of capital and that a non-dominant firm who lost customers would continue to make a competitive return and we submit that that's just an assumption that's made that is not borne out by the evidence, in particular the submission we make further up the page, is that a rational firm in a competitive market would not give up long-term revenues in order to stem short-term losses. It would want to keep and increase the number of customers in its network. And what you in fact have with every customer who goes, you lose also their, you not only use the add-on, the extra revenues from other telecommunications products, but you also lose – you save, you save on the, not having to supply the service, which is a marginal cost only, but what you lose is that customer's contribution to your fixed costs. So those, yes, pages 31 to 34 is really at the heart of our complaint about the way the counterfactual was analysed in this particular case. Now –

TIPPING J:

It was on that financial balance that the High Court came to the view was it that Company X would be indifferent to a loss of –

MR FARMER QC:
Yes.

TIPPING J:
– residential – that was the premise on which -

MR FARMER QC:
That's right. The so-called cost and benefit analysis –

TIPPING J:
Yes.

MR FARMER QC:
– and the conclusion was that the –

TIPPING J:
That equates in effect.

MR FARMER QC:
They equate, they equated.

TIPPING J:
In your case they don't equate –

MR FARMER QC:
Exactly.

TIPPING J:
– by a sufficient margin to make all the difference?

MR FARMER QC:
Yes, that's right. Now the other point about the counterfactual analysis is just the characteristics of it and we've got the written submissions here, I can probably deal with that easiest by taking you to paragraph 5.4. So looking at the bullet points. The first one, at least three firms operating in the relevant market, Company X, Company Y, which was Clear, and at least one other, none would be dominant. No firm will be earning supra-normal profits. Now there's an immediate problem because when you look at the second bullet point, like Telecom and Clear, companies X and Y would be parties to an ICA with the essential features of a 1996 ICA. Now an essential feature in the 1996 ICA was that both Telecom Clear were

earning supra-normal profits and it was the fact that Clear was earning supra-normal profits which enabled it to adopt the business plan that it did, which created the termination payment situation that Telecom then sought to address through 0867. Then looking at the third bullet point, like Telecom, Company X would be bound by the KSO, that's the kiwi service obligation, now known as the TSO under the Telecommunications Act –

BLANCHARD J:

Why would only one company be bound by a KSO in a situation where they've all got lines?

MR FARMER QC:

Well our point about the KSO was that it wasn't, it was neither here nor there that this was, Dr Bamberger said well I can deal with the counterfactual whether it's got KSO in it or not but our basic position was that the KSO was, as I say, neither here nor there. It's – the relevance of the KSO in this case, as raised by Telecom, was that it was regulatory constraint that had the effect of depriving Telecom of market power in the residential market because there was a limit on the prices or the charges that could be made for line rentals and because it required, it prohibited Telecom from charging on a per call basis as well. Now that did not, that argument was not accepted. The High Court did not accept the argument and said, no we think that Telecom did have market power and in that respect reference was made, I think in the judgment, but certainly in argument, to the Fletcher Inquiry which proceeded the passing of the Telecommunications Act and which made the point that the KSO originated with Telecom at the time it was established, and which was part of an agreement with the government, that there would be no increase – the free calling, the free local calling would remain and there would be no increase in line rentals other than per the CPI but as the Fletcher Inquiry report pointed out, that that left open the issue as to whether enshrined within those initial charges, the current charges that were being made at the time, that Telecom began operation, whether in fact there may have been quite large margins, profit – monopoly margins, between its costs and its charges, and also there was the issue that as Telecom became more efficient, as it reduced its costs which it really had to do, should do, and its costs came down, the prices remain the same. They didn't come down with the costs and so any margin, monopoly margin, monopoly profit, if anything, got larger so that, so for those sorts of reasons the KSO was not found to be any effective constraint on Telecom's market power. So just what the relevance of it was in terms of the counterfactual, with respect, is hard to see.

BLANCHARD J:

It just seems to me it's a bit problematical for any counterfactual because it's not realistic to think that there would be a KSO if you had three companies each of which had lines.

MR FARMER QC:

Yes. That's right. Then the fourth bullet point, both Company X and Company Y like Telecom and Clear would have their own ISP and have other ISPs on their network. Just quite why they had to have their own ISP is not clear either, I must say. Whether that, at the end of the day, makes any real difference to the analysis one way or the other may be another question. And then it continues, "It must also be assumed that as Telecom did with Ihug, Company X was able to come to an agreement with an ISP which gave it not less than 75 percent in aggregate of the ISP's terminating traffic." Well Xtra, I can't recall actually whether the 75 percent figure I mentioned before included the Ihug traffic, because ultimately what happened with Ihug was that Telecom paid them I think some 16 million dollars to bring their, to say on the, keep their business on the Telecom network, but just what the particular relevance of that point is, other than adding unnecessary complexity is I'm not quite sure.

And then the final point was the counterfactual must assume that Company Y has a small number of residential customers, which Clear had relative to its ISP terminating traffic so as to replicate the nett end balance of termination fees which Telecom experienced. So that's just saying probably correctly that although these three networks are ubiquitous so that there can be switching, a telephone subscriber can easily switch from one to the other to no disadvantage to itself because the network is ubiquitous, in order to replicate the issue that we're looking at here, you have to put on company-wise network a small number of residential customers so that the bulk of the calls, the Internet calls that are being made are being made off Company X's network and it's that, that replicates the volume of the issue because those calls are then being made and you have this imbalance of termination fees, which Telecom experienced.

Now, there was an issue, the Court of Appeal, we say, wrongly found that all these characteristics had been agreed to by the party's three expert witnesses and we submit that's not what actually happened. It also wrongly regarded as determinant of the experts' opinions as to the assumptions to be made in the counterfactual. Now, in any event, now we've given our reasons, given the references to in particular Dr Bamberger's evidence, but certainly the counterfactual at the end of the day is for the Court to determine, but – and then we've listed the, our criticisms of the counterfactual itself and I've gone, I've just have already gone through them, and in particular the second one, the KSO one, we did not accept that Company X or Company Y should be subject to the KSO, and I've given the reference to the transcript, and then the assumption relating to an ISP Ihug in the fourth bullet we said should not be part of the counterfactual Telecom settlement with Ihug was after the introduction of 0867, so that was a point that the High Court seems to have got wrong in the first place, that what actually happened was that the Ihug settlement, the 16 million dollars was paid some time after the agreement was reached, some time after 0867, so that can't be relevant in any sense to the counterfactual analysis.

Now, paragraphs, pages 31 to 34 is what we say about the key issue on it. Dealt with that. And I should also refer in this context to page 36 of our submissions, which I touched on earlier, that there was, the High Court did not include in the analysis, the counterfactual analysis, the wholesale market for network access, and the reason for that being the one I gave earlier that they found that they ruled that Telecom was not dominant in the wholesale access market. The Court of Appeal reversed that finding but then did not go on to consider the effect of that on the counterfactual analysis, and our submission was and is that the impact on Telecom of losing customers, the impact on Telecom of trying to introduce 0867 in a competitive market was that it stood not only to lose residential customers in the way that I've described, but it also stood to lose wholesale access customers. It stood to lose it – for example if it went to Company Y and said, unless you subscribe to this ITA we will not give you an 0867 number and you will therefore lose your Internet service provider customers, in that counterfactual situation it would always have been open to Company Y to say, well, okay, we will no longer be interconnected with you, we'll take our access into connection from Company W, and we will get access to your customers through Company W because in fact Company W would have an interconnection agreement with Company X and it would be able to, Company Y would be able to rout its, the traffic through Company W and that would – so there would be that ability in a competitive market that doesn't exist in the factual situation where Telecom has all the cards and where everyone has to connect with it. I should say in the Hong Kong telecommunications market, this sort of process of indirect interconnection is very common. You have something like, I think eight landline networks and something like about 300 mobile networks and there aren't interconnection agreements between all of those companies. There's no need to. It's simply because this process of indirect interconnection is what is mainly done.

TIPPING J:

This is quite a difficult exercise to do off paper, isn't it Mr Farmer? The High Court didn't reach it because they held there was no dominance –

MR FARMER QC:

Yes.

TIPPING J:

– in the wholesale.

MR FARMER QC:

Yes.

TIPPING J:

The Court of Appeal didn't deal with it.

MR FARMER QC:

Yes.

TIPPING J:

And we're dealing with it for the very first –

MR FARMER QC:

Yes, I –

TIPPING J:

– time on a second appeal.

MR FARMER QC:

Yes, I agree, but it's not as difficult perhaps as Your Honour's suggesting, because –

TIPPING J:

Well…

ELIAS CJ:

No, but even if it isn't difficult, it's something that I would have thought a second appeal Court should enter into only very reluctantly.

MR FARMER QC:

Yes.

ELIAS CJ:

If only because –

MR FARMER QC:

Yes.

ELIAS CJ:

– we would be first and last resort.

MR FARMER QC:

Yes, I accept that, but it's not impossible to do it.

ELIAS CJ:

Yes.

MR FARMER QC:

And I agree with all of those traditional sorts of limitations on the final Court of Appeal and so on, but really it's quite a simple exercise in the sense that, as Dr Bamberger points out, it's just another revenue stream that Company X stands to lose. The interconnection revenues, if it loses Company Y as a customer. And if it loses Company Y as a customer well then that, if anything, is just going to exacerbate the issue about losing residential customers as well. So it can be dealt with, we would submit, at that level of generality.

TIPPING J:

Another revenue stream with no countervailing saving of cost?

MR FARMER QC:

Yes.

TIPPING J:

That's…

MR FARMER QC:

Yes. Well that same cost is –

TIPPING J:

It will be the marginal cost.

MR FARMER QC:

Is miniscule.

TIPPING J:

Yes, minimal, yes.

MR FARMER QC:

It's a marginal cost only, yes.

TIPPING J:

Yes.

MR FARMER QC:

Now at, finally ready on this point about the counterfactual analysis is the way the High Court approached it and they drew a distinction between depriving arrival of its revenues and saving

costs, and that's the sort of approach that Telecom have taken generally throughout. They've said, well no we weren't trying to deprive our rivals of their revenues, we were just trying to reduce our costs and that's a different thing. And the High Court really bought into that and in their judgment at volume 1 at paragraph 102. Well perhaps starting really at 100, paragraph 100, "The goal of eliminating terminating payments for Internet calls was a substantial purpose. It must be conceded that it was capable of being anti-competitive, if as Mr Farmer has submitted. Telecom's real or primary objective was to deprive its rivals of revenue, not to reduce its own costs." There's the distinction. If what they were doing was to deprive rivals of revenue, that could be anti-competitive, but if it was simply to reduce their own costs that wasn't. He maintained this was the case, Telecom was seeking to prevent or deter Clear from exploiting a legitimate competitive advantage, it had in competing with Telecom. That competitive advantage derived from the terms of the 1996 ICA and its removal was said to be a foreseeable and foreseen consequence of Telecom's conduct. The Commission argued that Telecom could not have been criticised if it had achieved the reduction in costs and consequently encouraged revenues by lawful means such as exercising a contractual right to reduce termination charges or by negotiation or other competitive conduct. It is the unilateral imposition of the 0867 scheme and the manner in which the reduction costs and revenue was achieved, which is said to show that Telecom acted for an unlawful purpose.

Then in 102, "In seeking to reduce its costs Telecom was engaging in normal profit maximising behaviour to be expected of any firm dominant or otherwise. That would be strange indeed if it had not sought to stem the ever increasing flow of termination charges". So just stopping there you will recall I referred to Dr Bamberger saying "That's not the issue, the issue is how they did it". And then it goes on to refer to a breach of contract point and then further down the page, about four or five lines up from the quote, "To paraphrase the majority judgment in the High Court in *Melway*, Telecom's relative freedom from competitive constraints did not make it wrong to secure business advantages which might not have been so readily achievable in a competitive environment." The comments of the Privy Council, Telecom and Clear are apposite and that's the *Olympia Equipment* Posner J quote, "A monopolist is entitled like everyone else, to compete."

And then in 103, "In support of his submission that Telecom's dominant purpose was to disadvantage rival carriers and Xtra's competitors in the retail Internet access market, Mr Farmer pointed to evidence that showed that Telecom was aware that the removal of termination payments would be to the disadvantage of its competitors. It also relied on what was referred to as the CallPlus incident in which call-plus incident in which CallPlus and ISP on Clear's network sought to avoid its customers paying the 2 cents per minute charge by a mechanism known as call readdress when Telecom attempted to block this manoeuvre CallPlus successfully obtained an interim injunction". I referred to that earlier which is

CallPlus and i4Free's attempt to get around the 0867 thing which led to their being cut off and that led in turn to them getting an interim injunction, but the damage was done and Mr Dick referred to the loss of confidence consumers had in their service that resulted.

Then the second bullet point. "Evidence that Telecom rushed the 0867 package into service in the knowledge that it suffered from a higher fault rate than other forms of Internet access. Mr Farmer referred to evidence that at the time the 0867 service was launched in September 1999 Telecom was aware of a significantly higher rate of faults with 0867 then with other Internet access methods. In its dealing with government and media, Telecom sought to suppress the fact that one of its purposes was to reduce the level of termination payments." That's relevant you'll find in Telecom's submissions that the minister consented, the minister knew about what they were doing and there was quite a bit of argument in evidence as to whether the minister had been misled and whether the whole thing had been put to him on the basis of network congestion rather than on the basis that's being discussed here.

The Court continued in 104, "We accept without question that Telecom knew that its strategy would disadvantage its competitors and those of Xtra. We accept that there were indications of technical problems that were associated with the introduction of the 0867 service that might have been lessened if its launch had been deferred. We agree that in its public statements and in dealing with government, Telecom focussed on the advantages of 0867 for network management purposes. Mr Parkes conceded candidly that Telecom chose to stress the network management issues as it was felt this was a more palatable, or sellable public message. In our view this evidence takes the Commission's case no further, it simply confirms that one of Telecom's objectives was to address the termination charge problem, and that was well aware of what the consequences would be for rival carriers and ISPs. Its response to the attempt by CallPlus to circumvent the 0867 initiative was consistent with Telecom's overall strategy and although in issuing an interim injunction the Court found that a serious question to be tried, it was never found that Telecom had acted in breach of its contractual obligations." In that case there was a complaint I think by CallPlus, a breach of contract in terms of the obligation it provide service. "As with all the litigation spawned by the terms of the ICA the CallPlus claim was eventually settled."

Now the question that arises really is this. Is there really a distinction between conduct, which is said to be aimed at reducing costs in the circumstances of this case, and conduct which is aimed at depriving rivals of revenue and our submission is that these are two sides of the same coin. The reduction of costs was the consequence of depriving Telecom's rivals of the termination payments that they were earning under the ICA and we've made that submission in paragraph 6.9 of our submissions, I won't take you to that but what we do do is rely on the *Apple Fields* which I touched on earlier and I think I would quite like to take you to that briefly, its volume 3 of our bundle of authorities, tab 23. I mentioned very briefly before the facts, I'll

just remind you quickly that the Apple and Pear Marketing Board had a statutory monopoly, it had the ability that all apples, whether produced locally or imported, could only be sold, had to be sold to the Board by the grower and could only thereafter be marketed by the Board and the Board had obviously power to levy, to impose levies to meet its costs and it had also a power to impose what was called a second tier levy and it exercised that particular power because it took the view that it wanted to reduce, it wanted to discourage further growers into the market and it wanted to discourage existing growers from producing too many apples. This is sort of my very rough summary of the case and that was challenged by Apple Fields who said "We actually do want to be more competitive, we want to produce more apples and have them marketed and we don't want to pay this levy," and so they brought a case under the Commerce Act.

There was an issue, as I mentioned earlier, as to whether the Commerce Act actually applied and ultimately the Privy Council, and indeed the Court of Appeal I think, said it didn't so the statutory exception applied. But there was analysis of the competition issues on page 162, which is very helpful to this point, this very point that I'm seeking to discuss. Now 162 is at around about line 15, Sir Robin Cooke said, "Well I am in respectful disagreement with Holland J in this part of the case as I find the question of purpose easier than the question of effect." Evidently the Judge was impressed by the Board's witnesses and the aim of the Board to be fair in the levy, although he rightly recognised that fairness or otherwise is quite a different matter from the lessening of competition. He said that, "The Board's purpose was not to restrict entry into the market or deter competitive conduct in the market, but was to recover from those entering the market, or increasing production, a fair proportion of the capital costs created by such entry or increase." So it was a cost exercise, cost recovery exercise was the argument and His Honour said, "The difficulty as I see it is that those two ways of analysing the Board's purpose are not really different. They are not in contrast, but alternative ways of saying the same thing. The Board has set out to ensure that newcomers would not be attracted to the industry, partly by the prospect of establishment costs seen by the Board as unrealistically low. Similarly the Board thought that established growers would be less likely to make new plantings if faced with a levy. By achieving some degree of fairness, the levy at the same time inevitably carries out a policy or purpose of restricting new production. Intrinsically, it is a policy restraining competition, seen by the Board and the Federation as unfair. For section 27 to apply, it is enough that the anti-competitive purpose is a substantial one. That has the effect of an elaborate definition in 25A. On the evidence in the Judge's analysis of the facts, I cannot avoid the conclusion that the arrangement for the levy between the Board and the Federation, however well motivated, has had a substantial purpose of deterring entry into the apple growing industry or increases in production." With respect, we submit that that's entirely the case here, and indeed in Mr Parkes' evidence, if I can just find the reference, he did not, he accepted – I'm just looking for it, he accepted that the purpose, Telecom's purpose was indeed, was inevitably intended to deprive the rivals of

the revenues that they were earning and – I'm sorry I just seem to have lost that particular – anyway. Perhaps I'll have to give you the references later. My learned friend has helpfully given me a reference in his brief. I was actually thinking of some, of the cross-examination and I don't think I can quickly…

TIPPING J:

If the expense to Telecom is the revenue to the others, surely this is a more vivid example of what you're talking about than this *Apple Field's* case? It's a direct correlation.

MR FAMER QC:

Yes, yes it is. The same amounts.

TIPPING J:

Yes.

MR FARMER QC:

Exactly the same amounts and –

BLANCHARD J:

If you intend to save yourself money, the effect may well be that you deprive a rival of some revenue, but it doesn't mean that you intend to have that effect on the rival.

MR FARMER QC:

I certainly couldn't say that that could never be the case, but the normal way in which a firm reduces its costs is by unilaterally introducing greater efficiencies into its own operation. It will reduce the costs of producing a product. The costs here do have this, it's just as His Honour Justice Tipping just said, they have this direct correlation to the revenues being earned by the rival.

BLANCHARD J:

But this is the perhaps unusual situation where the revenues, instead of going to a third party and you're trying to cut them down for your own benefit, happen to be going to the rival.

MR FARMER QC:

Yes.

BLANCHARD J:

But you still should be able legitimately to try to reduce that cost.

MR FARMER QC:

The key word there is "legitimately".

BLANCHARD J:

Yes.

MR FARMER QC:

And, yes, that is absolutely right, with respect and…

BLANCHARD J:

The fact that they are opposite sides of the same coin doesn't per se make the conduct illegitimate.

MR FARMER QC:

No, it doesn't per se, but nor – but what has been said against us is that this was a reduction in costs and somehow – well, what the High Court said first of all was if the purpose was to reduce the revenues, then that could be anti-competitive. But they went on to say, but that's not what the objective was. The objective was to save costs, and…

TIPPING J:

Perhaps they were reflecting my brother Blanchard's point without expressing it in that way.

MR FARMER QC:

Well then we are back into a broader assessment of what was going on here, and there were other ways of reducing that particular cost and they are the three ways that we mentioned earlier, that it could be, it could in fact compete more vigorously for ISP business, it could compete more vigorously for…

TIPPING J:

Yes.

MR FARMER QC:

Residential customer business. It could renegotiate the ICA with the carriers. Those were the sorts of options they had available to them.

TIPPING J:

Maybe it –

ELIAS CJ:

It doesn't matter if they had options. I'm just thinking in terms of the application of the statute.

MR FARMER QC:

Yes.

ELIAS CJ:

If they did propose to deter any other person from engaging in competitive conduct -

MR FARMER QC:

Yes, yes, yes.

ELIAS CJ:

- even though they may also have proposed to increase their own, or reduce their own costs.

MR FARMER QC:

Yes.

ELIAS CJ:

Isn't that sufficient?

MR FARMER QC:

It is because in fact –

ELIAS CJ:

Yes.

MR FARMER QC:

- you'd only have to show a substantial purpose. There can be more than one purpose.

ELIAS CJ:

Yes.

MR FARMER QC:

And if a substantial purpose is the anti-competitive deterrent –

ELIAS CJ:

Well I'm not even sure that you have to have a substantial purpose on the statutory language, but –

TIPPER J:

But the definition…

MR FARMER QC:

I think section 25 of the –

ELIAS CJ:

The 25, yes, yes, of course.

MR FARMER QC:

Yes, yes, yes, and –

ELIAS CJ:

Yes.

MR FARMER QC:

– it had, it deals with that. So, yes, that's correct. But our point in referring to the other options is to say that that, the fact that there were these other options assists in coming to the view that their true purpose was what we say it was.

TIPPING J:

Well, included what we say it was is presumably your better argument. That you don't –

ELIAS CJ:

Yes, yes.

MR FARMER:

Yes, included, included, included, that's correct. That's as far as I need to go, and – I'm just very cross at not being able to find the, I don't know whether it is or not. Yes, I think it's in volume 4, I do remember that much. At page 1053 –1058**.** No it's back at 1016, volume 4, 1016, beginning at, I will read this quickly, at line 5, this followed quite a lengthy slightly difficult period of cross-examination. The question was to be focused on, so line 5, "All I want you to agree to now is that the successful implementation of 0867 inevitably meant, first that the ISPs who are receiving termination revenues would lose the benefit of that, do you agree?" Answer, "That was an outcome we were looking for, a bill and keep arrangement which is what the ITA would have provided for, termination payments were wiped". "And a second outcome that you're also looking for and one which could arise in 0867 was

successful, was that carriers such as Clear, who were receiving termination revenues for Internet calls would lose that because once again, bill and keep would be the outcome?". "That's correct, yes". So that for both ISPs and the carrier their position would have been disadvantaged commercially by 0867, do you agree?" And then we had a little bit of to-ing and fro-ing about that and –

ELIAS CJ:

Sorry, I lost the page, what was it?

MR FARMER QC:

Its 1016, beginning at line 5.

ELIAS CJ:

Thank you, yes.

MR FARMER QC:

And then if you – there is a bit of fencing went on at that point about use of language, but if you go over to next page 1017 at line 6, "I was getting a little bit testy." "I know that, I know that Mr Parkes, but it's quite a simple question, would you agree that if everyone ended up on bill and keep Clear and the ISPs who had been on their network would have lost a competitive position or advantage that they previously held?" He said, "Yes they would've lost an advantage, a sum of money." "And that was the intended outcome that Telecom had wasn't it?" "Well it was one of the outcomes, we were looking to avoid paying out very large sums of money." So it's not conclusive but it indicates clearly enough that they saw, they recognised that this would deprive the rivals, the carriers and the ISPs of a competitive advantage they had and that was what they wanted to achieve. Now if the Court pleases that is really what I was going to submit to you, I'm conscious that we've got this Privy Council point to deal with that Your Honours raised earlier and we've got a few other points, miscellaneous points to deal with, but we'll presumably deal with those in the morning?

ELIAS CJ:

Yes. Yes we'll take the evening adjournment. Now you would expect to be through by the morning adjournment tomorrow Mr Farmer?

MR FARMER QC:

I think that's possible, quite possible, yes.

ELIAS CJ:

Yes. Thank you.

COURT ADJOURNS: 4.03 PM

COURT RESUMES ON TUESDAY 22 JUNE 2010 AT 10.00 AM

ELIAS CJ:

Yes Mr Farmer.

MR FARMER QC:

If Your Honours please, my learned friend Ms Coumbe will address you on the subject; on the subject of the Privy Council precedent and the effect of the 2001 amendments and then make some short submissions about material facilitated. There are other topics that are dealt with in our written submissions, in particular the issue of dominance in the two markets, residential and wholesale, which Telecom is really having to make a running on, because in effect saying what was held below is wrong, so we would propose not to address those issues and just leave it to reply if need be.

ELIAS CJ:

If need be, because we have, of course, read the submissions.

MR FARMER QC:

Yes.

ELIAS CJ:

Yes. Yes, thank you Ms Coumbe.

MS COUMBE:

Your Honours the submissions that I'm going to address will deal with the point that was raised by the Court yesterday, the suggestion that whilst the law had been changed by the 2001 amendment there were strong reasons for not disturbing the Privy Council ruling on the counterfactual and there were two issues that were mentioned yesterday. One was Telecom's supposed reliance on the law as stated by the Privy Council when it introduced 0867 and the second was the fact that the conduct in this case is solely governed by the pre-2001 amendment.

If I could first of all just briefly outline the course that my argument is going to take, because it's not covered in the written submission, I think it's probably important that I just summarise it for you first and then I'll go through it in a little more detail. I think I will be done by morning tea, I'll certainly be gone by lunch time.

ELIAS CJ:

All right. We won't hold you to morning tea.

MS COUMBE:

Your Honours there are basically three submissions that I'm going to advance and the first one is that we say that the correct approach to take to the interpretation of section 36 in this case, is to – is not to follow the Privy Council insofar as they did rule that the question of use required a hypothetical counterfactual approach as an exclusive test of use and that there are persuasive reasons why that was a significant error in the interpretation and the application of section 36 and that the Court's ruling on that issue will in turn flow through and be authority for the future in terms of how the post-2001 version of section 36 is to be applied. As I'll mention there have already been two cases in the High Court where the Courts took the view and I'll take you to them, that the 2001 Act did not effect any change in the law and the Courts have continued to apply the counterfactual approach so that direction is needed from this Court. I'll also take you to some quite authoritative statements in two decisions of the High Court of Australia. One where they refused to follow one of their own decisions and one where they refused to follow an earlier Privy Council decision on the grounds that there were issues of statutory construction involved and that in their view their duty as the final appellate Court was to rule on the correct interpretation of those statutes particularly where, as in this case, there had been a judicial gloss imposed on those statutes which should not have occurred. And they did that in those cases even though at the same time they also acknowledged that that course might lead to some undesirable consequences in terms of parties having relied on those decisions. There were also, in addition to those two High Court of Australia cases which are both in my learned friend's casebook, two further quite useful comments on this issue by Judges of our Court of Appeal, Cooke J and Hardie Boys J on those same issues, so we say, yes you should look at and examine whether you should follow the Privy Council in both *Telecom v Clear* and *Carter Holt* and that in turn will affect the ongoing, or have ongoing utility because of the further amendment to the 2001 Act. As part of that we say the Court should adopt the more flexible approach that has been preferred by the High Court of Australia.

The second submission will be that in this case the Court should determine whether that flexible approach should be applied to these facts and I'll come to that in more detail, but essentially we say that in this case, and so far no Court has just examined Telecom's conduct on its facts, and we say on the facts as established and accepted, this is a self-evident and plain, indeed quite blatant, exercise of market power. That the 0867 scheme as a whole and its sort of interlocking parts, was able to be introduced and was expected by Telecom to work in its favour because of Telecom's position of market power in both the retail market, the retail residential market and in the wholesale access market for terminating services.

ELIAS CJ:

Now this argument was covered in your written submissions wasn't it?

MS COUMBE:

The argument about – yes Your Honour, the argument about the material, the facilitated test and how it applies to this case, is in the written submission and at that point I will turn to the written submission and perhaps just elaborate on that.

ELIAS CJ:

Yes.

MS COUMBE:

I should also just signal again by way of summary, because I am conscious that Your Honours have a concern that Telecom, as it has said in its submissions, has acted in reliance on Privy Council decisions and has presented its case in a certain way. We say there are, there are certainly at least seven reasons why that in this case there are not circumstances that would amount to a kind of acting on the decision in a way that would preclude you from now ruling on the law as it should be, and just to sum those up, the first one is that it's clear from the evidence, and I'll give you the references, that Telecom knew when it introduced 0867 that it was at some risk of infringing section 36, but it proceeded nonetheless.

Secondly, there's no evidence before Your Honours or in the High Court record that Telecom did in fact do a kind of, and perhaps you wouldn't expect them to, but certainly no evidence that they did, proceed on the basis of a counterfactual approach confident that they would fall within that and indeed one would wonder how you could ever derive any certainty from attempting to apply a counterfactual approach in this case. We've seen how refined and speculative that approach is. Further we say that in the – at the time when 0867 was introduced, which was that 1999-2000 period, yes we had had the Privy Council decision in *Telecom v Clear*, but we hadn't yet had the further decision of the Privy Council in *Carter Holt* and in the meantime there had been some sort of dissatisfaction brewing with that earlier Privy Council decision and I'll take Your Honours to a few cases, but there was for example – there were three in effect that indicated that the law wasn't quite regarded at least here, as having been settled. The first was the *Port Nelson* case where His Honour Gault J queried why a simple straight forward factual approach would not be the proper approach. The second one was a decision which should have been handed to Your Honours this morning, which was a decision of His Honour Smellie J in the High Court in 1997, which was in fact a dispute between Telecom and Clear where Telecom in that case, was accepted as being dominant in the market, telecommunications market because of its ownership of the PSTN and it had cut off access codes that Clear was relying on and so Clear brought proceedings about that and His Honour Smellie J observed after referring to *Melway, Queensland Wire* and the Privy Council in *Telecom v Clear* that the law still seemed to be in a state of evolution on the question of use. But even more significantly is a decision which is in our casebook,

although I don't know that we've really given it much prominence in our written submissions, which I'll come to, which was a decision of the Court of Appeal in an earlier particulars argument on this very case, where Their Honours Gault, Blanchard and McGrath JJ all looked at the earlier case law on determining use under section 36 and referred in particular to the judgment of His Honour Smellie J and approved his statement or that the law seemed to be in a state of evolution and queried again why a simple, straight forward, factual approach might not be sufficient and also did express some initial reservations about how one could postulate a non-dominant Telecom in this case if, as a counterfactual would require, most of the residential customers were on Telecom's network. And again I'll come to that judgment and I'll take Your Honours through that, but all that is just going to indicate that perhaps from Telecom's perspective, the law wasn't quite as settled and certain at that point and then of course by the time of the trial we'd had *Carter Holt*, where they did say, yes, well that is what we did mean in *Telecom v Clear* we meant in all cases.

I'll also – the fourth point on this was that there had been many cases where, notwithstanding the Court's acceptance that parties might have relied on a decision, they have intervened in any event to change the law because they have seen it as important that error be corrected rather than perpetuated and in particular where that involves the interpretation or the application of a statute. So that – we say that also in terms of any balancing of interests you would have – the interests of the Commission also and representing the public interest in this case, would also enter into it in the sense that the Commission has been somewhat confined to this counterfactual test at High Court and Court of Appeal level and not yet has there been a proper assessment of the actual facts of this case. What in fact did Telecom do? Did it, in fact, exercise or make use of its market power and in what way. Instead the whole analysis has been on the basis of this hypothetical situation which we say really doesn't bear any reality to what actually happened in this case. Sometimes I accept you can have a case where a very rudimentary counterfactual test can be postulated, for example, a simple refusal to supply, such as *Queensland Wire*. Perhaps a refusal to give access to an essential facility as in *PAWA*, where you can postulate a very simple, rudimentary counterfactual when you just assume, even though that's unrealistic, you assume a competing supplier and – but in this case where you have complex contractual arrangements, you have dominance in two markets. You have an alleged effect on competition in two further markets, we say that the counterfactual just gets too refined and becomes too unrealistic and so that this case really is crying out for more of a factual approach such as the materially facilitated approach or, as my learned friend said yesterday, a more simplified counterfactual approach that simply refuses to go into the kinds of permutations and assumptions that have been put up here.

So if I could – essentially that's where I'm going. I'll now just go back and start with my first submission which is that in our submission the Privy Council in *Telecom v Clear* and then again in *Carter Holt*, fell into significant error in its interpretation of section 36, as it then was

under the pre-2001 Act, because it added this, to adopt the Attorney's submissions, a judicial gloss on the wording of that provision that was neither needed nor was there. The deliberately general language of use which as Your Honour Justice Tipping said yesterday, suggests more of an enabling or facilitation rather than some rigid "but for" test of causation. So it's not supported by the language of the section, nor is it supported by the original purpose of section 36 which was based on a broad concern to prohibit those in a dominant position from using that position for an anti-competitive purpose. In terms of the legislative history, which I'll come to next, was intended to be, from the outset, was intended to be modelled on the Australian legislation and to follow the Australian approach and was not meant to, there was not meant to be any difference between the word "use", as used in the New Zealand provision, and "taking advantage" –

TIPPING J:

Are you going to come to this? Is there any reason that they were trying to follow Australia, why they simple – why they changed the language?

MS COUMBE:

Yes well this is actually referred to in the Crown's submissions and if I may just –

TIPPING J:

Yes.

MS COUMBE:

– go to that and I'll show you where that –

TIPPING J:

Because they did this all over the place. They did it in the Fair Trading Act. They thought they could put it better presumably.

MS COUMBE:

If I could just – we could go to the Crown's submissions, which are very useful, in terms of providing the sort of detail of the history, legislative history of both section 36, as originally enacted, and the 2001 Act. So if you could perhaps go to paragraph 37. I note that the Competition Bill, because in some ways the chronology in this case is going to be important, so the Competition Bill was introduced in 1983 and then in the Crown's submissions at paragraph 37 they note that section 36, in terms of its first draft, was modelled closely on section 46 of the Trade Practices Act but the Select Committee opted for the word "use" rather than the expression "take advantage of" to establish the connection of exercise of a dominant position to a proscribed purpose. And the reasons for this were given by Peter

Neilson MP who had the Second Reading, in response to an Opposition proposal to replace "use" with "take advantage of" made it clear that contrary to initial impression, Parliament was in fact seeking consistency with Australia on this point. And he says, and I'm now at the top of page 14, and this document is in the Crown's bundle of authorities at volume 1, tab 10. He says, "The Opposition says that the legislation should be amended to be exactly in line with the present Australian legislation. It is important to remember that the Australian legislation is subject to review at this time." I think that was the Blunt Committee, which is referred to earlier in the Crown's submissions, and is likely to be changed. In other words they thought that the Australian legislation might have been going to change from "take advantage" to "use".

TIPPING J:

They thought they were anticipating that change.

MS COUMBE:

Yes and so the New Zealand Parliament thought, well we'll just leave it at "use" because we're trying to line – it's like, you know, you fly to Australia to see your friend who at the same time is flying to Auckland, they kind of slightly missed each other, but clearly the intention was that "use" and "take advantage" were going – meant the same thing and if you look at paragraph 38 it's further confirmed there and this document is in the Crown's bundle –

TIPPING J:

Well you've now helped me by understanding why they would have chosen "use" if they were trying to say the same thing because they thought they were going to be ahead of the Aussies.

MS COUMBE:

Yes, so really they – the purpose was to align with Australia and there wasn't seen to be any material difference between the words "use" and "take advantage" and that, of course, has been confirmed subsequently by the Courts in Australia.

TIPPING J:

Not everybody agrees with that.

MS COUMBE:

Yes.

TIPPING J:

Do they? Some say that the phrase "take advantage of" does actually capture the nuances, and I hate that word, of this test more accurately.

MS COUMBE:

Yes that may be so but certainly –

TIPPING J:

Historically I agree.

MS COUMBE:

Historically the legislative intention was to, that they were to align with Australia and subsequently of course in *Queensland Wire* we had every Judge, I think, in that Court saying well, "take advantage" just means "use". Anyway so the original purpose, we say, supported by this legislative history that's helpfully set out by the Attorney, does confirm that.

In the next, in terms of the chronology in 1989 we come to *Queensland Wire*. I won't take you to it but just note that it's in our bundle of authorities at volume 2, tab 12, where there and the references are given in footnote 48 of our submissions, the Courts adopted – or confirmed that "take advantage" simply meant "use". Mason CJ and Wilson J at page 91 said, "The question is simply whether a firm with a substantial degree of market power has used that power for a purpose proscribed in the section, thereby undermining competition." And of course in *Queensland Wire* this is where we also now get the first articulation of the counterfactual test, but we say there is nothing in the judgments of that Court to suggest it was intended to be an exclusive test and of course that view was confirmed later in *Melway* and in particular in Kirby J's decision in that case where he referred to the fact that none of the Judges in *Queensland Wire* had mandated this as an exclusive test.

Then we now go forward to 1995 and to *Telecom v Clear*, the first Privy Council decision where at page 403, and I won't read that quote again, it's well known to Your Honours, they appeared to require an exclusive counterfactual test in the sense that that was the only approach they referred to, then in *Melway* which was in 2001, and that's in our bundle of authorities, at volume 1 tab 6, the High Court of Australia in *Melway* made it clear that a flexible approach was permissible whilst they referred to and accepted that the counterfactual test had a place and if you could undertake a cogent analysis would be useful, and the Commission would certainly accept that. Nevertheless it wasn't exclusive and they accepted that the materially facilitated test could be applied.

TIPPING J:

It's interesting the materially facilitated was simply a narrative wasn't it? It wasn't articulated as a test as such, it seemed to me anyway when reading it, it was just part of Their Honours' narrative, if you like, of what this amounted to?

MS COUMBE:

I think Your Honour I would say that –

TIPPING J:

That doesn't knock it as a useful tool –

MS COUMBE:

Yes.

TIPPING J:

But it just demonstrates to my mind that there are various ways in which you can put the same idea.

MS COUMBE:

Yes, yes.

ELIAS CJ:

Perhaps that the very idea of a test is a gloss on the statute which should be avoided, but what you're talking about is processes of reasoning that are available.

MS COUMBE:

Yes, the test is used.

ELIAS CJ:

Yes.

MS COUMBE:

And as Your Honour said there are other ways.

ELIAS CJ:

Well, I – yes, the test is use for an anti-competitive purpose.

MS COUMBE:

Yes, and that they also refer to His Honour Deane J's approach in *Queensland Wire* which was the effect that you would have a use of market power or taking advantage if the purpose in question could only be achieved by having that market power. So then –

ANDERSON J:

Well, doesn't that take it a bit too far? I mean you can be subject to fewer constraints, fewer competitive constraints if you have market dominance. That might be using it.

MS COUMBE:

Yes, yes. In terms – to accept that Deane J talked about only achieving through – I don't think we would necessarily say that Your Honours had to follow that exact formulation, just that there should be a more flexible approach and that might be a slightly high standard. Then you come to 2001 and by this stage the New Zealand Government, this is after *Melway*, or alongside, is considering amendment to section 36 and throughout that legislative process and I won't take you to all of them, because they are conveniently set out in the Attorney's submissions, but the general theme running through those documents is that the Privy Council had misunderstood the intended scope and purpose of section 36, in imposing this counterfactual as a gloss on the statutory wording. Perhaps I'll just take you to two paragraphs in the Attorney's submissions and read just two extracts from that.

The first one is at paragraph 59 –

ELIAS CJ:

Sorry, page?

MS COUMBE:

It's at page 21, paragraph 59.

ELIAS CJ:

Thank you.

MS COUMBE:

This was a statement in the Acting Minister of Commerce's paper to the Cabinet Finance Infrastructure and Environment Committee and I'll just read you that second paragraph. This document was, I understand, referred to the Select Committee and in paragraph 59, second half of that quote, I'll just read that. "However, a 1994 Privy Council decision developed an explicit use test and said it was necessary to show that the firm acted in a way in which a firm, not in a dominant position, but otherwise in the same circumstances, would've acted. The risk of developing such a test and the Privy Council's observation that one cannot simply reason back from the existence of an anti-competitive purpose to prove use, is that

subsequent Courts may focus on the formula and questions of proof rather than reasoning behind the formula. The risk has proven to be the case in a number of instances and the consequential hypothetical analysis of firm behaviour required of the test is proving complex, costly and reducing the certainty of litigation outcomes."

Then in paragraph 62 we have a statement from the Select Committee itself which in the Crown – paragraph 62 half way through that paragraph, it's in the Crown's bundle of authorities, volume 1, tab 13, where it was recorded by the Government members of the Committee that, "Government members wished to make it very clear that the intention of Parliament in adopting the words "take advantage of" would be to reverse this interpretation by the Privy Council and to provide the New Zealand Courts with the opportunity to apply the test with an appropriate level of flexibility without giving them carte blanche to apply a subjective purpose driven approach."

I'm going to come back to the effect of the 2001 amendment but just to, before that, complete the chronology, you then had the Privy Council later in 2005 continuing to apply *Telecom v Clear*. Also saying that Australian authority be followed but overlooking, and not referring to *Melway*, where this more flexible approach was apparent and they made it clear that, to the extent there was any question about it, yes, they did intend the counterfactual to be a necessary test.

So we say that when Parliament, first of all we say that Parliament, it was never Parliament's intention in section 36, as originally enacted, to introduce a counterfactual test, that was never part of the intention, they wanted to align with Australia, there was nothing in the language that demanded it or required it. We say the Privy Council got that wrong and that when Parliament came back in 2001 with the 2001 amendment in changing the words "use" to "take advantage" it may not be clear from the actual amendment but it's clear from the parliamentary history, that what they were intending to do there was to not change the law in the sense that it had never been intended, that the counterfactual should be part of section 36, but really more to confirm or declare what the law was and had been and on that I'd just like to refer you to – I've handed this in, but it's an extract from that very good book by Burrows and Carter, *Statute Law in New Zealand*", where there is a statement in the top left-hand under the declaratory statutes, it says here, An exception from the presumption against retrospectivity is in relation to declaratory statutes. "If an amending statute, instead of laying down new rights and duties, merely explains the meaning of terms in the principal Act, it is normally deemed to relate back to the time of commencement of the principal Act, and thus to cover all matters that have happened after that time."

Now I'm not really suggesting, you know, I'm not really advocating that kind of retrospective effect as in the normal understanding of that term, but more, I think there's a similar principle, whereas I think here, what Parliament had intended was to reverse the Privy Council not at

least on this point, not because up until that time 36 had required a counterfactual test, but because the Privy Council was seen as having got it wrong, so that the intended effect of the 2001 Act was to restore or clarify or declare if you like, what had always been intended by that provision.

TIPPING J:

But it was to change the law I would've thought, at least insofar as the Privy Council's determination –

MS COUMBE:

Yes, that was intended and that takes me to my next point, which was that unfortunately it appears that the words used may not have been clear enough and it goes back to, well it goes back to this –

TIPPING J:

Meaning the same thing.

MS COUMBE:

Interchange between use and take advantage, that they mean the same thing. I'll just take you to the recent "*Data Tails*" decision in the High Court, which was a case which concerned both section 36 pre-2001 and post-2001, because the conduct that was there, held to have been an exercise of Telecom's market power, straddled sort of both provisions, it's in the bundle of authorities, the Commission's bundle of authorities in volume 2, tab 13. This case was, just to briefly put you in the picture, this was a situation where Telecom was, because of its having the only ubiquitous local loop or network, companies wishing to compete with Telecom to supply high-speed data services needed to buy from Telecom, an essential input which was the data tails which was the link from say Clear's network to the customer, that had to often be, to occur over Telecom's network and in pricing those data tails Telecom departed from ECPR and also priced frequently the wholesale price of two data tails at either end of the circuit which actually exceeded Telecom's retail price of the entire circuit, making it difficult for competitors to compete in the wholesale market.

Now one of the issues here was whether the counterfactual test applied, and that's dealt with at paragraphs 10 and 11 and there, if I read paragraph 10, there's a note that the 2001 amendment replaced "use" with "take advantage of". It is accepted that no change to the meaning of section 36 resulted –

BLANCHARD J:

Why is it saying it is accepted?

MS COUMBE:

I think that was because of the prior decisions by the High Court of Australia that there was no difference between "use" and "take advantage" so the view of the Court –

BLANCHARD J:

Well, it rather suggests that there's been no argument to the contrary.

MS COUMBE:

Well I think –

BLANCHARD J:

That's what you say when counsel has made a concession or simply taken something as a given. It would be a surprising thing to say if there was argument to the contrary by counsel.

MS COUMBE:

Yes Your Honour, I don't believe it was argued to the contrary.

BLANCHARD J:

Well in that case, this isn't much of a precedent for anything. Was the parliamentary history drawn to the attention of the Court?

MS COUMBE:

No, I don't believe so Your Honour. In the other –

BLANCHARD J:

Well in that case this isn't really proving anything much, other than that untutored a High Court Judge, and expert, could think that there was no change being made in 2001.

MS COUMBE:

Yes I think, and the other case I refer to, *Bay of Plenty*, again I'm not sure that it was – the contrary was argued but there was reference to the fact that Parliament, I think, I believe there may have been reference in that judgment to the fact that Parliament have intended otherwise, but in using the same language, the Court was content to proceed on the basis that no change had been achieved.

BLANCHARD J:

Well you would, sitting at first instance, with the Privy Council judgment still in place and having two Privy Council judgments, one before and one after the relevant period of time and no challenge being made.

TIPPING J:

Well it's just as my brother says, the point wouldn't have been present to the Court's mind, the issue.

MS COUMBE:

Yes Your Honour.

TIPPING J:

And these aren't binding on us.

MS COUMBE:

I'm not suggesting for a minute they are binding on you, what I'm saying is that there does appear to be, or at least counsel and Courts have proceeded on the basis that the counterfactual test as stated by the Privy Council is still binding, even under the 2001 Act and there have been these two cases so far where that has occurred.

TIPPING J:

But what do you want us to take from that?

MS COUMBE:

Well all I wanted – I really don't want you to take too much from that other than that our primary argument is that the Privy Council got it wrong, both in *Telecom v Clear* and *Carter Holt*, and we say there was a significant error in terms of what was originally intended.

TIPPING J:

Look, I understand all that, it's just perhaps can we put this business of the High Court decisions out of our minds, because they're not going to help us are they?

MS COUMBE:

Yes, you can. What we're really saying is, look the proper approach here is to find that the Privy Council was wrong in prescribing an exclusive counterfactual test as being demanded by the wording of section 36.

TIPPING J:

I completely understand that, that is your primary argument. I just don't think these High Court decisions add anything to it.

MS COUMBE:

No, no, and we say that Your Honour's ruling on this issue under the old provision will inevitably become an authoritative ruling going forward in terms of the new provision.

BLANCHARD J:

And there are observations, even though they are obiter on the 2001 legislation, won't?

MS COUMBE:

I think it's more important in this case that the, I'm not saying that a High Court would not place of course, weight on any statement this Court made about the effect of the 2001 Act, but our primary submission is that there are good reasons in this case why Your Honours should also, and this case after all is governed by the pre-2001 version of section 36, why Your Honours should look at, or should find that the Privy Council's approach was not a correct approach to section 36.

TIPPING J:

Ms Coumbe, if we say that we don't need to revisit the Privy Council because Parliament has changed the law, that being part of the reasoning why we don't, I'm putting this to you as a hypothesis, that wouldn't be obiter would it? It would be an essential part of the reasoning as to why we're not going to revisit the Privy Council, assuming that was the Court's view. I mean it appears obiter because we don't have an issue directly before us on the new section, but if it was an essential part of the reasoning leading up to that point, it would be a bold Court below is that said "That's not binding".

MS COUMBE:

Yes, but I still want to advance, and I still have further –

TIPPING J:

I know, but I'm just exploring with you how weighty this argument is that it would only be the victim.

MS COUMBE:

Well it would – no I don't think I would suggest that it would lack weight Your Honour. But still our primary submission is that there are good reasons why, and of course it's essential to the Commission's case because it is governed by the pre-2001 amendment, which we say declared what the position was always intended to be, didn't change the law in terms of what –

TIPPING J:

But an essential reason for overruling a past precedent of high authority, is to set the law on the correct course. Now if Parliament has already set the law on the correct course on your argument, why do you need to overrule the Privy Council?

MS COUMBE:

Because this case is governed by the old section 36.

BLANCHARD J:

But it's the only case around that is.

MS COUMBE:

Well the "*Data Tails*" case also, which is going on to appeal I think is –

BLANCHARD J:

Well that's taken so long to get here. Tough.

MS COUMBE:

Well, I still want to finish my argument about why we say that it shouldn't just be left standing –

TIPPING J:

I'm not wanting to stop you for one moment, I'm just wanting to get your assistance with a problem that I see your argument may run up against.

MS COUMBE:

Okay, yes, I'll come back to, I'm going to come back to that. What we say here is that the Privy Council got it wrong because section 36 from the outset, not just from 2001, was never intended to encompass a counterfactual approach and if I could refer you to a couple of decisions of the High Court of Australia where they do stress the importance, if there is a question of construction of a statute, an issue of intervening and that principle is not necessarily linked to how many parties might or might not be affected. It's seen as having some primacy. The first one is in the respondent's bundle of authorities, volume 1 tab 21. If Your Honours could please go to page 439 and you'll see there at the bottom of 438, top of 439, first of all Their Honours, the majority of the High Court of Australia has set out four grounds that justify departure from an earlier decision and I think Your Honour Justice Blanchard may have adopted or referred to those factors with approval in the recent *Couch* decision. Then they go on and they talk about, or one of the factors they talked about at the bottom of page 438 was the fourth, was that the earlier decision had not been independently acted on and then half way down 439 they go on to say, "The fourth

consideration is not present." What they meant was this was not a case where it had not been acted on. On the contrary they say, "As this case demonstrates, the decision in ***Curran* (10:42:56)"**, and this was an earlier decision of the High Court of Australia, "has been acted upon by taxpayers as a basis for ordering their affairs." And then they go on and say, "These are powerful reasons for following ***Curren*** in the present case, because that decision was under attack and it was being suggested that it should be overruled. They say, "On the other hand, there are special considerations applicable to the doctrine of stare decisis in cases of statutory construction. Those considerations were adverted to in," and they refer to a case there, "although that case was not concerned with the question whether this Court should overrule its own earlier decision. In that case, Mason J said, "The fundamental responsibility of a Court when it interprets a statute is to give effect to the legislative intention as it is expressed in the statute. If an appellate Court, particularly an ultimate appellate Court, is convinced that a previous interpretation is plainly erroneous then it cannot allow previous error to stand in the way of declaring the true intent of the statute. It is no part of a Court's function to perpetuate error and to insist on an interpretation which, it is convinced, does not give effect to the legislative intention."

And then Their Honours go on and say, "These comments are highlighted when the Court is called upon to consider an earlier decision in which there was" - as of course there was in *Carter Holt* – "a division of opinion among the Justices of the Court constituting the majority, and there was a persuasive dissent. That is not because such a decision is any the less a precedent, it is only that those circumstances point to a possibility that the decision may later be challenged as erroneous. But in the end the justification for not following an earlier decision construing a statute must be that the view of the Court that the earlier decision was wrong, that it was wrong in a significant respect, and that the Court should give effect to the intention of the Parliament. The same considerations, in our view, apply with equal force if the issue is identified as one of the application of a statutory provision, rather than one of statutory construction in the strict sense."

BLANCHARD J:

Have you got any case where that approach has been applied in circumstances where the legislation in the meantime has been amended?

MS COUMBE:

Well I have to go back and find the case, but I do recall a comment by, in one decision, where if the legislation has been amended in a way that kind of suggests that what – for example, if there had been an amendment here to suggest that, or make it clear that the counterfactual test did apply, well my argument wouldn't get off the ground. But what we've got here, we say, is the kind of amendment that confirms that the Privy Council's approach was wrong and, if anything, that should help the Court or justify the Court intervening in saying the

Privy Council got it wrong because the Court is not then just making a decision about some old statute that only now applies to a couple of people and has been superseded, it has been, Parliament has since or has, in terms of parliamentary history, confirmed that the Privy Council was wrong. There is certainly every reason for the Commission in the present case in your intervening and saying the Privy Council got it wrong, and the subsequent amendment helps in that it confirms that and it also provides the ongoing reason and utility for doing so because the judgment of course will continue to have authority under the amended provision and the Attorney makes the same submission in his written submissions. But that is not a reason not to intervene, that is a reason to intervene to – I mean if for example, going back to that, if Parliament in 2001 had said, no well we think the Privy, the counterfactual test is right and we're now going to amend section 36 and say that to enshrine it, what would be the point in changing the law before that. I mean there would be more force in that argument, and I know that there have been cases before Your Honours where that kind of thing has happened. There has been a superseding statutory change that would make overruling the earlier decision pointless, because essentially it's been confirmed. Whereas here what you've had, or what was intended, was an amendment that was supposed to get rid of the counterfactual and confirm the intention of Parliament as it always was from the time section 36 was enacted, which was to follow the Australian approach and so I don't know whether I can say any more than I think it does help but not hinder our argument.

McGRATH J:

Ms Coumbe, can I just raise one question coming out of the line of reasoning followed in this passage we're looking at in *John* and I'm looking at the quoted passage at the top of page 440, the observation that "it is no part of a Court's function to perpetuate error." Doesn't that rather suggest that what the High Court was concerned with in that case was an error that was going to continue to have effect, in other words that there had not been a legislative change and if the only effect was going to be the one-off effect in the particular case, this principle might not have been applied. I'm focussing on the word "perpetuate".

MS COUMBE:

Yes, I think "perpetuate" there is more aimed at perpetuating a wrong interpretation and we would say that, if you didn't intervene in this case, in a sense you would be perpetuating an error because we say that the Privy Council did get it wrong and as a result it has affected how this case has been dealt with and how we say at least one other, and how no doubt how other cases have been dealt with. The amendment in 2001 confirms the original intention of Parliament and I think assists Your Honours in saying that the Privy Council got it wrong and so if you overrule or – you don't have to overrule, just not follow the Privy Council on that point of the exclusive counterfactual it's not just – it may be necessary just in some cases, you will not be perpetuating error, because you will be correcting the position in terms of that

statute, which is continuing to have effect in this case and in at least one other case and that will also govern the ongoing interpretation under the new provision.

TIPPING J:

What happens when the perpetuation of error and the reliance issues converge? I know you say they didn't rely here, but let's assume for the moment that they did, what happens when people have relied on something, it was wrong, but they're now said to be liable to a large fine. I find it difficult to reconcile those two, because you've got potential grave injustice on one side and this is the whole awkward issue of prospective overruling in effect.

MS COUMBE:

Yes Your Honour, I fully accept that that is an issue and I'm about to deal with that point –

TIPPING J:

Ah, thank you.

MS COUMBE:

And I come to that next, but I just wondered if before I do, I could just give you a couple more references on – because we'll come back to this again, the weight that the Court gives when considering whether to depart from an earlier authority to the fact that it relates to the interpretation or application of the statute, I'll just give you a couple of further references on that, and then I'll come straight back to that question about reliance on the decision.

The first further reference I wanted to give you is simply over the page in the same case, or further over on page 452. I won't read through that, but in the middle of the page there is a very similar statement by His Honour Brennan J about the importance of getting it right when you're talking about interpretation of a statute and of course I should add that in this case they did overrule an earlier decision of their own, even though they acknowledged that for many, many years, people had been relying on it and ordering their affairs in reliance on it and lower Courts had been applying it.

The other case which – and perhaps it's even more on point – is *Barns v Barns* (2003) 214 CLR 169 (HC of A), also in my friend's casebook, the same casebook at tab 17, where again the question was, this time it was a question of whether to follow an earlier Privy Council decision, this was an appeal from the Privy Council, from an Australia, a South Australia Court that ended up in the Privy Council. It was a longstanding decision and the High Court of Australia was looking at whether they should follow it or not. It turned on a question of

statutory interpretation, again very much as in the present case, where there had been a powerful dissent and if you look at page 205 –

McGRATH J:

So what tab are we in now?

MS COUMBE:

We are in tab 17.

McGRATH J:

Thank you.

MS COUMBE:

Barns v Barns.

McGRATH J:

Thank you.

MS COUMBE:

And I'd like you to go to page 205. And at paragraph 104, this is a majority, sorry this is Gummow and Hayne JJ, "In the end, the justification for not following an earlier decision construing a statute must be that the view taken of the statute in the earlier decision was wrong in a significant respect." And they note that in *Easterbrook*, "Insufficient attention has been given to the basic question of the construction of the words of the statute in the context in which they appear, including the evident purpose and policy of the statute."

And then further on at paragraph 123, this must be a rare occasion when His Honour Kirby J was in the majority and he, at paragraph 123 on page 210, made these comments. "In my opinion, for the reasons given by Gleeson CJ, *Dillon* was correctly decided. Lord Simon's dissent in *Schaefer* is to be preferred. Although this Court continues to pay respect to the judicial reasons of the Privy Council, especially in respect of Australia appeals at a time when the Privy Council was a Court within the Australia judicial hierarchy, we are not bound by such reasons. As the final Court of the Australian judicature, in a proceeding brought before it for disposition, this Court is obliged to state its own conclusions. Not least is this so where the issue in such a proceeding is (as here) the meaning and application of legislation enacted by a Parliament of the State of the Commonwealth."

And at the top of the following page 211, at paragraph 126, he also, in the same vein says, "Where conduct is affected by the terms of the written law, for example by a statute made by

a legislature within the Commonwealth, it is the duty of Judges, indeed of all persons, to obey, and give full effect to, that written law. They must do so even when such effect involves a departure, indeed a significant departure, from obligations otherwise derived from the pre-existing unwritten law made by the Judges."

ELIAS CJ:

Ms Coumbe, I can't see that there's any quarrel with these general principles. I'm not quite sure why we're being taken to them at such length. Because I would've thought that the propositions were entirely acceptable.

MS COUMBE:

Yes Your Honour.

ELIAS CJ:

It's really the application to the circumstances of this case.

MS COUMBE:

Yes, I'll deal with that now Your Honour. As I understand it the concern of the Court is that Telecom has relied on this decision, has relied on a supposedly settled state of the law, as set out in *Telecom v Clear*, in –

BLANCHARD J:

Well it's not only relied on in a general sense, the first of the Privy Council cases was actually about the relationship between Telecom and Clear and in it Telecom were being told that its conduct would be judged by a counterfactual. It's a very unusual situation where the two parties are again at loggerheads and the Privy Council decision is still there at the time that they're at loggerheads and it deals with their conduct.

MS COUMBE:

Yes, if I could – I'll address that.

ANDERSON J:

Another matter also you could address helpfully, when it's convenient to you, and this is the submission really on behalf of the respondent, that they ran their evidential case at first instance and reliance on the legal proposition.

MS COUMBE:

Yes Your Honours. I'll deal first with Telecom's reliance on the decision at the time 0867 was introduced and then after that I'll deal with the way the case was run in the Courts below in

this case and why we say that neither of those should preclude this Court revisiting and looking at this again.

As I mentioned earlier there are a number of reasons which I think go to sort of diminishing the level of reliance or the weight, the weight that should be placed on it, because of course just as the need to correct an incorrect application of a statute is not an overriding inflexible criterion, nor is reliance by parties on a decision always overriding either and there have been a number of cases where Courts have departed from longstanding authority, notwithstanding such reliance. So the points in relation to Telecom specifically are first of all we have Mr Parkes in evidence and my learned friend Mr Farmer took you to these references yesterday, so I won't go to them again, but just give you the references, essentially acknowledging and, this is a case on appeal volume 4, tab 117 at 1120 that Telecom was aware of the risk it might be running under section 36 in embarking on 0867.

Then my second point is –

BLANCHARD J:
But that could be related to a risk judged by a counterfactual.

MS COUMBE:
It might be, but there was certainly no evidence that Telecom in this case, that Telecom had sort of formulated or relied on a counterfactual approach as opposed to a broad assessment of section 36, certainly nothing in any of its internal documents where it talked about what it was proposing to do in terms of –

McGRATH J:
Mr Parkes I think describes himself as a bush lawyer and was following his own advice isn't he?

MS COUMBE:
Yes. But there's certainly no evidence that that approach – and I think there's never been any suggestion by my learned friends that that was ever adopted, and one does wonder how Telecom could have gained any certainty from applying or trying to formulate a counterfactual in this case. I think His Honour Hammond J in the High Court – sorry, in the Court of Appeal – commenting on the complexity of the counterfactual and the level of refinement of the counterfactual as it has proceeded in this case, enquired of my learned friend as to whether Telecom had held an internal moot at the time to determine its parameters. And, as I mentioned before, although – so really it's not a test thing, if it's any certainty, quite the contrary, other than in a very straightforward case where a very rudimentary counterfactual can be postulated, such as a simple refusal to supply or a simple refusal to give access to an

essential facility, such as *PAWA* or perhaps *Queensland Wire.* It's an inherently uncertain test and, I mean, that's reflected in the tortuous progress of some of these cases through the Australian Courts. In *Melway*, for example, where you had a majority, as I recall, of a full Federal Court taking the view that the counterfactual test was met and there was, taking advantage of market power. And then it gets on to the High Court of Australia, who took the view that it wasn't met and there had not been a use of market power, and then you had a dissent from His Honour Kirby J. So, it's an inherently uncertain test and there's no evidence to suggest that Telecom had applied it in this case, and I should also mention that of course the question of use of market power in the realm has not changed, the provision's the same as it was at the time Telecom embarked on 0867. But there's a further point that, yes, and going back to the chronology, in 1995 the Privy Council had for the first time suggested that as far as application of section 36 was concerned you should adopt this counterfactual approach, but –

BLANCHARD J:

Well, it was more than a suggestion, wasn't it?

MS COUMBE:

Well, I don't – well, certainly the Privy Council in *Carter Holt* has confirmed that that was what was intended but, in the interim, there was some querying by the New Zealand Courts in cases involving Telecom as to whether that is what the Privy Council had intended at the time, and if I could just take you – I'll just mention some of these cases, as I may take you to one of them. So, you've had *Telecom v Clear* in the Privy Council in 1995, then you get to a year later in *Port Nelson* in the New Zealand Court of Appeal – this is in the bundle of authorities at volume 3 tab 19 – where the Court of Appeal, His Honour Gault J – it's in our submissions, and I'll just tell you what he said. He stated that it was, "Not easy to see why use of a dominant position should not be determined simply as a question of fact, without the need to postulate artificial scenarios." And then there was a further case in – perhaps I should fast forward to 2001. Although this is after the conduct in 0867, you'll see why I'm referring to it – it's at volume 1 tab 5 – and it's an earlier decision of the Privy Council in this case – sorry, of the Court of Appeal in this case. It was a dispute about particulars in 0867 –

ELIAS CJ:

So, it's volume 1 of which – your case book, is it?

MS COUMBE:

Volume 1 tab 5, sorry, of the Commission's bundle.

BLANCHARD J:

I see I was in it, but I have absolutely no recollection of it.

ELIAS CJ:

They're all a blur.

BLANCHARD J:

Port Nelson I do remember.

MS COUMBE:

No, actually, two of Your Honours were in this. I'm just going to remind you, I'm really looking forward to reminding you what you said actually.

McGRATH J:

You already have.

TIPPING J:

What case was this? I'm sorry, I –

ELIAS CJ:

You weren't in it.

MS COUMBE:

This was an argument about particulars in this litigation, I must say a shamefully long time ago, in 2001 –

TIPPING J:

Good Lord!

MS COUMBE:

– and if I could take Your Honours through the relevant parts of it, page – essentially it was about, you know, to what level of particularity was required, particularly in relation to the, among other things, the counterfactual test, and we get to page 186 paragraph 17. Here Their Honours noted that, "Use of a dominant position in a market for one or more of the specified purposes might seem a straightforward, factual enquiry, once the dominant position is established, and that is to be assumed for present purposes," and then they note that in *Queensland Wire*, "The High Court of Australia considered that the way to test whether BHP was taking advantage of its market power was to ask how it would have been likely to behave in a competitive market. Was the conduct possible because there was not a competitive market?" And the Court of Appeal noted in paragraph 18, "It was that decision that influenced

the approach taken in *Telecom v Clear* litigation, culminating in the judgment of the Privy Council," and they refer of course there to the material passage which you are familiar with. Going over to paragraph 19, the Court of Appeal continued, "The Privy Council thus employed a similar approach to that referred to in the *Queensland Wire* case. It is not clear whether, in using terms such as 'inevitable' and 'necessary' Their Lordships were looking beyond the circumstances of that particular case." We say this doubt kind of remained until the Privy Council and *Carter Holt* said, "Well, yes, we did mean 'necessary' when we said 'necessary'", but in the meantime here is this querying of the position. It said, "In that respect the High Court of Australia more recently has qualified its approach. In *Melway* the majority judgment indicates that the hypothetical question of how a party would have behaved without market power can be relevant but is not a necessary test for use of that power. Where it is employed, the High Court of Australia recognised," and so on, and then they just set it out. But they make this qualification, of course, that the test, "Should only be applied if you can give it a cogent analysis". I think it's worth repeating that statement, "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 section 46. But the cogency of the analysis may depend upon the assumptions that are thought to be required by section 46. In some cases a process of inference based upon economic analysis may be unnecessary. Direct observation may lead to the correct conclusion." And then the Court of Appeal noted that that last sentence, "Reflects the view that was offered by the Court in *Port Nelson*," where they had said, "Well, why can't it just be a straightforward, factual inquiry." The Court then goes on to say – and this is where it's significant, because now they're referring to a decision in 1997 of His Honour Smellie J involving Telecom, so this is 1997, just before the conduct – well, 0867 was 1999 and 2000, so you've got Courts, in effect, both before and after that conduct, expressing doubts about really did the Privy Council truly intend "necessary" in all cases? And what they say here is, "In the circumstances, it must be said there is substance in the comment of Smellie J in *Clear Communications v Telecom*," and the statement was, "It seems to me that the vexed question of use, in respect of which section 36 gives no guidance, is still in a state of evolution," and so –

ANDERSON J:

The next sentence –

MS COUMBE:

Yes.

ANDERSON J:

– helps your argument also, doesn't it?

MS COUMBE:

The next sentence?

ANDERSON J:

By using the word "if" there's the suggestion that it's an option, not an imperative.

MS COUMBE:

Yes. Yes, so they go to say, "What can be concluded, quite readily, is that if the hypothetical competitive market test is to be employed, the economic modelling or analysis involved is a matter for evidence not pleading." I've handed – Your Honours should have a copy of His Honour Smellie's J decision. The only other points I'll note about that was that, again, the question was, allegation was, that Telecom as the owner of the only ubiquitous telecommunications network, the PSTN, had used its dominant position – I think it was to do with cutting off code access numbers to Clear and the Court just made an observation if they had to – if you applied or you looked at what would've happened in a competitive market, then there wouldn't be a use of dominance because Telecom wouldn't have done it in a competitive market because they might have lost consumers, people might have moved away from them.

Going on to – I'm still on this Court of Appeal decision in 0867. The final paragraph I'd like to refer Your Honours to is the next page at page 24, where after having doubted whether it was truly established that the counterfactual test was an exclusive test, they called into question how credible it might be in this case in any event, because they say, "The request in paragraph C proceeds on the assumption that the hypothetical contestable market is to be constructed and seeks particulars of it. In this respect we comment that without further assistance we had difficulty in postulating Telecom confronted by the Internet problem (which seems to rest on its high proportion of customers) yet not dominant in the market." And of course this was just a particulars judgment, but of course it goes back to the submission my learned friend was making yesterday, that it is very hard to construct a plausible counterfactual in this case that doesn't strip Telecom of the very characteristics that give it its dominance. One of them of course was the fact that it had most – in fact Telecom had, apart from a few streets in Wellington where I think Saturn had some residential network, Telecom had all the residential customers on its network, Clear had no residential customers. That was the factual.

Now translating that into a counterfactual with no one with dominance is inherently problematic. So that – so in essence the submission there is that during the period of the conduct there wasn't the degree of certainty that Telecom might like to say there was, the law wasn't quite as settled, as least in terms of how the New Zealand Courts and in cases

involving Telecom saw it and I just would refer there too to some comments that Your Honour the Chief Justice made in *Chamberlains v Lai* [2007] 2 NZLR 7 (SC), where there the Supreme Court –

ELIAS CJ:

It's a mile away from this –

MS COUMBE:

Yes I know.

ELIAS CJ:

That's a matter of general – that's a general proposition that you're about to invoke again is it?

MS COUMBE:

Yes, I wouldn't suggest the facts were comparable. It's simply – it was an observation that Your Honour may wish to simply – confirms this approach I'm taking here that the profession really couldn't, despite *Rees v Sinclair*, the profession, notwithstanding there was a Court of Appeal authority on point, profession couldn't be really confident that the law was final and certain because there had been sort of growing murmurings about that case and it was sort of poised to be reconsidered and so no one really would reasonably rely on it or regard it as completely settled and so here we would say that Telecom can't be realistic or reasonable that Telecom was entitled to take – construct some refined counterfactual at that time of 0867 and confidently assume that that would still be the approach by the time this gets to trial.

McGRATH J:

Your argument really has to focus in terms of the time of events, on the *Port Nelson* case doesn't it, rather than the later cases which are after the conduct?

MS COUMBE:

Well it's the *Port Nelson* case, which was 1996, which was before the conduct, and also His Honour Smellie J's case –

McGRATH J:

1997.

MS COUMBE:

Which was 1997.

McGRATH J:

Yes.

MS COUMBE:

Which the Court in 2001 in the case I've just taken, the Court of Appeal accepted as having indicated some doubt at the time. So –

McGRATH J:

Does it really come down to this? If Telecom was relying on the Privy Council view of the law as later clarified in the *CHH* case, they were ignoring some obvious signs that it might not be as clear as they would've thought it was.

MS COUMBE:

Well at the time that 0867 was undertaken, the conduct in this case, that was 1999 up to about September 2000.

McGRATH J:

Yes.

MS COUMBE:

Of course *Carter Holt* was a long way off and so all they had was this – they had the initial decision of the Privy Council and then they had our Court of Appeal and High Court both expressing, at least in the cases we're now about, expressing doubts about whether that was intended to be an exclusive test for all purposes.

McGRATH J:

But they didn't have *Melway* nor our particulars judgment in the Court of Appeal.

MS COUMBE:

Yes *Melway* was –

McGRATH J:

2001. March 2001

MS COUMBE:

March 2001. But they had *Queensland Wire* which did not, which was a decision of the High Court of Australia which did not mandate a counterfactual test. *Queensland Wire* I think was 1989. So, yes. So we say there isn't, there wasn't really any particular reasonable basis for

Telecom to have any certainty about really where the law would go on this. They had the broad language of section 36 and that should've been their test.

TIPPING J:

What relevance does the fact that this is penal legislation, have?

MS COUMBE:

Well it's – I don't – we would submit that it doesn't affect the analysis in terms of whether Telecom could rely, because we're saying that case was not certain. The position was not certain.

ELIAS CJ:

It must be a factor in your favour in urging departure from precedent that there are penal consequences?

MS COUMBE:

Yes, I am happy to adopt that and I think that is reflected in some of the early –

ELIAS CJ:

Well I may not be right about it, but –

MS COUMBE:

No I think in the High Court of Australia where they've emphasised the importance of getting –

TIPPING J:

Well it makes the – the flexible law makes it easier to be caught, not harder.

MS COUMBE:

I think I'm happy to adopt Her Honour's –

ELIAS CJ:

I was directing to a different point.

TIPPING J:

I think we're talking about different points.

ELIAS CJ:

I was directing it to your submission that we should depart from settled precedent for the future.

TIPPING J:

I just have an anxiety that, you know the Bill of Rights is that you don't visit people with penal consequences for an offence that's not an offence according to the law at the time you did it, or something like that. Now we're getting sort of close to that territory I would've thought. Maybe it's not precisely an offence.

MS COUMBE:

It's not precisely an offence and –

TIPPING J:

And you're not precisely convicted, but the flavour of it is certainly a factor, at least in my mind at the moment Ms Coumbe, that's why I raised it with you.

MS COUMBE:

There is, that is a factor that could be taken into account, any ultimate penalty.

TIPPING J:

Oh no. No, no. It's to do with whether or not you've actually committed an offence. The traditional learning, and this was common law as well, you have not committed an offence, if according to the law at the time you did it, it wasn't an offence. It's a very simply proposition. It's not only Bill of Rights it's common law and I think the Chief Justice referred to this in that rather debated case of *R v Pora* and I joined the judgment. Now it's just flavouring this. I don't know that the Bill of Rights directly applies, it may do, but I just think we ought to have it in our minds.

MS COUMBE:

I would say Your Honour that that should not be an overriding factor in this case if the Court is otherwise satisfied that the Privy Council got it wrong in their interpretation and application of this provision. That the importance of the Court rectifying that in terms of the cases I've referred to is a powerful one.

TIPPING J:

We know what the law was in, the Commerce Commission with some justification perhaps, doesn't like it. But we've got to accept haven't we, that the law was at the time when this all happened, that the counterfactual was the "test"?

MS COUMBE:

Well that, we say Your Honour that that was in doubt.

TIPPING J:

Well it may have been in doubt at the time, but it was clarified after the event so we know what the law actually was at the time these events took place.

MS COUMBE:

But if Telecom, Telecom's argument though is in terms of its reliance at the time.

TIPPING J:

No, I'm moving off reliance.

MS COUMBE:

Yes.

TIPPING J:

I'm moving off, I'm raising another strand in this difficult thing. I may be right off the beam, but maybe signals are coming that I am, but I think at least it's in my mind for better or for worse.

MS COUMBE:

It can't be right that the Court can't intervene to correct an incorrect interpretation of a statute, I would say, particularly where it's a provision that visits consequences in terms of a penalty, that you would not want to just let that –

TIPPING J:

But let's say –

MS COUMBE:

– lie.

TIPPING J:

– they're off the hook on the counterfactual, let's pretend that. You want them on the hook on a different test.

MS COUMBE:

It's not a different – we want, we say that section 36 as – should be applied in terms of its correct interpretation and that its correct interpretation may embrace and can embrace a counterfactual approach in an appropriate case –

TIPPING J:

Well I would like some authority that these propositions apply in the criminal or quasi-criminal arena as well because that would help relieve my mind from its present issue.

MS COUMBE:

Yes I accept that Your Honour. Can we come back to you with –

TIPPING J:

Of course, of course.

MS COUMBE:

And come back to that.

TIPPING J:

I'm just flagging it, that I think it needs addressing.

MS COUMBE:

Yes.

McGRATH J:

One avenue may be that law is perhaps more readily given a purpose of interpretation under the Interpretation Act than – some of the old common law presumptions don't carry quite the force they used to.

TIPPING J:

I'd need a lot of persuasion that you can be hit by a different version of the law from that which applied at the time you did it. For myself. I mean I may be able to be persuaded but that is a problem in my mind at the moment. But it's linked with my brother's point about how all the evidence was directed to the counterfactual.

MS COUMBE:

I'll come to that too Your Honour. I'll come back to that but subject to that point the submission still is that there wasn't that level of certainty and in terms of what the law is, when Telecom decided to embark on 0867 it could not confidently rely on the counterfactual and yet it went ahead and we say embarked on a scheme which was self-evidently an exercise in market power, and I'll come back to why I say that.

TIPPING J:

Well if you can catch them on the counterfactual then of course you're home and hosed.

MS COUMBE:

Well we are. We're wanting to have it both ways.

TIPPING J:

My brother says it's section 26 of the Bill of Rights in case you want to –

ANDERSON J:

Which applies only to offences.

MS COUMBE:

This is not an offence of course but I'll come back in a bit more detail.

TIPPING J:

I hope I haven't startled a most unfortunate hare but it's in my mind so.

ELIAS CJ:

I also would like to startle a hare. I'd be looking again, with closer attention, at both *Telecom* and *Carter Holt* and I wonder whether they really are as bad as the appellant's argument is seeking to portray them. If in *Carter Holt* it had been said, the word "unless" had not been used in that very important paragraph in Their Lordship's views at page 403 of the judgment.

MS COUMBE:

Of *Telecom v Clear*?

ELIAS CJ:

Yes. Bearing in mind that in both these cases the Privy Council was concerned that the New Zealand Courts were going straight from purpose to a breach of section 36 and were doing it in the context of pricing cases in both cases I think and particularly the *Carter Holt Harvey* one, is that right?

MS COUMBE:

Yes that was – *Carter Holt Harvey* was a case of predatory pricing.

ELIAS CJ:

Yes. So was fixed on that more simple scenario and so the Privy Council thought that the New Zealand Courts had placed too much reliance on purpose and also affirmed that you couldn't just get there through effect, it had to be use of the dominant position with the anti-competitive purpose. If in that passage in Their Lordship's view, it cannot be said, et cetera, the word "unless" is substituted with "if", would you disagree with it? If it could be said –

MS COUMBE:

Your Honour I just need to actually locate the –

ELIAS CJ:

It was 403.

TIPPING J:

Well the trouble is that "unless" makes no sense and everybody has read it as if Their Lordships –

ELIAS CJ:

Well I know but one wonders whether in New Zealand, very sensitive to correction, we might have seen it as an overcorrection.

MS COUMBE:

Because it's always been accepted as having been a typo and in subsequent decisions Judges have referred to that and said well, what was meant was "if" because otherwise it doesn't make sense. I think the minority in the Privy Council –

BLANCHARD J:

The minority in the Privy Council attempted to correct it.

MS COUMBE:

Yes.

ELIAS CJ:

In Carter Holt?

MS COUMBE:

Yes.

TIPPING J:

Everyone's read it in the sense of "if" rather than "unless" for the reason you say, that it doesn't make sense.

ELIAS CJ:

But is that wrong? If it is "if", "if he acts in a way." If a person in a dominant market position acts in a way which a person not in a dominant position would have acted…"

MS COUMBE:

Well on the face of it that would suggest I think what Your Honour is getting is that would suggest just one way of perhaps assessing –

ELIAS CJ:

Well it's maybe, it's maybe one way. It's more the emphasis on counterfactual because really a principal submission you make is that the counterfactual in this case is too hard to construct.

MS COUMBE:

Well it becomes so unrealistic that the Court just loses sight of what actually happened.

ELIAS CJ:

But in that case is it not the case that it cannot be said that he's used it in a way which a person not in a dominant position would have acted? In other words you just can't have a counterfactual so you can rely on the presumption? I just don't see anything wrong with this approach.

MS COUMBE:

Your Honour I'm just not, I'm not entirely clear that I'm – perhaps –

ELIAS CJ:

I'm probably not explaining –

MS COUMBE:

– just being a bit thick. Perhaps I should take morning tea.

BLANCHARD J:

You're not alone. I mean I think it's worth pointing out that in *Carter Holt* the majority, at paragraph 60 –

MS COUMBE:

Yes.

BLANCHARD J:

– having referred to a number of authorities, including the Australian authorities, said, "It is, as the Board said in *Telecom v Clear*, both legitimate and necessary, when giving effect to section 36, to apply the counterfactual test."

ELIAS CJ:

And that is picking up paragraph or proposition 4 on page 403 which clearly relates back to the hypothetical stated in proposition 3 which is why –

MS COUMBE:

Yes so –

ELIAS CJ:

So in context it's a little less startling and certainly in the context of the predatory pricing in issue in *Carter Holt* it may have been perfectly all right.

BLANCHARD J:

If you could have done it.

ELIAS CJ:

If you could have done it, yes.

MS COUMBE:

The minority clearly didn't think that but the majority –

BLANCHARD J:

No, I don't think the Court of Appeal did either.

ELIAS CJ:

Yes but the Court of Appeal may have felt a little hurt, sensitive. Anyway, all right. We'll take back that hare. We'll take the morning adjournment, thank you.

COURT ADJOURNS: 11:29 AM

COURT RESUMES: 11:47 AM

ELIAS CJ:

Thank you. Yes Ms Coumbe.

MS COUMBE:

Your Honours, just to at least return briefly to the issue that Your Honour Justice Tipping raised about the fact that a change in the law would normally have full retrospective effect and how does that impact on the fact that this was a statutory provision that provided for a

penalty. Just in the very short time available in the break, and we can come back into this in more detail, but I at least have a reference to, as it happens, a decision of Your Honour's in –

TIPPING J:

It's not *Dental Council v Bell* is it?

MS COUMBE:

Yes.

TIPPING J:

It's in the book.

MS COUMBE:

It is in the book. It is cited in Burrows and Carter's book on page 599, at footnote 64, and what – I'll just read what the citation says here because obviously I haven't had time to look at the case or to study it but this is what the footnote says, and they're talking about when statutes can be retrospective legislation and the principle against retrospectivity. It says, "In the *Bell* case the new provisions about disciplinary proceedings in the Dental Act 1988 were held to apply to acts and omissions committed before the Act came into force. Justice Tipping so held, despite the fact that there were significant differences between the disciplinary powers in the old and the new statutory provisions. He treated the relevant provisions as being primarily regulatory provisions exercisable for the public benefit. However, as His Honour acknowledges, the same may be said of at least some criminal penalties too." And I just make the point that in this case we're not dealing with a criminal offence but with a regulatory penalty.

TIPPING J:

Yes, thank you.

MS COUMBE:

And there was a further point which I have been urged by my learned friend to, just to come back to and just make a further point before I move on because I think I, my next topic that I'm moving to is why should you apply any different approach to section 36 now at the second level of appeal given the way the case has been run in the High Court. Just before I go back to that, just one final comment on the 2001 amendment. As we said, we saw that as declaring what the intention had always been in section 36 which was to align New Zealand with Australia and the means that Parliament chose to try and achieve that was to substitute the words "take advantage" for "use". Now we say that there wasn't a change in the law as a result of that provision but if there was and the change in the law arises from the words "take advantage", just to point out that – and that "take advantage" therefore of itself denies a

counterfactual test, the fact remains that the High Court of Australia, for example, has always equated "take advantage" and "use" those two phrases, words have always been regarded as meaning the same thing. So that if "take advantage" denies a counterfactual then so must "use" have denied that test and that just reinforces that the Privy Council, in our submission, made an error in prescribing a test, a narrow test to be applied as part of that statutory language of "use".

I'll turn now to that topic. Just before, perhaps, just one final comment. Perhaps I'll just turn now to a submission that the Court should be willing and should be ready to entertain and apply a different approach in this case, notwithstanding that this is the second level of appeal. Essentially there are about three points there. First of all that this Court can certainly determine the legal question of whether the Privy Council was wrong notwithstanding that that has not been considered in the Courts below and that there's been no legal argument on that and that much is clear from at least four of Your Honours' comments in the recent *Couch* decision where Your Honours accepted that where – rather than a novel point of law, perhaps it hasn't been considered before, where what is in issue is a change or a departure from a high standing precedent such as the Privy Council saying in reply to an earlier decision of Your Honours. It's not appropriate for the lower Courts, the High Court and the Court of Appeal, to express a view about what the law should be, whether it should be changed or what direction it should go in. That's the legal issue.

Of course what the Commission wants to do in this case goes beyond that. We want you, of course, to find that the Privy Council was in error but we also want you to apply, in particular, a materially facilitated or more of a factual based approach akin to the materially facilitated approach to the facts of this case and we say that there – you can do it for these reasons. First of all, the case in the High Court, the Commission had no choice but to run that on a counterfactual, exclusive counterfactual approach because, of course, we now have *Carter Holt* who made it clear that necessary wasn't a necessary approach so there was no choice but to run the case on that basis in the High Court. I think Telecom in their submissions suggest that there was a concession made that the counterfactual applied, it's not appropriate, of course, to talk in terms of concession when that was the binding law, binding on the parties, binding on the High Court.

Then there's the point that on appeal, as Your Honours are of course aware, it's a rehearing. I won't go into the principles on that because you're obviously very aware of them. Section 24 of the Supreme Court Act makes it clear that an appeal to this Court is a rehearing. It's not a hearing de novo but it is a rehearing where the evidence in the record, the exhibits, the statements of evidence, the transcript of evidence, can all be looked at and this Court can make its own assessment of the issues. The cases there are the recent *Paper Reclaim* decision of this Court in 2007. *Paper Reclaim v Aotearoa International Ltd*, there's a

statement as to what is meant by a rehearing in paragraph 128 and there's also the *Austin, Nichols & Co* decision which was in 2008. Again a decision of this Court at paragraph 16 where emphasis was put on the fact that on appeal not only may full regard be had to the existing record but the Court can make its own assessment if the matter is in issue and form its own view and indeed should do so.

TIPPING J:

Does one have enough evidence to apply a different legal test? I agree with everything you've said so far but it can often be difficult, if the legal approach changes, to be satisfied that the evidence is complete, if you like, as against a test.

MS COUMBE:

Yes I accept Your Honour's point and of course this was a point that Your Honour Blanchard J also made in the *Otago Station Estates* case where parties sought to advance new arguments on appeal and one of the reasons for not doing so was that the Court couldn't be confident that there might not be further factual evidence to be put forward. That case, of course, didn't, as does here, involve whether or not the Court should follow an earlier decision of the Privy Council. So dealing with that question we take a very simple approach to that and say that this case is a case where a materially facilitated kind of approach would be very appropriate. If Your Honours get to the point of looking at this you will have accepted that there shouldn't be any one rigid test but a more flexible broader approach and we say that the facts that are established and accepted in this case, in terms of how 0867 was introduced and how it operated, self-evidently indicate an exercise of market power and that all the facts that you need are there and that materially facilitated is not an economic concept. So it's not a term that you would need to put to an economist and we say that if you apply the materially facilitated test, which is essentially, although of course this Court will formulate its own particular formulation, but in terms of how it was formulated by the High Court of Australia, has the firm done something that has been made easier by the existence of a substantial degree of market power, or in this case dominance, even though it may not have been absolutely impossible without that power, of course the counterfactual requiring that absolutely impossible approach. In *Melway* the way it was advanced by the ACCC as intervener, they suggested that the phrase was satisfied if the existence of market – this was at page 5 of the judgment, this is in the bundle at volume 1 at tab 6 – the phrase was satisfied if the existence of the market power protects the company from the usual commercial consequences of its conduct and that protection is more than de minimis, or as Your Honour suggested yesterday, appreciable would be another way of putting it, and we say that really in this case to meet that test is not that hard. The facts are there you just have to look at how the scheme was constructed and put together.

If I could just go through it. Under the – we'll just take the 1996 ICA, even though of course there were four of them, but the Clear Telecom ICA, under that termination payments were payable to either party for terminating local calls on the other's network. Although in the case of Telecom, I think my learned friend said that initially the price was twice as high, I think it was closer to three times as high initially, for calls that Clear terminated on Telecom's network and that encompassed, and throughout the period of the ICA, five years, neither party ever disputed, and it's clear from Telecom's internal documents that that applied both to voice calls and to calls to the Internet. But when Telecom found itself becoming the disadvantaged party under this contract, having previously been, as the Court of Appeal described it, "In a very happy position under the contract," with everything stacked in its favour, the contract, because of changed economic circumstances, turned to its disadvantage. There's no dispute on the facts so far in terms of what I'm outlining and, of course, that kind of thing frequently happens with contractual arrangements. If someone enters into a fixed term mortgage and then the market changes, they could find they're paying an interest rate that's too high or too low for a certain period, having thought initially they'd entered into, it might become more favourable or less favourable to them. This had become less favourable to Telecom. So, Telecom wanted to get out of a contract which no longer was working in its favour. Well, it's not even that it was working so badly against it, because, again, these are established facts in the record: we know that in March 1999 Telecom earned – this is just in terms of local interconnection, because it always earned a huge amount under this contract for toll interconnection, I think it was 50 million in that year. But in terms of the local terminating revenue – and these references are in our written submissions, and these come from Telecom's documents – that in March 1999 Telecom earned local revenues of just over – sorry, had to pay local revenues or termination charges of just over seven million, but received revenues of more than five million, so that the amount it was actually paying or paid that year in termination charges, or net amount, was 1.6 million. In the scheme of things, for a company like Telecom, it was not exactly, it wasn't exactly being, I think bleeding, "customers were bleeding" was the phrase used by the High Court, and that's hardly supported by those figures.

So, Telecom, we say, had a number of competitive and commercial options it could have used to get out of that situation. They would all have involved a cost. Telecom might have competed to get more ISPs to move over to its network and might have had to pay them some money to do that, as it later did with Ihug, it could have competed through Xtra to get more retail Internet customers, it might have had to pay some money there by offering discounts, or it could have renegotiated that contract that it now didn't like by dealing with Clear but, instead of that, and now I'm going to go into what we know about the 0867 scheme to show Your Honours how we really don't need any more facts than are there, because instead of doing any of those things, which it could have done, and I should just add that those options, including for example making a payment to Clear and to the other carriers in

order to renegotiate the contracts and eliminate termination payments by moving to bill and keep, would also have dealt to the so-called 205 million that Telecom says it had to pay to upgrade its network, because by adopting those commercial options they would have also eliminated the termination payments and would have eliminated what they called, "the perverse incentive", and if you look – I won't take you to it now – but the documents that record the 200 million make it clear that that was to deal with the extra traffic generated because of the so-called perverse incentive. Now, we don't accept necessarily the accuracy of that figure, but the point I'm just making at the moment is that one of those commercial options, those commercial options would have got rid of that at the same time. So –

ELIAS CJ:

Ms Coumbe, this part of your submissions is contained within the written submissions, isn't it?

MS COUMBE:

Yes, I'm actually at page, top of page 26.

ELIAS CJ:

Thank you.

MS COUMBE:

So, instead of adopting one of those commercial options, which would have not only resolved its difficulty about termination, having to pay termination payments, but would have also resolved this excess network traffic problem, and that's quite apart from the additional network options we say it had available, Telecom decided, instead of using those commercial competitive options, to fabricate and implement this 0867 scheme, which had several interlocking parts which depended for its sort of effectiveness on Telecom's dominance. It depended on, if A does a certain thing then B will do this and C will do this, and all of these things will work and come together and this scheme will work, but only because Telecom was not facing the normal competitive constraints of competition. So, looking at the first step, step 1 of this 0867 scheme was to introduce the 0867 numbering service and, happily, Telecom had 99 percent of the network and therefore almost all of the residential customers, so introducing this charge, the two cent charge, was going to have an effect. But Telecom had all of those customers and so, and I think Mr Parkes acknowledged – again, this is in the record – this was what Your Honour yesterday referred to as "a stick", but the stick was never really intended to be a stick, because Telecom knew that everyone would go for the carrot, or anticipated that they would, and Telecom had all the residential customers, who had nowhere else to go. There was no other, there was no other residential network at the time, other than a few streets in Wellington where Saturn had some residential network.

Clear had none, Clear got no residential network until 2001. This is all undisputed, in the record.

So, Telecom introduces this charge, knowing that it's not really going to be a charge, it's just, it's an incentive, it's an economic incentive to push its customers, who have no choice, into moving over into 0867. Because what Telecom wanted to do, it didn't have to breach the agreement, it wanted to, it could, because of its market power it could devise a scheme that sat outside that agreement and got it out of the agreement, by forcing everyone to do other things. And so the first one was to force customers into 0867, that was step 1. Step 2 was, well, what effect would that have on the ISPs, the ISPs of course knowing that Telecom had all the customers and knowing that customers would not want to pay that charge so would move to 0867, because there was nowhere else for them to go. That meant the ISPs then faced pressure to take up an 0867 number as well, they had to get one, or they would lose their customers. So, and I've said in paragraph A, ISPs, including ISPs on competing networks, because even the competing networks had to rely on Telecom's residential customers, had no choice – these are competing networks who might have an ISP but no residential customers – had no choice but to use a carrier who could provide 0867 numbers. So, the ISPs were then constrained in who they could use as a carrier, and we say that Telecom – then you turn to a third step – we say Telecom's dominance in the wholesale market materially facilitated its ability unilaterally to declare that the 0867 numbers were outside the ICA. As Telecom said, well, yes, we've been paying for Internet calls under the ICA all these years but now we're going to give them an 0867 prefix and that now makes them a different type of call, which is not covered by this agreement but sits outside, they devised a form of call that sat outside the existing agreement, even though it was to the same ISPs, and they said, if you want numbers for that, if you, the carriers, want to keep your customers, then you will need an 0867 number, and what they then did was say to the carriers, we will only give you this 0867 number if you enter into a new ITA, an Internet traffic agreement, that acknowledges that 0867 numbers do not get any terminating revenue, so, these are all the interlocking parts.

So, what choice did the carriers have? Telecom is the only source of interconnection, because it has the only ubiquitous network. This gave Telecom enormous bargaining leverage. The ISPs, if they wanted to keep their – sorry – if the carriers wanted to keep their ISP customers, needed these 0867 numbers, and the terms of these draft ITAs that were circulated to the – and again, it's all in the record – that were circulated to the carriers, like, they were Clear, Compass, Saturn and Telstra, provided that they wouldn't get any termination payments for 0867 numbers but at the same time Telecom was wanting to keep the benefits under the existing ICAs that it was getting for its toll interconnection and its local voice interconnection where Telecom was earning big revenues there, but wanted these carriers to sign ITAs foregoing terminating revenue on Internet calls. So we say that this

ability, just want it to be unilaterally to increase profit at the expense of rivals without losing market share, because Telecom faced no potential competitive consequences from either customers, who couldn't go anywhere else, or from rival carriers who couldn't go anywhere else either, they all had to deal with Telecom.

So we say in C, Telecom's dominance in both markets materially facilitated Telecom's refusal, because at one stage Telecom refused to give Clear any 0867 numbers because Clear wouldn't sign the ITA. So all of those things together, the reason that Telecom, Telecom being stuck with this unsatisfactory contract, the ICAs, wanting to get out of them, was able to use its market power to devise this whole scheme that would sit outside that and force everyone to play the game, force the customers, force the ISPs and force the carriers.

TIPPING J:

Is this really saying in more figurative terms, that because of its market power they had all these other players captive?

MS COUMBE:

Yes, they were – one of the, I think in *Melway* that the Court, the High Court of Australia stressed that the concept of market power is not just about ability to raise prices, but about being free of significant constraints from competitors and suppliers and we say that the fact self-evidently showed that if you can institute a scheme like this you can only do so, that you have market power.

TIPPING J:

In bringing this back to the submissions of your learned leader, is this tantamount to saying that this was striking at the competitive process rather than at individual competitors, it was doing both?

MS COUMBE:

It was doing both.

TIPPING J:

Both, but the important point is that it was striking at the competitive process.

MS COUMBE:

Well it was also – it was – but it was also striking very much at the individual competitors –

TIPPING J:

Oh yes.

MS COUMBE:

Because the carriers were just being forced to sign away their entitlement to revenue.

TIPPING J:

And there was no general benefit to consumers out of this?

MS COUMBE:

No. We say no.

TIPPING J:

That's a significant –

BLANCHARD J:

What happened to Clear when it wouldn't sign an ITA?

MS COUMBE:

Well I think at one stage Telecom was refusing to deliver 0867 calls to Clear's network. Now ultimately down the track, settlement was reached, but this was after the introduction of 0867, a settlement was reached with Clear, I think the beginnings of it were, well it was September 2000, but that resolved a number of issues between Telecom and Clear about various things. I can give Your Honours the reference to those settlement documents if you – but otherwise we can just accept that there –

ELIAS CJ:

Is it dealt with in either of the judgments? Can you give us a reference there, no?

MS COUMBE:

I'm sure there would've been, but I can give you very easily, the reference to the documents. There was a Clear Telecom renegotiation agreement in May 2000, again this was after 0867 and that's at COA 33 –

BLANCHARD J:

So what was the date of 0867?

MS COUMBE:

It was introduced in June 1999.

BLANCHARD J:

So Clear was able to carry on for over a year without an 0867 connection?

MS COUMBE:

Well it could, but it did have an impact on Clear and I think there is evidence given in the record about the financial impact on Clear.

BLANCHARD J:

I'd be interested in having that reference.

MS COUMBE:

Yes, I can get that for Your Honour.

ANDERSON J:

Is it the case that Telecom would be constrained by the Kiwi Share from simply charging a dial-up fee to its retail customers?

MS COUMBE:

The Kiwi Share Obligation is a separate argument relating to Telecom's dominance in the retail market, but our argument was in the High Court and Court of Appeal and it was accepted in both of those Courts, that although that does provide a certain degree of extremely light-handed regulation, it has a social policy of protecting local calling that was not in any sense, a sufficient constraint, goes to Telecom's dominance, was not a sufficient constraint on Telecom's dominance to have had any impact on it in both the High Court – the High Court accepted that the Court of Appeal by inference accepted that and of course it didn't constrain the introduction of 0867 in this case.

ANDERSON J:

No, but that was offered as a free alternative.

MS COUMBE:

Yes, and that was how it was presented to the Minister?

ANDERSON J:

They did charge a fee effectively didn't they?

MS COUMBE:

They did. Effectively –

ANDERSON J:

But they gave a free alternative to it.

MS COUMBE:

Yes.

ANDERSON J:

So obviously they could charge a fee in some circumstances?

MS COUMBE:

Yes, and they used that fee as I say, intending it as an incentive to drive customers to where they wanted them to go, which would in turn drive the ISPs and drive the carriers to all fall in behind.

ANDERSON J:

Suppose they had simply said, retail customers, when you dial up your ISP you're going to be charged a fee. What could the customers have done about that?

MS COUMBE:

Well I suppose that might not have the outcome they wanted though, what they wanted to do was force customers to take up an 0867 number and have that domino effect on ISPs and carriers to eliminate the termination payments and – perhaps if my learned friend Mr Farmer has given me a reference which Your Honours may find helpful in volume 4 at page 662.

ANDERSON J:

Of the case?

MS COUMBE:

Yes.

TIPPING J:

Page?

MS COUMBE:

Sorry it's the page number 1013, volume 4. The question put by, to Mr Parkes, who clearly was feeling dominant this day as well judging by his response, he was asked, "The two cent charge was an economic incentive to move to an IN based number range." Sorry that was his answer. The next question was, "And that was, and to do that you had to induce the Telecom Internet user to deal only with an ISP who had an 0867 number?" And the answer was, "Well if the customer wanted not to have to pay the two cent charge, that is correct." "In fact

Telecom never received, it never expected to receive revenues from its Telecom customers from the IDC did it?" "No, as I say in my brief it was a product that we weren't expecting to get money for, that wasn't its purpose." So they imposed that two cent charge as an inducement to get customers to move to 0867 because they wanted to implement this entire scheme to get carriers to give up termination payments. The two cent charge was never a genuine thing. I mean it certainly doesn't reflect the costs of interconnecting or delivering a local call with the Fletcher Inquiry described as a small fraction, a small fraction of a cent.

TIPPING J:

The whole of this evidence is actually quite significant isn't it? Right further down the page too, but I don't want to take you beyond your immediate point.

MS COUMBE:

Yes, it was that scheme and the next step was to force carriers to sign an Internet agreement and so on, so that what it comes back to, and I think this would be my final submission that to sum up, that I understand Your Honour's concern at the thought of applying a different approach, but what I'm really saying to you is that this was – first of all this was always the correct approach and secondly this – the evidence is all there, it's just in terms of how, what this scheme was and what it did. You don't really need to go much beyond that, the evidence is all there to form a conclusion about and we would submit that this was a blatant use of market power, Telecom adopted these bullying tactics to force everyone else into a scheme that would allow it to get out of an agreement, under which it was losing some money, and not even a huge amount, and that that is not an option that, but could do that without fear of any, of the sort of market constraints from competitors or suppliers.

I think that – I'm sorry, we do have just some evidence references about the effect on Clear. Perhaps I could just give those to Your Honours and then I'll conclude? It's in the case on appeal and it's at volume 2, and it's the statement of evidence of Mr Forsyth and it's at pages 135 to 136 of the volume.

Just one more reference. This is the case on appeal volume 3 page 785, Mr O'Brien's statement of evidence. Those are revenue figures.

Thank you, Your Honours.

ELIAS CJ:

Thank you, Ms Coumbe.

Now, it's probably sensible to hear you, Mr Palmer, next, if that is convenient to Telecom? Is that what you had expected, Mr Shavin?

MR SHAVIN QC:

We understood that our friend, Mr Palmer, would address the Court if called on –

ELIAS CJ:

We would like to hear Mr Palmer on the legislative history. He's indicated he's going to be relatively brief, and it's probably more sensible to hear him so that you can respond to anything he says, Mr Shavin.

MR SHAVIN QC:

Yes, Your Honour.

ELIAS CJ:

Yes, thank you. Is that suitable?

MR PALMER:

Yes, Your Honour. I'll just take a minute to get set up here.

ELIAS CJ:

Yes.

MR PALMER:

Thank you, Your Honours, for the opportunity to address the Court on behalf of the Attorney-General. I am aware of the concerns of both parties to ensure that this proceeding is conducted effectively and quickly, and so we will take little time but would invite Your Honours to ask any questions or put any points that you wish to at any point.

In the interests of efficiency of time, the Attorney has prepared a one page handout of the key points of the Crown's argument, which I do not propose to take Your Honours through but thought that it might be worth you having.

ELIAS CJ:

Thank you.

MR PALMER:

This case does concern an important point of law that has significant implications for competition law and policy and their effectiveness. The Attorney's intervention was sought only in relation to the point of law, with respect to the first limb of the terms of leave to appeal, and the Attorney expresses no view on the outcome of this particular case or of the application of the law to the facts of this particular case.

The Attorney does submit that the point of law primarily of issue, which you will see reflected in point 1 in the Crown's handout, which is whether section 36 requires a counterfactual test to be the sole determinant of use of a dominant position. The Attorney does submit that that point of law requires clarification by this Court.

The key points on the one-page handout have been the subject of our written submissions and the Court has already heard a number of aspects of those submissions today. But, in brief, point 2 is simply a number of arguments against the decision of the Privy Council in *Carter Holt* which, in turn, confirms their decision in *Telecom*. We would say it has a judicial gloss, as I think Your Honour the Chief Justice had suggested earlier in these proceedings. We say that it is not consistent with a statutory purpose which envisaged a general and flexible assessment to be conducted by those administering the law, which had the purpose of promoting competition and to be in harmony with Australian law and New Zealand CER obligations, and I will return to those points shortly.

We further say that it was an error by the Privy Council in purporting to follow the Australian case law, that, in our submission, they did not follow the Australian case law, and that it was contrary to consistently expressed concern by New Zealand Courts, including the Court of Appeal, and the Court has heard submissions by the Commission in that respect already.

And, finally, we say that the Privy Council decision is not rooted in sound, economic principle, it pursues a policy of illusory certainty and creates uncertainty, and I am happy to expand on that.

I'd like to come in the bulk of my oral comments to point 3, but before – and that is the point about whether it is appropriate for this Court to depart from the decision of the Privy Council now or not. But, before I do that, I just wish to respond to the Court's invitation to canvass one aspect of the Crown's submissions in relation to legislative history that had not been canvassed by the Commission's counsel, and this is in relation to the Closer Economic Relations context of section 36 and its sister provisions. And if I could direct the Court to paragraph 26 of the Crown's submissions, just prior to paragraph 26 the submissions have gone through the entry into Closer Economic Relations by New Zealand

and Australia, in 1983. I'm just checking that all of the Court has the submissions in front of them.

ELIAS CJ:

Yes, carry on.

MR PALMER:

Thank you. Paragraph 26 makes the point that there was a Protocol to the CER that was entered into and that is rehearsed in paragraph 26. And under article 4 of that Protocol, "Each country would take appropriate actions by the 1st of July to achieve the application of its competition law in a manner consistent with the principles and objectives of the CER agreement." This is what gave rise to the enactment of section 36A of the Commerce Act, and this is referred to in paragraph 27. So there was an equivalent provision enacted in Australia at the same time which was section 46A.

BLANCHARD J:

Have we got section 36A?

MR PALMER:

Your Honour I was just looking at that very question before, there is section 36A contained in the respondent's bundle of authorities at volume 1 at tab 2. However, it appears that none of the three parties before the Court have actually put into the Court the version of section 36A that existed before 2001. The simple point is that section 36A is materially similar to section 36 both before 2001 and after 2001 and at tab 2 of the volume I've directed the Court to, you have both section 36 and section 36A from 2001 onwards. During the lunch break we can provide section 36A.

ELIAS CJ:

What is the difference? Is it simply the change in terminology?

MR PALMER:

Yes Your Honour.

ELIAS CJ:

Yes.

MR PALMER:

So in section 36(2), "A person that has had substantial degree of power in a market must not take advantage of that power for the purpose," and you will be familiar with the purposes.

And section 36A has similar wording. The purpose of section 36A was to extend the reach of these provisions to regulate the use of a dominant position in a market in either New Zealand or Australia or in both countries. So section 36A is a sister provision of section 36 in New Zealand, section 36A in New Zealand law is also a sister provision of section 46A of the Australian law and that provision I think is contained in the Crown's bundle of authorities at volume 1, I don't know whether Your Honours wish to go to that. Volume 1, tab 2.

TIPPING J:

And so does each Court have, each judicial system have jurisdiction over the combined markets?

MR PALMER:

That's correct Your Honour.

TIPPING J:

So you'd have a real anomaly in such a situation?

MR PALMER:

If they were different. Yes Your Honour. And you can see by brief reference to the legislative history in New Zealand the relevance of this. This is just slightly fast forwarding the Crown's submissions to paragraph 43. Because the Crown's submissions were set out as a chronology, this is the point in the chronology that this occurs. So paragraph 43 of the Crown's submissions makes the point about the enactment at section 36A, which also entails consequential additions to definition of the market in section 3. And it is at the top of page 16 of the Crown's submissions, is the quotation from Hansard which notes that the Minister was asked about the potential for a difference in the interpretation of section 36 in New Zealand Act, section 46 in the Australia Act and he advises the House that the New Zealand Courts have regularly quoted extensively from cases concerning section 46, this remember was in 1990, of the Australia legislation. No attention has been drawn to the differences in the wording. The alleged differences of effect between the sections, and then indeed he goes on to note the Australians were considering moving away from that section. So this reinforces the earlier views that New Zealand Parliament had had about there not being a difference of content in the law and indeed expecting the Australians may well harmonise the terminology. That did not occur in the end it was New Zealand who harmonised terminology. But the point is New Zealand did not expect, New Zealand Parliament did not understand there to be a difference in the use of the words "use" compared to "take advantage of". So just returning to paragraph 28, of the submissions the Crown submissions, we do suggest that article 4 of the Protocol contemplated substantial commonality of the application of the domestic provisions in both, in each jurisdiction, for a number of reasons that are set out there. Including the point that provision has subsequently been made, this is at 28(4). Provision has subsequently

been made for the reciprocal enforcement of section 36A and section 46A. And so the punch line I suppose, of the Crown's submissions in this regard on the next page, is it is our submission that section 36 and section 36A of the New Zealand legislation, need to be interpreted consistently and that section 36A and its Australian counterpart, need to be interpreted consistently and section 36 and its Australian counterpart ought to be interpreted consistently. And this is in recognition of Closer Economic Relations between New Zealand and Australia, being an essential part of the context of Parliament's purpose when it passed section 36 originally and at the heart of Parliament's purpose when subsequently amending section 36 and introducing section 36A.

McGRATH J:

That's really a submission Mr Palmer, that there can only be one true meaning of what is in effect, the same text?

MR PALMER:

Yes Your Honour.

McGRATH J:

Both Courts should work towards that I suppose.

MR PALMER:

Should work towards it Your Honour, yes, and the way that the Crown has put that, is that absent some compelling reason, those interpretations should be the same. Certainly that is what the New Zealand Parliament envisaged, that is what its purpose was in enacting these provisions in each and every step, including 2001 where it sought to clarify –

TIPPING J:

It would be very odd if, in the combined market, you had one answer in Canberra and the other answer in Wellington?

MR PALMER:

Absolutely Your Honour.

TIPPING J:

Could the 2001 Act be reviewed as a corrective? In other words New Zealand's got out of step with Australia, the Australian position has now become clear from *Melway*, right we'll correct the position?

MR PALMER:

I would certainly agree Your Honour that the 2001 Act was intended to fix the position that the Privy Council had created in interpreting the law in Carter Holt Harvey and Telecom. The problem that this creates, and this really turns to the second sort of set of issues that I wish to address, is that from the New Zealand Parliament's perspective all along, there has been consistency between Australia and New Zealand. Parliament's purpose before 2001 was also that this wording should be consistent with Australia, as it has been subsequent to 2001. And if the reasoning of *Carter Holt Harvey*, of the Board, the Judicial Committee, in *Carter Holt Harvey* and *Telecom* is held by this Court in this case to stand in relation to the pre-2001 section 36, it's difficult to see why commentators and lower Courts will consider that it does not stand in relation to the post-2001 law. This Court would –

BLANCHARD J:

Even if we say otherwise?

MR PALMER:

Well, I guess that in –

BLANCHARD J:

Even if we say that the 2001 Act effected a correction?

MR PALMER:

Yes, Your Honour, and how would it be that that correction and this change of words would affect the reasoning of the Court in the Privy Council?

BLANCHARD J:

Well, it wouldn't much matter.

MR PALMER:

Would it not?

BLANCHARD J:

The Privy Council's speaking for the pre-2001 situation, it's never addressed the 2001 legislation, and it won't be addressing it.

MR PALMER:

The Privy Council did address the pre-2001 legislation, and the reasoning of the Privy Council in *Carter Holt* and *Telecom* about the interpretation of the word "use" is difficult to distinguish from how that reasoning should apply to the interpretation of the phrase "take advantage of." So –

BLANCHARD J:

Well, we have the benefit of the Australian interpretation.

MR PALMER:

As did the Privy Council, Your Honour, and the real problem, Your Honour –

BLANCHARD J:

Well, the Privy Council didn't address *Melway.*

MR PALMER:

Would it be helpful to just have a look at the Privy Council's decision in *Carter Holt?*

ELIAS CJ:

The Privy Council did purport to apply the Australian interpretation.

MR PALMER:

It certainly did, Your Honour.

BLANCHARD J:

But was *Melway* referred to?

ELIAS CJ:

Your point, I think, Mr Palmer, is that it would be a little disingenuous to take the view that because the legislation is different we can move on.

MR PALMER:

It has the faint air of an escape, Your Honour.

ELIAS CJ:

Yes.

MR PALMER:

And –

ELIAS CJ:

Escapes are not bad.

TIPPING J:

Can we say they got it wrong but we're not going to overrule them for this case?

MR PALMER:

Well –

BLANCHARD J:

Yes, well, that was what I was introducing.

MR PALMER:

And I understand, and certainly –

BLANCHARD J:

I certainly think they got it wrong.

MR PALMER:

Well yes, with respect, I think that the Court, if it believes that, should say so.

BLANCHARD J:

Well, not necessarily. One can say they got it wrong but, "We're not going to depart from it in a particular case."

MR PALMER:

Yes, Your Honour, I think this is where we go straight to the sorts of factors that are relevant, in particular in the *Couch* decision.

McGRATH J:

Mr Palmer, can I just perhaps stop you there, and you're saying that the Court should say so if it thinks it got it wrong, but there is a concept of respect for precedent –

MR PALMER:

Yes, Your Honour.

McGRATH J:

– that is an important element in the stability of the law.

MR PALMER:

Absolutely.

McGRATH J:

And that's something I think the Court has to take into account which would run against that argument.

MR PALMER:

Yes, Your Honour, I do acknowledge that, and I think that that is very evident in this Court's decision in *Couch,* about the various different factors which are relevant to departing from a decision of the Privy Council, and it is clear that that is done slowly and with consideration to a variety of the factors which I would propose just to go through.

BLANCHARD J:

And "slowly" doesn't mean nine years after it.

MR PALMER:

Now, Your Honour.

McGRATH J:

Isn't one way of looking at it –

MR PALMER:

But –

McGRATH J:

I'm sorry, no, you want to finish.

MR PALMER:

I would say that I certainly acknowledge that it is a factor to have regard to precedent, but there are a number of other factors which militate in the opposite direction and the Crown would say, do so determinatively, in favour of departing from the Privy Council, pre-2001, in this case.

McGRATH J:

I thought you weren't too concerned with this particular case?

MR PALMER:

Your Honour, we are not concerned with this particular case, we, the Crown, but the Crown is concerned with the effect of the judgment of this Court in this case on certainty of the law, of the current law.

McGRATH J:

Yes.

MR PALMER:

And it does seem to me that there is some potential for a judgment of this Court to raise questions about what the current law is, if it were to confirm the Privy Council's decision in *Carter Holt*, because other Courts would be left with the question of why that reasoning does not apply to the existing legislation, and my learned friend has already take the Court to two High Court cases, where it is assumed that it applies. Perhaps it would be helpful to also take Your Honours to another document where the same thing is said to exist, and I would refer Your Honours to volume 17 of the case on appeal.

ELIAS CJ:

Of the case on appeal authorities? The case, is it?

MR PALMER:

The case. It's volume 17 page 7000, Your Honour, this is the Fletcher Inquiry. Perhaps page 6999 would come first. So, this is part 3.6.2 of the Inquiry report, the Ministerial report, and at the beginning of that part on page 6999 the Inquiry notes that few successful cases have been brought under section 36, "It has not been the problem of proving dominance that has generally prevented defendants, it has been the problem of proving use of such dominance, within a very narrow test enunciated by the Privy Council in *Telecom.*" It then says that "the proposed changes to section 36," and they were proposed at this stage, "Are unlikely to address the difficulties proposed by the use test. This is because," and this is at the bottom of page 6999, "This is because, on the basis of cases such as *Queensland Wire*, to take advantage of a substantial degree of market power." And then going over the page, "Is likely to be held to be equivalent to using such market power." And there, I think, my learned friend had taken the Court earlier to the authorities that are quite clear on that and have been clear on it. "The problem lies not so much with the test itself," it is entirely appropriate in most circumstances and the Attorney does agree that there could be a place for this test to be used, "but the problem lies with the assumption that it is the sole test to be applied, and in some cases it is either difficult to apply in any meaningful way, for example, where the conduct in question restricts entry not in a market in which it takes place but in another market, or involves a high degree of artificiality. Moreover, the test ignores the fact that conduct that is equally characteristic of a fully competitive market may have a significantly different effect," this is the point already made by my learned friend, "in a less competitive market. These issues are of particular concern in the electronic communication sector." So, the Crown is not arguing that this is evidence as to what the law is, but it is saying that there is a perception, an understandable perception, by commentators and by at least two

High Court – the only two High Court judgments to have considered the question to date – that "use" is the same as "take advantage", and there is good authority for that proposition.

TIPPING J:

But if that were so, the exercise which Parliament was engaged on in 2001 would have been meaningless.

MR PALMER:

Yes, Your Honour, and that is clearly not consistent with Parliament's purpose.

TIPPING J:

Although I respect and understand the point you're making, I would have thought it's not one that's likely to cause practical difficulty, as long as this Court speaks clearly.

MR PALMER:

I would agree with that hope, Your Honour, but I could imagine, I could envisage – and I think my learned friend's submissions from Telecom in relation to leave to appeal were in agreement with the point that I've been making that Parliament intended to change the law in 2001, but they were very careful not to agree with that proposition and I would be –

BLANCHARD J:

Well it's what we say, not what they say that counts.

MR PALMER:

I understand Your Honour, but it is also what arguments future counsel will make to future Courts.

BLANCHARD J:

Well we'll have to leave little room for wriggle.

MR PALMER:

And Your Honour the Crown submission is that that little room for wriggle is best achieved by confronting directly the question of whether the Privy Council should be departed from or not. The Crown has looked for a number of alternative ways of putting this, but it is not a task to be lightly undertaken to depart from the Privy Council, but in terms of its reasoning, in terms of the interaction of the various different points of law here, I would submit Your Honours that it is difficult to see an alternative.

McGRATH J:

What is wrong in terms of your concern that there be certainty as to the principle in the future, with the Court saying that words capable of having different meanings, obviously they're not precise vehicles for conveying meaning, and the Privy Council gave a received meaning to use, which, if we accept the appellant's submissions, we would say was wrong, but if we just simply were rather to observe this received meaning was given to use and to take advantage was given a different received meaning, albeit in the same context of sections in the High Court of Australia, and what the 2001 legislation did was to indicate that the received meaning that was being given in Australia was preferred by Parliament over the received meaning given by the Privy Council, and we left it at that, wouldn't be giving the necessary certainty that you're endeavouring to achieve, without necessarily overruling, going on to overrule the Privy Council decision as to the meaning prior to 2001.

MR PALMER:

Your Honour I think it may do, it may do, but it does seem that that is a way of avoiding the logical implication that the Privy Council was wrong and I'm not sure that – and perhaps I could come to this perhaps after the break.

ELIAS CJ:

Well we'd have to say that the provision is different.

MR PALMER:

Yes Your Honour and it's difficult to know in what way the difference is.

ELIAS CJ:

Whether Parliament intended that it be different, is only one of the perhaps, indications that one would use in getting to that conclusion but we would have to put hand on heart and say it's different.

MR PALMER:

Yes Your Honour.

ANDERSON J:

Well in the 2001 amendment, Parliament was adopting a semantic solution to a non-construction problem. The problem was not a matter of interpretation in *Carter Holt* it was the test that was positive and the correction for that was to alter language to indicate we want Australian jurisprudence to apply.

MR PALMER:

Yes Your Honour, the Parliament's purpose was to have the Australian case law apply in New Zealand as well, but in doing that the Australian case law that these two, the different pieces of language were the same –

ANDERSON J:
Well it indicates –

MR PALMER:
It was also relevant, it's a –

ANDERSON J:
Well it indicated the result it wanted, by adopting a semantic solution.

MR PALMER:
Yes Your Honour. But I would submit that Parliament's purpose was clear.

ANDERSON J:
Oh yes, I'm not saying that – I don't see it myself as a matter of a construction in *Carter Holt* but the problem with positing a single test in the solution was by this particular means, indicating we want off trading jurisprudence so we will indicate that by adopting the Australian expression.

MR PALMER:
Yes Your Honour I agree.

BLANCHARD J:
I must say, I think that far too much is being made of the difficulty of this. I don't see it as particularly difficult at all.

MR PALMER:
Would you like me to respond to that Your Honour?

ELIAS CJ:
I'd find it helpful.

BLANCHARD J:
Well the submissions have been extremely helpful, I'm not intending to start on that, it's just I don't really see much difficulty in leaving the Privy Council's decision in place for pre-2001 matters.

MR PALMER:

And that is so –

BLANCHARD J:

Of which there are now hardly any.

MR PALMER:

Your Honour, perhaps I could put it this way. Leaving the Privy Council's decision in place with respect to pre-2001 matters, confirms the Privy Council was correct in saying that the counterfactual should be the sole determinant of use of a dominant position.

BLANCHARD J:

No, you're not saying it's correct, you're just saying you're not disturbing it.

MR PALMER:

Yes Your Honour, and therefore it is the law that applies –

BLANCHARD J:

It was the law.

MR PALMER:

It was the law that – and it is the law –

BLANCHARD J:

We're going around in circles.

MR PALMER:

Yes Your Honour yes, but it applies to presumably the "*Data Tails*" case as well.

BLANCHARD J:

Maybe.

MR PALMER:

So that would be the effect of that hold.

ANDERSON J:

So what's involved in that case, I don't know anything about it?

MR PALMER:

I'm not involved in that case Your Honour, thankfully. I'm sure there are others in this Court who could speak more authoritatively on that if they wish. Your Honour I do have some points to make in relation to the points in *Couch* but perhaps they're better saved.

ELIAS CJ:

Where are you intending to go with your submission Mr Palmer, just so that we know?

MR PALMER:

I simply wished to point to a number of relevant considerations in relation to departure from the Privy Council, and that was about it, so it should not be more than half an hour, perhaps 20 minutes.

ELIAS CJ:

Yes. Are you intending simply to give us general propositions on the circumstances in which we should depart from a decision of the Privy Council –

MR PALMER:

No Your Honour.

ELIAS CJ:

Because if so –

MR PALMER:

I was proposing to identify the general position to say how they applied to this case.

ELIAS CJ:

All right, thank you. It's just that we have had quite extensive argument on this, so if you can add to it, that would be helpful.

MR PALMER:

Yes thank you Your Honour.

ELIAS CJ:

All right, we'll take the lunch adjournment now, thank you.

COURT ADJOURNS: 12.57 PM

COURT RESUMES: 2.13 PM

MR PALMER:

Your Honours, I'll be very brief. The key point that I was making before the break was the problem the Crown has in distinguishing in principle between the law before 2001 and the law after 2001. In fact, just thinking about it a little bit more, it may even be that if this Court was not minded to depart from the Privy Council then it would be departing thereby from the Privy Council in the Privy Council's following of Australian case law to say that "use" and "take advantage of" is the same, so there is a conundrum here, but I don't make much of that point.

The key points that I just wanted to put briefly to the Court was that, in the Crown's submission, the Court's giving of leave to the first limb of the terms of leave in this case does put squarely on the table the question of whether the Privy Council should be departed from or not, and that the most relevant sets of factors that bear on that question are the considerations that are contained in the decision of *Couch* of this Court. The Crown's submissions, if I could just suggest Your Honours turn briefly to those, deal, again briefly, with those considerations. Just before that section, I'll just suggest that Your Honours turn to paragraph 74 of the Crown's submissions. You have heard from the Commission as to the nature of the test that it suggests is relevant to the question of use, and at 74 and 75 the Crown's submissions as to that are contained. So we are in substantial agreement with the Commission that it is a matter of fact, degree and, ultimately, of judgment, so it is of the nature of a factual inquiry here, and that while the counterfactual test may be useful in some circumstances, for the reasons that have also been put to Your Honour, the Crown submits that it is not useful in all circumstances and, in fact, it is not economically literate to apply the counterfactual where what you are seeking to analyse is assumed away, as part of the counterfactual, but that point has been covered.

The next page of the Crown's submissions, paragraph 77, turns to the *Couch* decision and puts, in the Crown's view, why this case is in the nature where departure from the Privy Council is appropriate. And perhaps I could refer briefly to a number of the factors that seem to have weighed on Your Honours in that case. One of the factors is that the Privy Council be in error, and I think we've canvassed that adequately already, as to the submissions, that the Privy Council is in error. Another is that it is inappropriate for New Zealand conditions. And the Crown would point in particular to the specific relationships between New Zealand and Australia under CER as a factor that it would be, perhaps this Court could be expected to have a better understanding of those conditions, fuller appreciation than the Privy Council, of the significance of those factors and of the harmonisation between Australia and New Zealand of competition law.

The existence of a strong minority judgment was also said – and I'm not taking Your Honours to the *Couch* decision unless you wish me to – that the nature of a strong dissent was also a

factor which was said to be significant in that case, and the Crown would submit that was clearly the case here, there was a strong dissent in the Privy Council and there were strong judgments in the Court of Appeal below and in other Court of Appeal cases, that go the other way from the Privy Council, to say nothing of the High Court of Australia decisions.

The overall test has been put differently by the different Judges in the *Couch* decision. Whether the Court feels that it should do so, in departing from the Privy Council, whether it was clearly wrong, whether there are cogent reasons or whether the Court thinks it is right to depart from the Privy Council, the Crown would suggest that all of those –

ELIAS CJ:

You're not going to suggest a test, are you?

MR PALMER:

We're not. We could offer further written submissions if the Court were to invite that.

ELIAS CJ:

No, I don't think there's any issue on this.

MR PALMER:

No, but –

ELIAS CJ:

If it is clearly right, as *Couch* and other cases have signalled, then we must do what's right.

MR PALMER:

Yes, Your Honour, and, in the Crown's submissions, the factors which were relevant in *Couch* too, overall in Privy Council are, unfortunately, relevant here. The point that Your Honours raised about reliance in the interactions with my learned friend earlier, is really the only countervailing factor to the other factors that have been put. So, I would suggest that that be viewed as a countervailing factor, but not a dispositive one, and, in the Crown's submission, the other factors are more cogent in suggesting that a departure is required in order to properly interpret what Parliament's purpose was.

The point about reliance – and I think my learned friend made this point but I'll just make it slightly differently – is that the notion of reliance suggests that there was something to rely on and, here, what is purported to be relied on is a counterfactual test that is not known in advance. So, Telecom, in purportedly relying on the Privy Council's decision was relying on

the existence of a counterfactual test without knowing what that counterfactual test would be –

ELIAS CJ:

You mean, without knowing what the –

MR PALMER:

What exact counterfactual would be chosen.

ELIAS CJ:

What the facts would be –

MR PALMER:

Yes, Your Honour.

ELIAS CJ:

– which would set up the counterfactual.

MR PALMER:

Yes, Your Honour. And, in particular, this sort of situation, where the existence of a dominant position is integral to the fact situation and is difficult to abstract from it in order to use the counterfactual test, means that there is sufficient uncertainty about the application of a counterfactual by a decision-maker in advance, that the Crown would submit that there is little certainty and therefore little to be relied upon.

Two final points. Your Honour Justice Tipping was, I think, concerned about the penal consequences of this statute, and I think I would suggest that the value to be attached to those implications ought to be encapsulated in the general reluctance to depart from Privy Council decisions that is expressed in the *Couch* judgments. And the Court could have particular regard to that one factor, but this is not a case where section 26 of the Bill of Rights Act is directly triggered, there is no offence, as I think Your Honour Justice Anderson pointed out, and I am not aware of any case in which a judicial correction of an interpretation of a statute has previously been held to constitute retrospective application in the manner that offends against that provision.

The one final point that I'll just make, and I make this somewhat hesitantly, is that if this problem is still a problem for the Court, in seeking to distinguish between the pre-2001 law and the post-2001 law, then I do believe that the Court has, in *Lai v Chamberlains,* left open – at least, Your Honour Justice Tipping has left open – the notion of prospective overruling.

TIPPING J:

Oh, no.

MR PALMER:

And I would not wish to make too much of that, and it is not something, just to be clear, it is not something that the Crown is advocating for, but I thought that I would draw it to the Court's attention in case you were interested.

BLANCHARD J:

Well, didn't Parliament do it?

MR PALMER:

Parliament could prospectively overrule –

BLANCHARD J:

Well, didn't it?

MR PALMER:

Well, I think Parliament meant to, Your Honour, yes.

TIPPING J:

But Parliament always speaks for the future, the Courts speak for the past as well, that's the difficulty. But I don't think it's desirable to go down the road that...

MR PALMER:

I agree, Your Honour. So, unless there are other questions?

ELIAS CJ:

No, thank you, Mr Palmer.

MR PALMER:

Sorry, Your Honours, I did also promise to hand up section 36A pre-2001.

ELIAS CJ:

Thank you.

MR PALMER:

So I'll just leave that with the Registrar.

ELIAS CJ:

Yes. Mr Shavin.

MR SHAVIN QC:

If Your Honour pleases, Mr Hodder will start. We divided the argument, if the Court pleases.

ELIAS CJ:

Thank you. Yes, Mr Hodder.

MR HODDER SC:

If Your Honours please. Just to indicate that division, in the spirit of trans-Tasman harmonisation, I propose to address context in the counterfactual, in particular in the context of the jurisprudence, and some of the issues that the Intervener has been touching upon. My learned friend, Mr Shavin, will be touching on the precise application of the counterfactual in the High Court, those deep and dark arts of the counterfactual have a beauty all their own, which he will explain. He will also address in more detail the supposed alternatives that Telcom had at the time it was dealing with these problems.

So, in part what I propose to say – and possibly the length will distress you until you stop me – is to say a few words, and rather more than a few words, in defence of the Privy Council. This case is about the old section 36 and its pre-2001 form, and that form has been elaborated and analysed by the highest appellate authority twice. And in *Telecom v Clear* and in the *Carter Holt* decision the Privy Council's approach to section 36 was designed explicitly, firstly, to promote competition and its consumer benefits through efficiencies, secondly, to promote legal clarity and the associated rule of law concepts and, thirdly, to reflect the tenor of relevant US and Australian jurisprudence, and in particular I'll have something to say about *Olympia*, the American decision which in some ways can mark the beginning of the jurisprudence this Court used to be concerned with, and *Boral*, a case which we've heard nothing about from either the appellants or the Intervener. Both Privy Council decisions were detailed and fully reasoned. There's a slight sense of shock in realising it's 16 years ago this week that the *Telecom v Clear* case was argued in front of the Privy Council for eight days. So this wasn't one of the short and concise Privy Council considerations of the topic.

This is an area of economic law. It's not simple, otherwise we would not be here, and the merits of the Privy Council's purpose of approach to section 36 can be and obviously have been debated. But this litigation, we respectfully suggest, is the very imperfect occasion for revisiting the Privy Council's approach. As has been said, the language of section 36 has been changed, apparently deliberately. Importantly, but not really mentioned so far, the

Australian legislation has changed markedly, in part in reaction to *Boral.* The 0867 package has long been approved by successive governments and is now found embedded in the Telecommunications Act. And the essential question in section 36 which, we suggest, is a mixed question of fact and law, has been answered in Telecom's favour in the Courts below twice. So, in Telecom's submission, the Privy Council's approach to the old section 36 should be regarded as settled. The Court's final view on the new section 36 should await a case when the new language is directly in issue, and on the facts and the law that it had to deal with the High Court and the Court of Appeal results were soundly based and there's no reason for this Court to revisit them and, obviously, this Court has the disadvantage on a second appeal of revisiting facts that were traversed over something like six weeks in front of the High Court which, in turn, had the benefit of a lay member sitting with it.

There are a few contextual matters that I want to touch on. The first is to indicate the way in which and why the 0867 initiative arose, and perhaps taking the Court to some of the documents that explain precisely why this was. The initiative was approved in the first half of 1999, that's internally, and as the Court will doubtless will have read from the submissions, it reflected the fact that there was a new phenomenon which was growing dramatically, one-way Internet traffic. That raised network management issues and it raised termination payment cash flow issues. And all that was taking place in the 1990s, the late 1990s, which was probably going to go down in jurisprudential history as the decade of the disputes between Telecom and Clear, which started back in the early 1990s and finished up in the Privy Council in 1994. And so when, in the Court of Appeal at paragraph 2 Hammond J says, "This is a continuation of disputes between Telecom and Clear," even though Clear's not a party to litigation, he's not mis-stating the point. This is a continuation of those issues.

Now, all of that dates from the era of light-handed regulation and, in particular, the KSO was one of the features of that and so was section 36 in its old form. That era ended a decade ago with a change of government and then the Telecommunications Act 2001. The Clear/Telecom dispute over 0867 itself ended in 2000 and by that time Clear had effectively won what had been a long campaign, occasionally no doubt lonely, against light-handed regulation, but it won the day with a change of government. And also by that time the new government in 2000, like its predecessor, had accepted the merits of the 0867 initiative. So the 2001 Act, which you haven't been taken to yet and it's in our materials, reflects the 0867 in two ways. Firstly, it recognises that the TSO obligation includes the exchange of correspondence between the Crown and Telecom about 0867 and requires those to be carried out as part of the TSO obligations for which there is in fact Commerce Act immunity by virtue of the Telecommunications Act. Secondly, in relation to the network traffic arrangements which are required under the scheduled services, there is a specific requirement to seek efficiency in network traffic arrangements which could be translated as avoiding perverse incentives. Now, all that and the way it's developed is summarised in Mr

Parkes' evidence. Mr Parkes was at the heart of these matters with Telecom, he produced a very long brief of evidence, there's a summary in the early stages between paragraphs 7 and 24, which I respectfully commend to the Court, and was cross-examined for some time, with respect, nothing essentially changed in relation to the picture he portrayed in his brief.

Telecommunications and telephone services in New Zealand have of course the historical baggage that comes from the fact that they were part of the Post Office, so there was a monopoly at the outset. As part of privatisation the KSO was implemented. That was designed to ensure, among other things, free local calls. That has two effects, among other things. One is that there's a degree of inefficiency inherent in the idea, because there is a cost, but there's no cost being paid by the consumer in relation to the call-by-call basis. There is, of course, a monthly charge which goes in part to the question of costs. And, secondly, it means that nobody else gets into the market, there's not much of a market for encouraging new investors to provide a free telephone service, and so that tends to make a huge difference to the market, and the analysis of the market has to take that into account. But the Minister, with the powers in relation to the KSO, was the regulator for these purposes. It was the Minister who had powers not only to enforce Kiwi Share Obligations to the extent they were departed from, but there was also the threat of regulation, which is referred to among other things in the submissions and, to a degree, in the Courts below. And that threat of regulation would either be industry specific and the kind that was ultimately in the form of the Telecommunications Act, or it would be price control under Part 4 of the Commerce Act as it then was and has been substantially revisited. And the Court will have read the Privy Council's decision on *Telecom v Clear* and recall that the presence of Part 4 of the Commerce Act was regarded as important by that Court in the way the interpretation of section 36 should be approached.

Can I invite the Court, if I may, to go to the Minister's letter which approved the KSO, approved the 0867 deal, because I think it demonstrates what the nature of what was going on was. That's in volume 13 of the case on appeal, at page 5338. Just to put this into context – I'll come back to this later on – but, to the best that the evidence tells us the, the sharing of termination charges by Clear with others, ISPs, seems to date from late 1998 and things escalated thereafter, and the fear of them was substantial. And the end result, as Mr Parkes' evidence describes in detail the processes that were followed through, there was an announcement of the 0867 initiative in June that, among other things, would –

ELIAS CJ:

What, 1998?

MR HODDER SC:

1999.

ELIAS CJ:

1999, yes.

MR HODDER SC:

So, the first sharing is in late 1998, concern builds, I'll come to a document called "the Project Morecambe document" which dates from May in 1999, which was the formal sign-off within Telecom. That's where, among other things, the $205 million figure comes from. In June it's announced to everybody and discussions take place with the Ministers of Finance and Ministers of Revenue, who are the Kiwi Shareholding Ministers, and obviously with the officials who are dealing with Telecom executives along the process.

So at paragraph 1 – just to back up one – this letter was a result of a series of negotiations going on between Telecom and the Ministers, and it's part of an exchange of letters. The first one is the one at 5338 and there's an acceptance letter at 5341, just a couple of pages further down the track. And that exchange of letters is the exchange that's referred to in the Telecommunications Act as being part of the current telecommunication service obligations, Telecom service obligation. The very fact that this is here is emphasised in Mr Parkes' evidence, because this was what Telecom was mostly focused on. Reference was made earlier today, I think, and yesterday, to the fact that Mr Parkes at one stage had talked about section 36 liability. If the Court wants to follow that through, it will be appreciated readily that what Mr Parkes was concerned about was a solution that discriminated against any of the carriers. He was concerned that if only, if he had to go onto Telecom's network to use the 0867 number, that would be discriminatory and create a section 36 risk. He wasn't talking about what we're talking about in this case. The very fact that Telecom was focused on this, which it thought –

ELIAS CJ:

Sorry, can you say that again? That he was concerned with what?

MR HODDER SC:

A solution which meant that any ISP that wanted an 0867 number had to go onto Telecom's network. That would be discriminatory, and that was not what 0867 offered. So they had to cease being a customer to some other carrier and become Telecom's customer, also a customer, and that was one of the things that 0867, as devised, was designed to avoid. So any carrier could get a range of 0867 numbers and offer them to their ISP customers.

TIPPING J:

Apparently, they could only get them if they signed up to a new agreement.

MR HODDER SC:

That's right, they were covered by no other agreement. I'll come back to the contractual position later on, but there was no agreement in relation to that traffic, which is why there has never been an allegation of breach of contract made in this litigation, and still isn't. But what Mr Parkes explains is that the prize that Telecom thought was relevant was to get the regulator's approval to the relevant aspect of this package, and this is it. And so paragraph 1 explains that what the initiative involved was two components, and it was the first one that required an issue because it meant that there was a qualification to the general concept of free local calls. So, 1.1, the first component, the introduction of an Internet dial-up charge. This is one of the acronyms, the TLAs, the three-letter acronyms which permeate this area of activity, so this was the IDC. At some point the Court may have come across and may yet come across something called "the PIC", which was PSTN Internet charging, different concept. So, this is the IDC, which was going to be imposed in relation to calls after the first 10 hours to connect to effectively to ISPs, Internet service providers. And then the, secondly, was the 0867 service to enable access to the Internet by connecting residential customers to ISPs through the dialling of the 0867 access numbers. Paragraph 2 records different advice that breaches the Kiwi Share, so the parties agreed to move on from that. At paragraph 3 it explains what the Crown wants to do is protect the interests of residential customers, and the Ministers say that the conditions they set out in the balance of the letter achieve that objective as long as Telecom adheres to them. If not, then the Crown will come back and enforce the Kiwi Share. And therefore, in paragraph 4, Telecom should state in writing to the Crown what it wants to do, what it's prepared to do, and that is the content that's foreshadowed with the letter from Dr Deane that comes on page 5341. And at paragraph 5, the Ministers are clear that if that's done then, as far as the government is concerned, the policy objectives of the Kiwi Share are being met and the Crown will not object to the 0867 initiative. And then the conditions are set out, the headings tell the story, calls to 0867 numbers must be free, Telecom must ensure that the quality is no worse than ordinary residential calls to the Internet. Note that's "ordinary residential calls to the Internet", not "ordinary residential calls", because that was one of the features –

TIPPING J:

Well, the features – can we just go back a step? You say there were two components, but the first component, that's the two cent per minute over 10 hours, was really no more than a device to make sure that everyone's lined up to the 0867, wasn't it?

MR HODDER SC:

In large part –

TIPPING J:

Yes.

MR HODDER SC:

– but it's all an element of the overall package.

TIPPING J:

Yes.

MR HODDER SC:

And, as you've heard, there was a charge payable, a termination charge payable. That two cents covered that termination charge.

TIPPING J:

They didn't want to just introduce 0867 for free.

MR HODDER SC:

No.

TIPPING J:

No, because they had to have a carrot, didn't they?

MR HODDER SC:

You're quite right, Sir, in your discussion or your metaphors yesterday, these are carrots and sticks to achieve a change in consumer behaviour. So, as I'll come to –

ELIAS CJ:

The carrot is also for the shareholding Minister, because the free access is being capped.

MR HODDER SC:

Well, there are two kinds of free access here.

ELIAS CJ:

Yes, I know, yes, sorry. But the residential dial-up one, is that right?

MR HODDER SC:

That can carry on, using the PSTN.

ELIAS CJ:

Yes.

MR HODDER SC:

The PSTN, by which we mean the seven-digit number, the N-X-X-X-X-X-X numbers that we're all familiar with.

ELIAS CJ:

Yes.

MR HODDER SC:

That's the PSTN calls, and the dial-up use of those numbers before 0867. And so, yes, the plan was that for the first 10 hours you could do that, but if you were a heavy user – and I'll come to what a heavy user was up to – then you'd be encouraged to move on to the other scheme, which was 0867. Now, I'm not sure if I answered Justice Tipping's point, but –

TIPPING J:

No, no, you have.

MR HODDER SC:

Thank you. Well, just to finish that off, yes, that was the point, it was meant to change behaviours. So, as far as Telecom was concerned and as the High Court acknowledges –

TIPPING J:

And the reason why it was meant to change behaviour was that they wanted the 0867 to be outside the framework of the present contractual arrangements.

MR HODDER SC:

Well, the fundamental purpose was to stop loss-making customers causing losses.

TIPPING J:

Well, that may have been one of the purposes –

MR HODDER SC:

Yes.

TIPPING J:

– but the other purpose, surely, was to get the leverage to get the new system outside the present contractual arrangements.

MR HODDER SC:

Yes, there's no question that they were clearly related one to the other, they were complementary arrangements, and the end result was to encourage traffic off the PSTN on to the 0867 system, no doubt about that.

TIPPING J:

Right, fine.

MR HODDER SC:

To the extent, well, to the extent – that that's a use of market power. What we will say is that when one goes into detail into the counterfactual, it doesn't, but that'll come –

TIPPING J:

I just wanted the groundwork cleared.

MR HODDER SC:

That's the groundwork. There's no dispute –

TIPPING J:

No.

MR HODDER SC:

– that these two are complementary processes and it's perfectly fair to describe them as a carrot and stick in relation to those customers. And, just to be complete on this, that in turn undoubtedly meant that ISPs, not just the residential customers, would see the things in a similar light, that it would be advantageous to have an 0867 number to maintain the residential customers of the ISPs themselves. And so the Court will appreciate that these customers were actually sort of – "bifurcated" is the wrong word – but they're customers and at different levels. They're all Telecom customers because they have residential lines but they're also customers, to some extent, of the ISPs, they may also be customers of other carriers if they have their tolls with Clear, for example, or somebody else.

So, the conditions that are set out in paragraphs 6.1 to 6.8, the emphasis of "free", and I was about to make the point, just below 6.2, the quality to be derived for these calls to 0867 number was to be no less or no worse than ordinary residential calls to the Internet. But, as the Court may have appreciated, the problem that was, a number of problems, but the volume of Internet calls was an issue and one of the things that 0867 provided was the ability to stack those calls, so ordinary calls, voice calls, would get priority. The quality being referred to here is not the same as a voice call, it's talking about the two kinds of ways of calling the Internet, on the PSTN or through 0867. And the idea was that you don't want the exchange overloading so you can't get your 111 calls and everything else that's useful in voice through the Internet calls where having a slightly less quality to that extent. The next one is about monitoring and quality, and on the next page, above 6.6, there was a delay. The original plan for Telecom was to implement this rather earlier, it agreed to a delay as part of the

arrangements with the Minister. And then 0867 calls to commercial organisations or to a carrier were to be free, and this is the bill and keep thing that you have heard about that, but rather than charging termination charges, Telecom was not to charge termination charges in relation to this traffic, if it was coming in or going out it was meant to be free. And that's what in part underpins the way in which the Internet traffic agreements, which were bill and keep based, were directed, they were consistent with this agreement. And, in 6.8, Telecom must actively seek agreements with commercial organisations and other carriers, with the provision by Telecom of the 0867 service. That was a requirement, and there was a great deal of evidence at trial about the fact that Telecom did do that, but in the state of relations it had with Clear, Clear was a tough nut to crack in terms of getting an agreement, it had a different view about how the world might operate. And, in the end, it became something of a three-way dance between Telecom, Clear and the Government, including two Governments, as it was spread over an election period at the end of 1999, as to how this all worked out. And the settlement negotiations took a great deal of colour from the political flavour of the day, rather than the particular economic aspects of it.

ANDERSON J:
Was the 0867 a technique for identifying Internet calls?

MR HODDER SC:
Yes.

ANDERSON J:
So a number would be given to an ISP on another carrier?

MR HODDER SC:
Yes.

ANDERSON J:
But would be identified at the point that it was transferred to that carrier's network.

MR HODDER SC:
Before, when it came into the exchange it was –

ANDERSON J:
Yes.

MR HODDER SC:
So, it went out of the –

ANDERSON J:
Yes, I understand.

MR HODDER SC:
The graphs you were shown yesterday, yes.

ANDERSON J:
It would be identified as a call, as –

MR HODDER SC:
As an Internet call.

ANDERSON J:
– an Internet call going onto that carrier, yes.

MR HODDER SC:
Yes.

ANDERSON J:
But it didn't require ISPs and other carriers to be on your network.

MR HODDER SC:
No. What was offered was a block of 0867 numbers. So, if you were ISP X you'd be given a range of numbers in a certain group.

ANDERSON J:
But an intelligent network might have done this by using sophisticated software.

MR HODDER SC:
Well, there was an argument about that. The evidence was that it wasn't ready for that and there were difficulties, yes.

ANDERSON J:
But they could both serve the same function if they were –

MR HODDER SC:
If it was possible to accurately identify every ISP number it might conceivably have worked, but the evidence that was explored didn't take it that far. And then, as I've said, page 5341 is

simply Telecom writing back saying, "Yes, we agree with what you proposed. You've asked to confirm a statement in paragraph 4.1 and we do do that." And Telecom will now press ahead with the initiative. And we say that has got a substantial significance here, because what is alleged against Telecom is it used market power to do this, and the most obvious use of market power is when you increase your prices. But Telecom couldn't increase prices for local calls without being in breach of the KSO or being at risk of being enforced against by the KSO Ministers. But what happens here is that it is allowed to increase its local call charge by the two cent IDC by the regulator, the Minister. Now, that goes to a number of aspects of this case, including the proposition we have which is in our written submissions, and I'll deal with that briefly towards the end of what I have to say.

TIPPING J:

But it's a two cent raise that can be very easily avoided.

MR HODDER SC:

You mean by using 0867?

TIPPING J:

Yes.

MR HODDER SC:

Yes. But just to carry the point through, if one did, if one for whatever reason failed to get on to an 0867 number as a customer who wanted to ring up the Internet then you would use your PSTN NXX-XXXX number, you would make the call, it would be carried, it would be terminated, Telecom would pay a termination charge to Clear if it was going to an ISP based on Clear and it would cover –

TIPPING J:

My point is, this wasn't an increase in price in any ordinary sense when you could so easily avoid it?

MR HODDER SC:

Well it was increased in the sense that if you did it the day before it came into force it would cost you nothing, the day after would cost you two cents after the first two hours.

ANDERSON J:

It provided a choice, didn't it?

MR HODDER SC:

It provided a choice.

ANDERSON J:

You still had the free access by using a certain option –

MR HODDER SC:

Correct.

ANDERSON J:

But you weren't obliged to do that.

MR HODDER SC:

Correct. But if you did nothing, there would be an increase in price, if you were using the Internet to the extent required.

ELIAS CJ:

It doesn't deal, of course, with the position of the ISPs. The shareholding Minister is not concerned with that.

MR HODDER SC:

He's concerned with the ultimate consumers.

ELIAS CJ:

His concern –

MR HODDER SC:

Yes.

ELIAS CJ:

Yes, the residential users.

MR HODDER SC:

Yes. But –

ELIAS CJ:

And there's no suggestion that the Commerce Act doesn't overlay all of these arrangements. I'm just trying to understand where your submission takes you in this.

MR HODDER SC:

My submission is that if there's a complaint of use of market power, the most usual evidence of which is reducing output or increasing prices, one can't ignore the regulatory context which was the KSO.

ELIAS CJ:

But it's not an answer.

MR HODDER SC:

Because it's not a use of market power because this is not a place where market power can be exercised because there's a regulator then we would say that is an answer. There's no clause –

ELIAS CJ:

So you take the very high ground?

MR HODDER SC:

Well there's no clause, as there is under the Telecommunications Act, which says if you implement that now, so nobody benefits in the claim against Telecom now because the Telecommunications Act expressly says the Commerce Act doesn't apply to giving effect to the TSO obligations. So we can't say that. What we do say is the same policy, the same concerns, nothing's changed with the commencement of the Telecommunications Act. The same policy factors are there and ultimately we're talking about policy factors in part in the way in which one approaches uses of market power.

ANDERSON J:

Is it the case that Telecom didn't simply say to Clear, we're not going to pay you termination fees for Internet dial-up because it couldn't conveniently decide or work out what was a dial-up and what wasn't?

MR HODDER SC:

It wasn't –

ANDERSON J:

I'm just wondering why Telecom didn't simply say to Clear, we're not going to pay your termination fees for Internet dial-up.

MR HODDER SC:

Well it goes back to the point Your Honour put to me before. I think there was an issue about identification which meant that wasn't practical at the time. Yes. So as it may be clear the contractual position has been canvassed to some extent but the contractual position involved

changes in effect to two contracts, or would involve two contracts. One was that the residential customers had a contract with Telecom which could be altered on notice and that was altered to give effect to the IDC. So that was one change that was made, that was the one that was expressly requiring, in Telecom's view, the Minister's approval and that was obtained. The second change, which wasn't a contractual change, was to stop delivering – I'll say that again, was to continue to deliver – let me back up, it wasn't a contractual change. The contract as far as delivering calls, PSTN calls, continued and termination charges continued to be paid. As far as Telecom was concerned that was an obligation to the contract. PSTN calls, when delivered, attracted a charge, they were paid. The separate issue about Clear's approach to the ICA which I'll come back to. As far as 0867 calls were concerned, they were not covered by the ICA and as we've heard that's why there isn't an issue here about a breach of contract. If they were there would be a much starker argument to say this was some kind of bullying, to use the language that the Commission has so delicately employed here. But in this case there was no contractual obligation. The short point, which I can take the Court to if it needs it, is that the requirement to pay termination charges was based on particular calls which were seven digit number calls.

TIPPING J:

Wasn't that the beauty of the scheme?

MR HODDER SC:

Yes, it was. On examination those calls, there was no obligation to deliver calls other than those that were NXX-XXXX calls.

TIPPING J:

So this was a way out of the difficulty?

MR HODDER SC:

It was. It was.

BLANCHARD J:

Are you going to give us a reference to that?

MR HODDER SC:

Yes. Bear with me one moment. It might be suitable to take the Court, if I may, to volume 7, page 2354 is where you find the table of contents for the interconnection agreement. Perhaps I should spend a moment on context before I deal with Justice Blanchard's point about the detail of this. The Court will recall that there was trouble at exchange that led to

going to the Privy Council back in the early part of the 1990s, that's how we get the Privy Council's decision in *Telecom v Clear*. That decision comes out in 1994, late 1994. There's a period of negotiation going on and then in 1995 there was evidence roughly to this effect, but not much evidence, there was an agreement worked out between the chief executives of Clear, at that time Mr Makin, and of Telecom, at that time Dr Deane. That was then negotiated in some detail and eventually resulted in this written document we've now got at page 2354 which is the 1996 ICA. There was no direct evidence about this because nobody who was involved in the negotiation of this was called as a witness and so I'd ask you to bear that in mind if you are reflecting on what's said by our learned friends for the Commission about this being imposed by Telecom, or whatever it was, created by Telecom. It was a negotiated commercial agreement and nobody who was there gave evidence about the circumstances in which it was negotiated. The only thing that I can perhaps point you to in relation to that is if we were to go to page 2448 and paragraph 41, clause 41.1, you'll see the reference, "This agreement entered into freely by the respective parties who have been independently legally advised contains the final understanding." Now you might have thought that in the light of the Privy Council decision and the fact that this was, had battalions of lawyers on both sides, that that might have been an answer to the proposition that this truly was a legally binding agreement, but, as I think the Court will appreciate from what's been said, in our submissions at least metaphorically the ink was barely dry, if dry at all, before Clear announced it and said it wasn't binding and it was in breach of the Commerce Act and it wasn't going to pay in relation to charges related to capped calls. And as one of our appendices to our submissions explains, in the end, I think about $40 million was withheld by Clear, all of which was going on through this period of 1998-1999. It's one of the reasons why when there's a blithe proposition that of course Telecom could have negotiated an agreement with Clear and that would have solved everything, there's a degree of hollowness from the Telecom perspective in relation to that.

Anyway that's what the, the only thing – there's no evidence that goes in relation to the topic covered by 41.1. In terms of the charging if we were to go to page 2508 that's effectively the obligation that Telecom had to pay termination charges and it has the point that has been made before that they were increasing over time from the beginning of the agreement through to the period when roughly this was going to come into force which was late 1999, 2000 onwards. The peak charge was two cents a minute. Just in relation to that it's probably worthwhile mentioning that there is a disparity between what was being paid by Telecom and what was to be paid by Clear and the proposition was that that – it's explained simply by bullying on the part of, or market power on the part of Telecom. There was acceptance at the trial that both those sets of charges were above costs. But the differential, we will say, has a rational relationship to the different network sizes. In terminating a call from Telecom, Clear had a minute network, and the cost of taking it to the furthest ends of the Clear network were much smaller than they were in taking a call and running it to the furthest ends of the

Telecom network, which could be the most obscure part of the country. As Clear's network was to grow, it was thought that that imbalance would change. That is the rational explanation for why there would be an increase over that period in relation to the termination rates.

Now, the key phrase in F7.1 is that Telecom will pay for each chargeable Telecom local call. And to find what a chargeable Telecom local call is one goes back to page 2501. If 1.1 tells us that it's a local call delivered from Telecom to Clear, which gives rise to the transmission of an answer-line signal – the technical stuff I don't need to worry about. So, what's a local call? We go to F1.7, it tells us it has the same meaning as in clause C1.6. We then work our way back to page 2471 and we find C1.6 defining local call in some considerable detail at the bottom of the page, page 2471. And for our purposes we note C1.6.3 for a call in a Telecom to Clear direction, the Telecom network, and unfortunately the call has originated in the Clear network number of the intended recipient, must have been the same local interconnect calling area. The point is, it's a call from a Telecom network number to a Clear network number. What's a Clear network number? We work our way back to the front of the agreement and we find, on page 2363, at paragraph 1.11, it's a seven-digit number and a number block allocated to Clear. And, for completeness, I probably should have drawn the Court's attention to schedule C paragraph C2.1 on page 2473, what the Telecom local interconnection service means, that is, when Telecom is offering local interconnection what's it doing? – it's C2.1.1 on page 2473 – it's delivering local calls to the Clear network, that's its obligation, and what it pays for takes us back to F7, as we saw earlier, F7.1.

Now, I'm sorry, that's a slight run around the block, but I was asked.

ANDERSON J:

What does it amount to in terms of excluding Internet dial-up?

MR HODDER SC:

On 0867, it's not a seven-digit number of the kind here, so an 0867 call, even if it's on Clear's network, is not a Clear network number as defined in this agreement.

ANDERSON J:

So, ISPs were generally on 0867?

MR HODDER SC:

Once they – well, before 0867, no, they weren't, they were on seven-digit numbers.

TIPPING J:

That was the beauty of the –

MR HODDER SC:

Yes, it was.

TIPPING J:

Yes.

MR HODDER SC:

Well, the main reason for spending time on this is simply to emphasise, and we do, that at various points as the argument develops for the Commission, it comes to a point which it assumes or implies there's a breach of contract been going on here, and there simply isn't. And that's, that I've just taken the time, having been asked, to explain why it is that there isn't a breach of contract here.

TIPPING J:

It was a method of avoiding – and I don't use that word pejoratively – the contractual obligation.

MR HODDER SC:

Well, there was no contractual obligation.

TIPPING J:

The contractual obligation to pay the terminating fee.

MR HODDER SC:

On a local call.

TIPPING J:

On the local call.

MR HODDER SC:

Well, it wasn't avoided, the local calls were, the traffic was transferred off local calls, that was the effect of it.

TIPPING J:

Sorry, yes, I follow you, yes.

BLANCHARD J:

The short point is it's not for this Court –

TIPPING J:

No.

BLANCHARD J:

– suddenly to decide there must have been a breach of contract.

MR HODDER SC:

One would hope not. I don't understand that was a submission made for the appellant.

BLANCHARD J:

No, it wasn't.

MR HODDER SC:

Now, I wonder if I could spend a minute or two on Mr Parkes' evidence? I appreciate the Court's read that, but just want to explain what the problem was in some detail. Well, not some detail, in enough detail to explain that this wasn't an issue that could be dealt with lightly. So, Mr Parkes' evidence is at page 911, which we'll find in volume 3, I think. It's at volume 3. So, the brief starts at 911, the summary I referred to is, as I said, paragraph 7 through to about 24, and you'll note at page 915, at the top of the page, a summary of some of the statistics which were occurring during this period. This was the point in the history of telecommunications where the voice ceased or was ceasing to be the major use of the telephone system, the data was catching up and all sorts of changes were going on. And you'll see for example, the third bullet point, the average length of a call at that stage was 22 minutes, compared to three minutes for a voice call. The average usage was 23 and a half hours a month, and the top 10 residential Internet users, 10 percent, were averaging 143 hours a month, that accounted for 51 percent of the residential Internet minutes. Now just, in terms of the use of the network, instead of a bunch of people making three minute calls, to say they'll be late home for dinner or whatever it was, you've got people staying on the Internet for a period of 143 hours a month, using up a line. So, the assumptions about how to manage and handle the traffic were having to change dramatically. Conversely, if you're calling somebody for 143 hours a month at two cents a minute, in terms of termination charges, that's a tidy sum per customer. At this stage I think the evidence was that the rental charge for a line was about $32 a month – I haven't done the calculation at the moment, but it doesn't take that long to get to the point that two cents a minute over a certain period uses up all of that before you're able to do anything else.

So, there's a bit of elaboration of this on pages 924 and 925 of Parkes' evidence. So, at paragraph 64, the length of calls is the long hold problem is discussed, on page 924. And then the network management issues are then discussed, 65 and 66, you have a

phased shutdown, where the exchange starts to become overloaded. It explains how the exchange has to shut itself down. At 67, he explains what happened with the beginnings of unlimited toll calling, the increase in volume and demands on the system did cause a crashing of local exchanges. Then at 68 he refers to the redialling, sometimes called "attack redialling problem". If you program a computer to keep on calling, when it can't get through the first time it keeps on calling. Unlike the sort of easily worn down human psyche which goes away and does something else, the computer doesn't give up, so it keeps on demanding access to the exchange and things get worse. And at 70 he explains things get even worse when there's something wrong with an ISP. If the ISP disconnects all its customers at once they all try and get back on again at the same time and you get these sorts of difficulties and, as he explains at the end of paragraph 70, that phenomenon was known as "attack dialling". And then he goes through to explain an exercise that occurred in 1999 involving Ihug which caused huge problems at the Mayoral Drive exchange in Auckland. So that's the kind of background to where this case from.

So can I take the Court then, if I may, to two documents which explain Telecom's internal consideration of this? The first is in volume 11, at page 4257. This was a minute – memorandum should I say from Mr Parkes and two of his colleagues to Dr Deane, the chief executive of Telecom, volume 11, page 4257. Just to explain under the heading "Kiwi Share" there's been a text that's been redacted for privilege in terms of the discovery process a factor that's not completely relevant in some of the points we've discussed about reliance. But this matter, this memorandum in March 1999, as Mr Parkes' evidence explains, is the point where there's an approval in principle by the chief executive to go down this track. This is the first time that the 0867 initiative comes together in the form that's announced. It gets massaged somewhat in the discussions with the Crown but up to this point there are two different work streams going on. They haven't quite got the thing together. This is the point at which it arises and it's also relevant to note the timetabling because if one goes back to 1998 the thinking is going on a different framework so looking at earlier memoranda can be quite unhelpful.

The issue, as identified on page 4257, spiralling growth of residential local calls, the Internet, now 20 percent of residential local traffic, growing strongly, estimated to be 40 percent in two to three years, driven by decreasing ISP costs which are now for reasonably priced all you can eat packages and free local calls. It's clear that the lack of economic incentives on customers is driving inefficient overuse of the network and if not addressed will lead to a huge investment of the network and/or congestion from impact on voice traffic which the PSTN is designed for. This 086X proposal is designed to address this. Mr Parkes explains he didn't come up with the seven for another few weeks after this so it was 086X at that stage. And then the proposal is explained in due course in terms of what the proposal is, the segmented data service and over on the next, 4259, discussion of the network benefits. Particularly in

the first paragraph under that heading, "Preliminary discussions held with Dr Milner who was Telecom's technical expert, gave evidence at trial. This has given us sufficient confidence that this proposal on our network, i.e. the division that runs the Telecom network within the Telecom group, to make cost savings and considerably assist in preserving the quality of the PSTN at an acceptable level." This goes to interconnect issues including a recognition of legal risks that Clear will claim the introduction of the 0867 service and charging for PSTN interconnect calls is simply a ploy to avoid payment of termination charges. Based on Clear's track record we should expect Clear to seek an injunction, lobby government furiously and run a PR campaign against the initiative. That didn't take a great deal of foresight and all proved to be true.

Then on 4620, question mark about how to charge or not to charge and then under the next heading "Government and PR" a miscalculation by Telecom. At that stage they would've thought that the approval of Kiwi Shareholder might not be required but in fact it was. So that's the brief introduction.

If I can take the Court then to volume 12, at page 4636. This document is dated 18 May 1999, it's the one I mentioned earlier. It's a business case for Project Morecambe. I do not know why it was called Project Morecambe. It wasn't a matter of – that detained anybody at trial.

TIPPING J:

Well at least they didn't call it Project Wise.

MR HODDER SC:

Well maybe that did detain us at trial. So this is a lengthy document. It runs for, the end of the document is about page 4730 so it runs for almost a hundred pages or so in terms of the various sign offs and the numbering is quite confusing. So just staying with page 4636 for the moment, this is in a sense a cover sheet and although it's addressed to Ms Gattung, who at that stage was not chief executive, the handwritten writing at the top is in fact, was accepted at trial was Dr Deane's handwriting. So this is the chief executive's sign off in relation to this. But you will see on the next page, 4637, a whole series of sign off pages, there are a whole stack of those which interrupt the way in which it's been dealt with. But effectively there is a short business case summary with a whole series of appendices which are set out on page 4636, A through to E, and for our purposes the one that I'll invite the Court to look at in a moment is D and that is the one that has the discussion in particular of the issues that gave rise to this initiative.

ELIAS CJ:

So which page?

MR HODDER SC:

I just wanted to show you the executive summary before I moved to D. If you just flick through the pages. So the cover page is 4636. You then have a couple of pages of people signing off on various parts of the bureaucracy and then you come to page 4642 and this is a memorandum which is part of this process going in, going to Dr Deane but coming from a manager of IS, Information Services Strategy and Architecture, and this is on the technical side, or aspects of it, and you see key findings on page 4642, what the aim of the project is set out under paragraphs number 1, 2 and 3, and then over the page on 4644 there is another memorandum again addressed to the chief executive and this comes from FIP. FIP is sort of the financial performance enforcement part of Telecom, Financial Investment Planning it's called. They are the, sort of the heavyweight bean counters and the particular proposal is for a limited amount of money but the 2.556 million is the, sort of the first stage of what was involved in taking this forward. Then FIP goes on to explain the financial background, the business case is entirely cost avoidance, and then –

TIPPING J:

Where are you referring to that, "entirely cost avoidance"?

MR HODDER SC:

That's – the recommendation says FIP supports, financial background, the next one says the financial basis, the next line, "The financial basis of this business case is entirely cost avoidance. It will deliver mainly for revenue but will prevent large spending on Telecom's infrastructure over the next four years." It goes on about the financial exposure to Telecom is not limited to purely increased infrastructure costs although these are the only avoided costs reflected in the financial. FIP accepts that the avoided infrastructure costs are sufficient financial justification. Then using a different metaphor at the bottom of the page to His Honour Justice Tipping's stick and carrot, you've got fences and ambulances at the bottom of the page. It describes what the risk is and says it creates a fence at the top which is the free calling access, which is 0867, and the two cent minute charge at the bottom which is the ambulance. So if a call does go through you have to pay a termination charge, there's an ambulance which pays or covers the cost of what has to be paid to the other carrier. And the top of page 465, "FIP agrees the risk of explosive Internet growth fuelled by perverse drivers of other carriers and ISPs is very unlikely in the current environment." And so it goes.

On page 4649 –

ELIAS CJ:

So it's justified on the basis of the –

MR HODDER SC:

Network of savings.

ELIAS CJ:

Of the infrastructure –

MR HODDER SC:

Avoided costs.

ELIAS CJ:

Avoided costs but it acknowledges other –

MR HODDER SC:

Yes.

ELIAS CJ:

– benefits not quantified?

MR HODDER SC:

Correct.

ELIAS CJ:

Yes.

MR HODDER SC:

Now, the actual executive summary, which goes almost back to the beginning, is on 4649. As I was trying to explain, the way these were copied into the case interpolate a number of pages, but if you look at the bottom of 4649 you'll see it's actually page 3 of the original document. But this is the executive summary. I won't take the Court through it, but perhaps the essence of it is summarised on 4651 under "Abnormal dial-up growth" – well, the whole section, "Project Morecambe justification", is relevant to this. The first part is dealing with managing costs and then, under "Abnormal dial-up growth" on page 4651, points out the risks of incentives generating growth at an uncontrolled rate, "This set of incentives results in ISPs subsidising residential customers' use of Internet access, creating abnormal growth in dial-up Internet traffic. Currently Telecom has no mechanism to manage the consequential growth in access lines and call volumes other than Telecom's physical capacity to support this growth." The detail of the incentives is presented in appendix D, which is what I mentioned before, and which is to be found on page 4674. Now, the text on 4675 explains this in detail – I'm not prepared to take the Court through it, but can I just point out that the passage that is found at

the bottom of 4675 is the passage cited by the High Court at paragraph 62, it's judgment is quoted by the High Court, and this is where it comes from.

ELIAS CJ:

What, the background in strategic issues?

MR HODDER SC:

Yes.

ELIAS CJ:

Yes.

MR HODDER SC:

And I think the High Court put it in bold, the last part of that, that is to say, "The Interconnect payments are not offset by revenue for Telecom as there is no balancing traffic from the carrier, and there is no revenue from the end user because their local calls to dial-up the ISPs are invariably free residential calls. The interconnect revenue thus earned by the terminating carrier is substantial and it can be shared with the ISPs as an incentive to join the carrier's network." And, over the page, "The concern for Telecom is that this revenue can then be further shared with ISP's customers to encourage them to remain online. As we show in the analysis that follows, the presence of these perverse incentives creates a likely scenario of much higher dial-up Internet traffic than forecast, either leading to unacceptable PSTN congestion for all services (including basic voice services) or requiring substantial investment to increase the capacity of the PSTN and its associated systems."

So, the problem that Telecom was anticipating here was that on this basis it made sense for the carrier and the ISP to pay the consumer to leave the computer on day and night. Money would come gushing down the terminating charges avenue, on that basis, and there was enough to share and incentivise people just to leave the computer on. And what that meant was that one line that was previously handling three-minute calls of a voice nature was tied up absolutely, and the had huge implications for what was to be done to the network. Not only that, but there was a compounding problem about stranding, which is addressed in the next part of page 4676, where it's noted about three paragraphs down from the "EVA and key drivers" heading, "Strategically investment and narrowed band telephony, i.e. the PSTN is contrary to Telecom's vision of leading New Zealanders online…the associated emphasis is on broadband investments and the minimisation of the future risk of stranded PSTN assets." So this was a concern for Telecom as well. If it did have to expend vast amounts of money on the PSTN at a time of dramatic change and the beginnings of a substantial move towards broadband, those would be stranded assets.

And, at the top of page 4677, you see the 205 million figure mentioned, in about line 4, ”Continuing with the status quo was rejected as being too costly, 205 million over three years, both in terms of expenditure requirements and customer impacts.”

BLANCHARD J:
What does “customer impacts” mean?

MR HODDER SC:
I would think it’s the quality of the service, but I can’t be sure, it wasn’t addressed. That if you have a completely unreliable service, because you can’t guarantee your quality, that's what it comes back to.

TIPPING J:
You couldn't guarantee getting through.

MR HODDER SC:
That's right. Now, that figure of $205 million, if the Court’s interested and wants to wrestle with the fine print, is dealt with on page 4689. Now, this wasn’t drilled down to any extent at trial, as I recall it, but on page 4689 in the top box, the do-nothing option, you will recall POTS was one of the FLAs, a four-letter acronym, plain old telephone service, and so this was a growth of lines over the 0867 scenario, and for the three years from 1999 to 2002 that's the number of lines. The next line gives you the cost of those lines at a thousand dollars a line, and those three lines together come to about $114 million. You go two lines further down and you get switching costs in thousands from one of Telecom’s internal models, and those three lines give you about $60 million. Then the next line, which are transport costs, adds up to about $31 million, and those three numbers give you the 205.

So that outlines, I think, where Telecom was coming from in relation to the 0867 package. And, as I think I mentioned, and it’s in our chronology, I think in appendix B at our submissions, the beginnings of sharing of revenue by Clear as a carrier date from about August 1998. I don’t propose to take the Court there, but you’ll find that in the chronological sequence.

Now, just before I move on to describing the arbitrage, just to indicate that this was mostly about Clear. Clear was the primary other player in this process, others were developing as well but it was the major player. But during this period Clear was taking what Telecom perceived to be a consistently difficult attitude, which was understandable, because what Clear’s game was was to change the rules. It didn’t like the Privy Council decision either, and it was seeking to have light-handed regulation replaced by heavy-handed regulation. And as, the references are in our written submissions, and it was quite readily accepted by the former

Clear executives, Mr O'Brien and Mr Forsyth, in their evidence and cross-examination, that there was a strategy to try and make as much noise as possible, to say, "This is all hopeless, light-handed regulation is not working, the Government must do something." And so, when there was a new Government it did do something and, to that extent, that carried the day. But that happens to be going on during this period, and in a way which means that negotiations with Clear were coloured entirely by that process and the narrative should be understood in those circumstances.

Anyway, the arbitrage opportunity, I think, is I hope reasonably clear in relation to those matters. 0867, as I said, was announced in June of 1999, the Crown discussions go on for some period. So, against that factual material, which I am obviously just skating over the top of, bearing that we had six weeks of this in the High Court, the question is, is that bullying going on by Telecom and is it any way to approach a question of the law, just to start using concepts such as bullying? The Telecom case throughout, including at trial, was that this was defensive. These were loss making customers. There were losses being already incurred and the potential to expand hugely in a very short space of time in a quite unchartered future and so action was taken. And in those circumstances the proposition is, and partly this gets explored on the counterfactual that was actually run at trial and accepted and applied by the High Court, this was no more than what would be done by a non-dominant party.

That may be convenient if I were to take the Court to Dr Hausman's evidence, Professor Hausman's evidence. If I could invite the Court to take volume 4. Professor Hausman from MIT was one of the two economic experts called by Telecom. The other was Professor Evans of Victoria University. I'll deal with Professor Hausman. What Professor Hausman said in his brief, and his evidence doesn't materially change on these issues, but if we can just pick it up at page 1430 of the case at paragraph 15.

McGRATH J:

Sorry 1430?

MR HODDER SC:

1430 Sir. He describes the assumptions that he is making from basic economic analysis. In particular they're all fundamental and debated by economists that these are, if they're not self-evident truths there's a reasonably high degree of consensus. The 15th point, "All firms, whether competitive or monopolistic, minimise their costs in order to maximise their profits." And in a sense that's where the analysis for Telecom starts. Paragraph 16 is of some interest because what Professor Hausman says is that economists, when analysing whether the conduct of a firm involves use of a dominant position must start by assessing the firm that was not in the dominant position, would otherwise face the same economic circumstances, would have undertaken the same conduct. I understand the Privy Council and the Courts of

New Zealand have also adopted this approach which has been described as a counterfactual. I understand that to indicate that economic analysis generally finds a counterfactual approach useful.

Then he carries on and this section is, was at the heart, as it were, of the case that Telecom advanced. It's what a non-dominant firm would do. And so as he says in paragraph 17, "A non-dominant firm would be facing the circumstances confronting Telecom in 1999, increasing costs in dial-up Internet demand. Increasing rapidly to the point that it was likely to impact on the quality of the services would have no option but to respond." Now as I understand it, that's accepted by the appellant. There had to be some response. His argument, they say, about how to respond but understanding why there was a need to respond becomes important. Doing nothing would not be an option because the firm would lose some or all of its margin, perhaps even experience net losses while offering reduced quality services.

Paragraph 18 sums it up in some ways. "The reaction of a non-dominant firm in these circumstances would be to reduce its costs where it could, increase its prices where it could not reduce costs and attempt to maintain the quality of its services." Now that was the justification for 0867. Those were the objectives of the 0867 initiative sought.

Paragraph 19, "If the non-dominant firm were unable to take these steps its business strategy would be to cease supply to those customers that are causing its costs to increase and its quality of service to decrease. This reaction however was not open to a firm facing the KSO which was one of the principal constraints affecting Telecom's possible reaction to its increasing problem in 1999." Now I don't want to belabour the point but the Court appreciates that if there is a young person who decides that they want to spend 18 hours a day on the Internet in 1999, using the family phone line, Telecom can't just say, we're not going to supply that anymore. The KSO says you have to supply it, you can't cut them off.

And so that's how Professor Hausman goes on to develop the argument through paragraphs 20, 21, "A non-dominant firm would first look to increase its price by charging something to the customers. Unless it took that step a non-dominant firm would incur a direct loss in each, under the service supplied. Secondly it would look to decrease its costs. It would do this by finding a way to avoid the terminating access charges. A well established method of achieving this would be to move to a bill and keep regime. Thirdly, it would introduce new technology which would better enable it to control the impact of the new traffic flows. The 0867 service was designed to and in fact did achieve this objective." In 24, "The non-dominant firm would design a strategy which would achieve these three objectives." Then he explains that in some detail.

In paragraph 25 the point I was discussing with Justice Tipping earlier, "The introduction of the two cent a minute charge provided economic incentive for Telecom's customers to move to this new more efficient system. No non-dominant firm facing the same circumstances that faced Telecom in 1999 could fail to react in a way similar to that identified above, if it were to work in accordance with the assumptions outlined by me above." He then goes on, and then there's a debate between Professor Hausman and Dr Bamberger who was the Commission's expert. The matter is the debate that the High Court resolves in favour of effectively Professor Hausman and Telecom and we say quite properly in the evidence. But all those were explored in the context of these kinds of considerations through the counterfactual. It wasn't a matter of standing back and saying, Telecom was bullying somebody else. That it's enough to say it's self-evident this is a use of market power but there's not much more sophistication than what the Commission has been putting to this Court.

Now at this point, if it pleases the Court, I'm going to start to talk about the law, possibly for some time. Can I start with, the Court obviously knows where I'm going. I'm going to resist the proposition the Chief Justice has been urging and just look at the words of the statute. That this isn't going to help us here very much. But what we are talking about is in fact the purpose of interpretation and the proposition is, that what the Privy Council did in both *Telecom v Clear* and in *Carter Holt* was to give a purposive interpretation to section 36 and so has the High Court of Australia, consistently, and indeed a point I'll come to is that the High Court of Australia and the Privy Council are largely in tune with each other and one of the difficulties that we have with the approach advanced, not only by the Commission but it turns out by the intervener, is the proposition that there is a need to reverse a decision which was a conscious harmonisation with Australian law. That is to say *Carter Holt* and I'll come back to this but there was a deliberate reliance and use and harmonisation with the *Boral* decision and I'll come to both those cases later, but my proposition to the Court will be that those cases reflect the same purposive approach to these kinds of issues. If I can also kind of anticipate where this takes us in terms of how does one give a signal if one's in Parliament then the answer has, in fact, been given by the Australian Parliament. In the last two years the Australian Parliament has passed radical amendments to section 36, designed to protect small businesses. If Parliament wants to give a signal that it doesn't like the existing law, then it can do what has happened in Australia, where that legislation, as I'll come to later, is a reaction to *Boral* and to *Rural Press,* and so Parliament has passed legislation, in particular the provision at section 46(6)(a).

TIPPING J:

That's to take into account those four things.

MR HODDER SC:

Including anything you think of in the bottom, yes.

TIPPING J:

Well, that's one of the four.

MR HODDER SC:

That's the one. The kitchen sink is, I think, subparagraph (d). But that's where it is. So, if I can just back off and pause, to the proposition that says, "The Privy Council is out of line and what we need is harmonisation." Harmonisation with what? The Australian Parliament has deliberately rejected the law from *Boral* and *Rural Press.* Are we going to harmonise with *Boral* and *Rural Press*? Well, if we are, we've done that, that's what *Carter Holt* does. If we're going to harmonise with section 46(6)(a), perhaps we'd better wait till Parliament passes section 36(6)(a), which it hasn't done.

TIPPING J:

But isn't the essential argument, Mr Hodder, that the Privy Council has made the counterfactual mandatory, whereas the High Court of Australia has it – forget the recent amendment in (6)(a) – has it one, maybe a very important one, but not the sole, that's all we're being asked essentially to alter.

MR HODDER SC:

I think that's what you are being asked to alter. The reality is that the High Court of Australia has always applied a counterfactual. There is discussion, which I think you, Sir, pointed out earlier in this hearing, there's not exactly a ruling in *Melway* discussing the concept of materially facilitating but not applying it. And it is in each of the cases that we are concerned with, from *Queensland Wire* through *Melway* through *Boral* through *Rural Press* through *NT Power*, it has applied a counterfactual, it has never applied another test.

Now, what I was about to say before I got diverted by the conclusion I was –

ELIAS CJ:

A Judge.

MR HODDER SC:

No, the conclusion I was going to come to, was the proposition that this legislation is economic law and economists have a role to play. It's a slightly shocking proposition for lawyers to advance, but let me do so, that because it's talking about economic objectives, because it's talking about economic concepts, then there is a place for economic input into process. That happens to be reflective of the fact that in these cases almost always there is a

lay member appointed, almost always an economist, and invariably we finish up, as my learned friend Mr Farmer said, with a hot tub involving economists, with its own –

TIPPING J:

Well, I gather the lawyers get into the hot tub as well. That's a novelty to me, Mr Hodder.

MR HODDER SC:

The phrase or the novelty…

TIPPING J:

Both.

MR HODDER SC:

Yes, well, occasionally – it's a rather gruesome metaphor, I do acknowledge, but for the most part if you can just –

ELIAS CJ:

Sounds very unhygienic really.

MR HODDER SC:

There's all sorts of hares that I will not pursue here, Your Honour. The proposition I wanted to put to the Court, which I will take from a case called the "*AMPS-A*" case. It's not in the bundle and I don't propose to give you copies, but the Court will be familiar with it. It's *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429, and there was a discussion about whether or not Telecom was entitled to acquire part of the spectrum, the decision of the Court of Appeal with a Court of five, presided over by Sir Robin Cooke, and with Richardson, Casey, Hardie Boys and McKay JJ, and the proposition that was put by Richardson J in that case, at page 441, "The Commerce Act is based on a premise that society's resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources" – I'll come back to "efficiency", he cites *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352, 358 – "That is the stuff of economics, and for economists expressions such as "competition", "markets" and "efficiency" immediately convey recognised concepts capable of description, debate and application. As Deane J observed in *Queensland Wire,* the starting point of the enquiry under the Trade Practices provision was the fact that the essential notions of markets and market power, competitors and competition and the objective which the section was designed to achieve were all economic ones. While it would be naïve to think that economics furnishes a body of settled conclusions dispositive of any particular factual circumstances, economists can assist the Commission and the Courts in identifying, explaining and debating

economic theory, including rival theories and their applicability in particular circumstances. And the uneasy relationship between economics and law is likely to improve as lawyers and economists become more familiar with each other's discipline."

Now, with respect, that is at the heart of the proposition that I wish to put to the Court as to why a purposive approach is appropriate. The purpose of this legislation is to promote competition. Section 36 is to be read in that context. And in each of the jurisdictions of New Zealand, of Australia and of the United States, a similar purposive approach has been taken to inject economic concepts into the legal texts that are relatively broadly phrased that deal with this area. The "concept of efficiencies", which is mentioned by Justice Richardson, is an important one, because it's efficiencies that give rise to consumer benefits. Those efficiencies, as the Court is doubtless aware, are sometimes categorised in three ways as being either dynamic, static or allocative, but the end result is a consumer benefit. The dynamic means you have innovation, the static means you get the lower prices and the allocative means that resources go to the part of the economy that can most appropriately reward them and use them. Those are the ways in which one gets, in the long run, consumer benefits.

The point that's critical in relation to the cases that this Court is being asked to consider, or reconsider, is competition and efficiency by large firms. And, as I'll come to, there's been a change in thinking over the 20th century about that. But what concern underpins *Queensland Wire* and *Telecom v Clear* and the subsequent cases is that large firms should compete and should be able to compete on the basis of reasonably well-understood ground rules, recognising that competition inherently involves damage to competitors. That's, I think, the outline. Where the spread of jurisprudence that this Court has to consider, in our submission, it runs in fact from *Olympia* which is Posner J's decision of 1986, through to the 2008 amendments to the Australian Trade Practices Act. There's a lot of territory in there, but the points that I made, I think, follow in explaining the developments in all those cases.

If I can just foreshadow the proposition in relation to the 2007/2008 Australian amendments, what happened there is that there was a strong reaction, politically, to the *Boral* decision, and an even, probably an even worse reaction to the *Rural Press* decision. So, the Australian Senate set up a subcommittee or a committee designed to look at the implications for a small business of the way in which section 46 was being applied. And, surprise, surprise, the Senate Committee came back with a decision that small business might feel more comfortable if *Boral* and *Rural Press* weren't in fact the law, and in due course the "Birdsville amendments", as they were called, came through in 2007 and then a separate set of amendments in 2008, and those are the explicit changes to section 46, for which we have no comparable changes in our legislation.

So, it's the case law focusing on the importance of competition by large firms, and then we have the most recent Australian legislative reaction, which is in fact that on the evidence we have, on the authorities we have, have been triggered by concerns for small business. Those are issues which, with respect, are not well suited for judicial determination, which is one of the reasons why I have submitted already, and we'll come back again to the proposition, that those are matters where we'd prefer that parliamentary action is appropriate to be waited for.

So, in outline, the propositions for Telecom are, firstly, that the Commerce Act is economic law and economic analysis is critical, and trying to avoid it by saying the counterfactual shouldn't be used doesn't help us. We will support the proposition that section 36 and the reference to "use" requires a connection – and I'll refrain from using calls or connection for the moment – between dominance and the proscribed purpose, but it's the counterfactual analysis that illuminates that connection.

TIPPING J:

Is it the connection between dominance and purpose or connection between dominance and conduct, or both?

MR HODDER SC:

Both, both. This will become more clear from my learned friend Mr Shavin's analysis of the actual counterfactual permutations used in this case at the trial but in our submission the counterfactual analysis explores every aspect of what may be relevant to this process. It doesn't define away the problem. The people who have to deploy it are alive to those issues. There may not be immediate agreement. There may not be simplistic answers to what the counterfactual should be, but consistent with what Richardson J said in the "*AMPS-A*" case, they do give you basis for exploring those difficult issues and coming up with reasoned considered decisions. So our proposition is that the Privy Council's approach in this area is considered, it is principled and it is settled and it is consistent with the High Court of Australia decisions.

Now there are two tests which I'll come back to later on which are being dealt with in the submissions for the appellant in particular. One is the materially facilitated idea and that was I think slightly backed away from an oral submission and the second is what's called the Deane J approach from *Queensland Wire*. In our submission they both, and in particular the Deane J approach, still add up to a counterfactual analysis. They're a variation on a counterfactual theme and that's not surprising. If you have a section that says, thou shalt not use dominance for a proscribed purpose, one of the ways of testing it is then to say such a thing as to say, well hang on, if you didn't have the dominance, what would or could you do? It's a perfectly rational, logical and inevitable question to ask. It's not some obscurity imposed on the process by some aberration or aberrant thought process.

The factual enquiry self-evident approach which is also part of Commission's proposals to this Court in its submissions, with respect, is unprincipled. It makes hindsight the decisive characteristic and in our submission the Privy Council is right, as was the High Court of Australia, in endorsing this point, to say that even a monopolist should know what they're going to do when they want to compete. It's part of the rule of law. It doesn't matter that it's not specifically covered by section 26 of the Bill of Rights Act. The proposition that parties can have some reasonable knowledge of where the boundaries are before they start, is fundamental to any aspect of the law, where there's a choice to be made.

ELIAS CJ:

But counterfactual, however, depends on the factual enquiry which necessarily will be undertaken ex post facto so is there so much more certainty in a counterfactual as opposed to a factual enquiry? I mean I'm not –

MR HODDER SC:

Can I –

ELIAS CJ:

– cavilling at your principal argument it's just your reliance on that strand of the Privy Council's reasoning that it's more certain.

MR HODDER SC:

Well can I take the premise, if I may by way of response, which is that ex ante consideration is possible. There is an article in our materials from an American I think the Leary article, I'll come to, I think he's ex-Federal Trade Commission but his proposition is that the critical place for anti-trust law to be enforced is by in-house counselling.

ELIAS CJ:

Yes, you referred to that in your submission.

MR HODDER SC:

So the same proposition applies here. If in-house counsel, or any counsel giving advice, know that the question is, what could rationally a non-dominant firm do, that's a quite different basis as giving advice to the proposition that says, it depends on whether the court thought it was justifiable. That's what the Privy Council reacted against –

ELIAS CJ:

Yes.

MR HODDER SC:

– in *Telecom v Clear* so with respect you can't accept the proposition for Telecom that it's always going to be after the event. Yes there will be disagreement about the details in a case such as this one. Do you consider the KSO as being in or not? Is there an ICA with imbalanced asymmetric charges? Well what you do, is you consider both propositions as part of a consideration. It doesn't say one counterfactual test, it says the counterfactual approach is a necessary way of questioning whether or not you can, in fact, get to a proposition as a use of market power. Now I think I've answered Your Honour's question but I'm not sure.

ELIAS CJ:

Yes I don't think – yes you have. I think in fact what I was putting to you is quite consistent with what you're saying. That – when you say that there isn't one counterfactual test, it's a methodology that people can be conscious that they can use. They may well get it wrong. I was really exploring with you the identification of the facts, that in the end will matter, but I think you've accepted that the fact that there will be contestability around the facts –

MR HODDER SC:

Yes, yes.

ELIAS CJ:

– doesn't affect the thrust of what you're saying.

MR HODDER SC:

Yes and I don't understand the Privy Council to be saying anything else.

ELIAS CJ:

No, no, I understand that and so at some points of the argument the proposition seems to be that what's been mandated by the Privy Council is something incredibly prescriptive which is a straightjacket which destroys the effect of section 36. We, with respect, there was no substance to that. Not least because of the flexibility which, in our submission, is found by exploring these issues.

TIPPING J:

Mr Hodder, the ultimate problem in these cases is to distinguish between vigorous competition and illegitimate competition, isn't it?

MR HODDER SC:

Yes.

TIPPING J:

Which statutory term carries the weight of that? Is it "use"?

MR HODDER SC:

Yes. Well under the jurisprudence we have in the High Court of Australia and under Privy Council, yes.

TIPPING J:

"Use" but surely not divorced from "purpose"?

MR HODDER SC:

Ah, in part that's what the jurisprudence has done on the grounds –

TIPPING J:

It seems to me –

MR HODDER SC:

– that it's too easy to go from purpose –

TIPPING J:

Not too easily, no. There's a caution there but it's not a warn off, surely, of viewing purpose as part of the equation?

MR HODDER SC:

Well there's no doubt – perhaps I can answer this way. There's no doubt that at the end what the Court has to do, any Court has to do, is ask itself has the section 36 language been satisfied.

ELIAS CJ:

I thought you were trying to warn us off that in your opening remarks. Don't start with the statute.

MR HODDER SC:

That's where you end, with respect.

ELIAS CJ:

Ah. It's conventional to start with the text.

MR HODDER SC:

Well one can start with the text but then one is left then with the difficulty that says that the moment that I got this problem I don't quite know what this means because if one looks at it in terms of –

ELIAS CJ:

It shouldn't matter. It shouldn't matter if you start with use of a dominant position. That's where you end as well. The rest is just methodology.

MR HODDER SC:

Conceptually Your Honour is, of course, right. The methodological terms, the final appellate courts, both our previous system and the Australian system, have found it appropriate to break it down to some degree and they have expressed repeated concerns that if you start with purpose, for example, you tend to get to the wrong point too quickly and then that goes back to the policy of the purposive approach which is you make it too hard for large firms to compete. If they don't compete you don't get the benefits of efficiency from them and they're an important part of the economy. So that's why *Queensland Wire* and *Telecom v Clear* right through to the most recent cases have gone down that track.

BLANCHARD J:

Mr Hodder, a little while ago I thought you said that the material facilitation approach or the Deane J approach were just variants of a counterfactual.

MR HODDER SC:

Yes I'm going to come back to that. Deane J is easiest because Deane J says "only" so whenever you say "only" well the obvious thing to say is take it away and what happens, that's the counterfactual approach. I'll come back with the text tomorrow with respect to Deane J.

BLANCHARD J:

Are you saying that because they're variants of a counterfactual they will be open to a New Zealand Court? If it thinks – that it's an appropriate approach?

MR HODDER SC:

Materially facilitated is slightly more complicated and less attractive for the Court I will suggest tomorrow but it terms of Deane's J approach when analysed it boils down to a counterfactual. It's just framed in a different language.

BLANCHARD J:

Mmm.

MR HODDER SC:

If you can only do this because of the nature of the market, you look at the nature of the market both as it is and as it might be. You do nothing different in the end. Your Honours, it's 4.01 according to the clock.

ELIAS CJ:

Is that a convenient point?

MR HODDER SC:

It's a convenient point. Tomorrow I will go into the particular cases we're concerned with, the Privy Council cases and the High Court of Australia cases and the legislation.

ELIAS CJ:

Yes thank you.

COURT ADJOURNS: 4:01 PM

COURT RESUMES ON WEDNESDAY 23 JUNE 2010 AT 10.02 AM

ELIAS CJ:

Yes, Mr Hodder.

MR HODDER SC:

May it please Your Honours. What I want to do this morning is to address you on the case law and the legislation that has to be considered by the Court as part of the determining this appeal. In relation to the cases, this isn't simple material, so I may be chastised by taking you to too many cases, but there are seven appellate cases from the Privy Council and the High Court of Australia that are relevant in this context and, in our submission, they show a degree of consistency which is not recognised in the submissions advanced for the appellant or the Intervener.

If I can indicate roughly where I'm going and then I'll attempt to go there via the cases. The first proposition is that this case is one which indicates that the statutory language has to be given a purposive meaning that is to enforce fair and appropriate competition and efficiencies associated with it. Clearly enough, the language of section 36 given us perhaps usefully four elements, which can be thought of as conduct, dominance, use and purpose, and it's the permutations between those that the case law is wrestling with in order to answer the question of whether there is or is not a breach of section 36.

In these cases that I'm discussing, the Australasian cases, there is a focus on use. It is seen as in the method of connection between conduct and dominance: if there is use it's not difficult to then have the further connection with purpose. The Privy Council and the High Court of Australia have also been on common ground and it's dangerous to reason from purpose to use, and one of the ways of avoiding that risk has been the use of the counterfactual tests. The use of dominance would not be found in the competitive market, so the question is, is the conduct such that a non-dominant firm could rationally engage in it? That is to say, without incurring adverse economic consequences. The High Court of Australia has used the words "likely" and there is a degree of flexibility in that formula. There is also the idea of a counterfactual inherent in the "could only" test, which is the one associated, among others, with Justice Deane and *Queensland Wire.* This could only be done. That itself implies a counterfactual that's not articulated and has a degree of risk in the sense that it runs the risk of running conduct and power together to find purpose and then use, which is not the way that other Judges have dealt with the matter.

ELIAS CJ:

Well, could it be, "was only done because of the dominant position"? Is it the "could" that you're quibbling with?

MR HODDER SC:

It's the "could" that I'm focusing on, yes.

ELIAS CJ:

Yes.

MR HODDER SC:

And I'm suggesting that the word "only" is the key to the fact that there's really a counterfactual. If you say "only", you have to compare it with something.

TIPPING J:

And that's the "could" in the sense of enabling.

MR HODDER SC:

Yes.

TIPPING J:

"It was only the dominance that enabled…"

MR HODDER SC:

Yes, that's the approach that's taken when that phrase is used, particularly in *Queensland Wire.* And we submit that it also explains a direct observation and self-evidently concepts. If one says that self-evidently there's a use of dominance, one is effectively inferring a mental process that involves a counterfactual. Now, we'll come to *Melway* in due course, but that's what's said there. The facts of *Melway* were an interesting example of why it didn't require an economic analysis of the kind that hot tubs and learned economists from around the globe have, there was simply an historical example of a counterfactual that was available. Further, the Court should be aware that this is the language of legitimate business decisions or legitimate business advantage used, that also involves a counterfactual analysis. Because to answer the question, "What is a legitimate business decision?" one has to go back to what is likely and expected in a competitive market. If it's something which would be expected and an advantage which was sought in an competitive market, then you're on the right side of the line between legitimate and illegitimate competition, otherwise you're not.

The most difficult concept, in our submission, is the materially facilitated part that we find the language from, first used in *Melway*. And, in relation to that, our primary proposition is that, that is in effect another search for words to capture the concept of connection. It really

focuses on the verb "facilitate" and, in a sense, it's almost superfluous when already we have "use" and "take advantage" and "rely", then "facilitate" isn't actually saying very much that's different. Alternatively, it may be that it's an elaboration or a clarification of the "could only" in the sense that the "only" is absolute and "materially facilitate" qualifies the absoluteness of the "only" way. That, we suggest, is the way in which that language is best understood and it does fit in with the balance of the case law and the decisions in all the cases, all of which in fact apply the counterfactual analysis.

Now, the question no doubt is whether or not I can make that good on the case law, and the case law, as I indicated yesterday, for practical purposes and leaping outside Australasia for a moment, really runs from the *Olympia* decision in 1986 through to *NT Power* in late 2004. There have been no ultimate appellate decisions since that period. The reason for mentioning *Olympia* is that it is cited with approval both in *Queensland Wire* and in *Telecom v Clear* and it's important, in our submission, because it is the case that indicates the purpose of approach to this language. And so if I can invite the Court to spend a minute on it, it is to be found in volume 2 of Telecom's bundle of authorities at tab 38. It may be that the Court's familiar with the case, but it's a decision from the United States Court of Appeals of the Seventh Circuit from 1986, and the panel and the author, the panel included Judge Posner and he was in fact the author of the decision, and that has probably given it a life of its own in some senses, given the Judge's –

ELIAS CJ:

I'm sorry, is it the appellant's case?

MR HODDER SC:

No, respondent's.

ELIAS CJ:

Respondent's, thank you.

MR HODDER SC:

Tab 38 of volume 2, Ma'am.

ELIAS CJ:

Yes, thank you.

MR HODDER SC:

The facts don't really matter for our purposes, except to say that the defendant had in effect created a secondary market, then decided it wasn't a good idea and removed the secondary market and some of its own equipment. And so one of the questions that directly arose was,

"Are you required to give a helping hand?" But the point of principle that I want to focus on for present purposes is at page 375 of the report, and it's the bottom of the left-hand column, the paragraph beginning, "Opinion about the offence of monopolisation has undergone an evolution. Forty years ago it was thought even a firm with a lawful monopoly could not be allowed to defend its monopoly against would-be competitors by tactics otherwise legitimate. It had to exercise special restraint, perhaps indeed had to hold its prices high to encourage new entry. So Alcoa was condemned as a monopolist because it had assiduously created enough productive capacity to supply all new increments of demand for aluminium," and he goes on a few lines later, "Later, as the emphasis of anti-trust policy shifted from the protection of competition as a process of rivalry to the protection of competition as a means of promoting economic efficiency," then there's a long series of citations put in brackets. It goes on to say, "It became recognised that the lawful monopolist should be free to compete like everyone else, otherwise the anti-trust laws would be holding an umbrella over inefficient competitors," and quoting another case, "A monopolist, no less than any other competitor is permitted and, indeed, encouraged to compete aggressively on the merits."

Now, that all seems old hat today, because that's been quoted in many of these cases. But the point at the top of the right-hand column, the emphasis of anti-trust –

TIPPING J:

But, just before you go on, the key phrase it seems to me in that dictum is, "on the merits."

MR HODDER SC:

I accept it's one of the key phrases. The phrase I was wanting to emphasise to Your Honours was slightly further up, that, "the anti-trust policy has shifted from the protection of a process of rivalry to the protection of it as a means of promoting economic efficiency," which I think is the same thing as competing on the merits.

TIPPING J:

Yes, if you are competing in the sense of promoting economic efficiency, –

MR HODDER SC:

That's on the merits.

TIPPING J:

– then that's on the merits.

MR HODDER SC:

Happy to accept that, yes. So that's one part that carries forward, that there's a policy element here that the efficiency and benefits for consumers are important. Protecting rivals for its own sake is not the process.

The other passage, I think, that it's also well known for is on page 379, which is a critique focusing on assumed purpose and intent. And His Honour is discussing the fact that, in some cases, intent is extremely important and leads to the conclusion that competition law is different. So halfway down the first paragraph on the right-hand column on 379 there's a reference to *Keeble v Hickeringill,* and just above that is the extract I'm drawing the Court's attention to, beginning, "Competition which is always deliberate has never been a tort intention or otherwise." I won't read the text to Your Honours, but that paragraph the next one beginning, "Most businessmen don't like their competitors or, for that matter, competition," carry through the proposition that that is what happens in those circumstances, and consumer would be worse off if a firm with monopoly power wasn't competing but was getting distracted in relation to lending assistance or protecting competitors.

Now, in New Zealand that case was picked up, relevantly for our purposes, in the High Court decision in *Telecom v Clear,* and that is in fact in tab 74 of volume 3 of our bundle of authorities. It's a long judgment and I don't want to spend long on it, but the *Olympia* passage that I have taken the Court to, or the first of them, is picked up by the Court at page 194 and goes on to 195. Just to recall, the Court comprised His Honour Ellis J and Professor Maureen Brunt, and I think it's recognised by all those who dabble in this field that Professor Brunt was highly regarded in this area –

TIPPING J:
What's the tab? I'm awfully sorry, Mr Hodder, tab…

MR HODDER SC:
74, Sir,

TIPPING J:
Oh, 74, I beg your pardon.

MR HODDER SC:
And I was drawing the Court's attention, Sir, to page 194.

TIPPING J:
Yes, thank you.

MR HODDER SC:

So, you see the heading, "Section 36 and the obligations of a monopoly facing competition," this is in the context of Telecom and Clear debating the merits of payments for access, for local access, and the preface to the Posner extract, "Overseas jurisdictions, in particular the US, UK and Australia, have had more experience of the problem than have we. In our view, a classic exposition of the obligations and rights of a firm possessing monopoly and power is contained in the judgment of Posner J." And then it goes on and sets that out over the next while, then goes on to draw similarly in relation to an extract from McGechan J in *Union Shipping,* and then His Honour's *Magic Millions* judgment from 1990 or thereabouts, and then goes on to cite the Australian High Court in *Queensland Wire,* then *Queensland Wire* also cites from Posner in similar terms about what it is that monopolists are expected to do in these circumstances.

And that is the way in which we say that policy concept from Posner and *Olympia* gets brought in to this scenario. If one goes over the page to 196, we see that the counterfactual is being picked up here in the early stages in the paragraphs in the middle of the page, counsel for Clear submitted that what *Queensland Wire* shows is that once conduct not possible in a competitive market has been identified, breach will follow virtually inevitably, so there's an assumption that we're into counterfactual territory, it goes on and discusses that and sets out what is perhaps the most cited passage from *Queensland Wire* from the joint judgment of Sir Anthony Mason CJ and Wilson J, "In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only," and I'll come back to that, "only by virtue of its control of the market in the absence of other suppliers that BHP can afford in a commercial sense to withhold Y-bar from the appellant. If BHP lacks that market power, in other words, if it were operating in a competitive market, it is highly unlikely that it would stand by without any effort and allow the appellant to secure its supply of Y-bar from a competitor." And that captured some of those words which keep on recurring, "only" crops up often, "if" crops up often, and the concept of commercial sense we have resonance of when we get to the Privy Council formulation of "could rationally". All of that, we say, is unsurprising and relatively commonplace in these authorities that I'm discussing at this stage.

The other aspect of the case which is perhaps worth spending just a very short time on, is the efficiency. One recalls Posner's reference to efficiency in *Olympia*. On page 217 of this judgment the Court first discusses monopoly profits, which was perhaps the major topic of debate in that litigation. But after setting out the 1, 2, 3, 4 propositions, after saying the Court wasn't a regulatory agency, the Court goes on to say, A, the telecommunication industry is an unusually complex industry, and then, another paragraph on, "Yet failure to use a pricing rule that charges for access to Telecom's network, that charges for the incremental cost imposed on Telecom, that shares the KSO, would, not might, foster the development of uneconomic bypass in the proliferation of uneconomic operators. In the end, it's our judgment implementation of the rule is more likely than the alternatives to improve efficient competition

in New Zealand telecommunications. In that case, Telecom can not be said to be using its position of dominance for the purpose of preventing or deterring Clear from engaging in competitive conduct in the market. If the defendant's conduct is more likely than not in light of available alternatives to improve competition, the defendant cannot be said to be in breach of the purpose requirements of section 36. There is a improvement in competition when there is an enhancement of an efficient competitive process. Effect does not necessarily imply purpose." And part of that goes to His Honour Justice Tipping's point about competition on the merits and efficiency, they are related, and they come together in that paragraph.

Now, that's all that I wanted to say by way of preface, in effect, to coming to the Privy Council decision in *Telecom v Clear* and the Court would be forgiven from listening to the submissions to think that the Privy Council in *Telecom v Clear* had, by some leap of logic completely unknown to humankind before, arrived at the proposition that a counterfactual might be useful. And the point of going to these first two cases is to show that it's in the context of the developments that had come through to that point. The Court of Appeal overturned the High Court in that case, largely on the grounds of monopoly profits. It said, "We're not satisfied there aren't monopoly profits and we can't see how this can be anything other than anti-competitive if it maintains monopoly profits." In brief, the Privy Council said, "We can't find any evidence that satisfies anybody that there were monopoly profits, but even if there were that's a matter for Part 4 of the Act, not Part 2 of the Act, and so the matter was reversed in the Privy Council. Now, the Privy Council decision is in tab 3 of the appellant's bundle of authorities, and I've no doubt the Court's looked at this with some care already and I won't take too much time. The famous passages are those on pages 402 and 403, so can I spend a moment on the less famous passages?

ELIAS CJ:

Sorry, which…

MR HODDER SC:

It's tab 3 of the Commission's bundle.

ELIAS CJ:

You're looking at the Privy Council judgment?

MR HODDER SC:

I am.

ELIAS CJ:

Yes, I've got it – yes, tab 3. But did you say page…

MR HODDER SC:

I was starting from page 396.

ELIAS CJ:

Thank you.

MR HODDER SC:

Although this is setting out in part the Baumol-Willig rule, which was the general state, but it has included some commentary from the process, and around lines 25 and thereafter the point about efficiency is made in the same way that we saw in the High Court, "If Clear is not charged the same amount for use of the PSTN as Telecom is charging itself and therefore its customers, then Clear can be less efficient than Telecom in a contested area, i.e. the provision of local service to customers, and still undercut Telecom's prices for a similar service. So there's a concern for efficiency there. There's also a concern for efficiency which can be seen at the bottom of 398 and 399, where there's a discussion of the High Court's approach. The very end of 398, "Clear's suggestion of a free exchange of calls will give Clear a free ride on Telecom's network and allow Clear to out-compete Telecom in areas where Clear is less efficient," and then it goes on and quotes the summary from the High Court decision. It says, "Page 90," it's actually page 214 of the report that I've referred you to in our bundle. And it found virtue in the Baumol-Willig because what would happen was that there would be competition, as it were, on the merits, in the area in which the parties were competing, and that is to be found on page 407 in the paragraph beginning about line 31, "It follows that the risk or monopoly rents has no bearing upon the question whether the application of the rule prevents competition in the contested area. If both Telecom and Clear are charging their customers the same in the area in which they are not competitors, this does not have any effect on their relative competitiveness in the area in which they compete. Therefore the underlying object of section 36 will be achieved if the rule is applied." The underlying object being to promote competition. And then just at the end of that paragraph, "The Court of Appeal took the view that section 36 had the wider purpose, beyond producing fair competition, of eliminating monopoly profits." Their Lordships did not agree, and that was the way in which the case was ultimately decided.

So those, as it were, around the fringes. The real dialogue, the real analysis of the issues that concern us are on pages 402 and 403, which have the numbered propositions set out by Lord Browne-Wilkinson before the Board. I don't know that I want to spend a great deal of time taking you through them because you will see them.

The essential proposition that we are concerned with from the prospective of the defendant, who I defend under a section 36 proceeding, is probably on page 403, and the concern about clarity, which we find in point 3 and point 4, so is point 3 about line 15 on page 403, "The

Privy Council agrees with the Court of Appeal that ultimately the question depends on the true effect of the statutory words used in section 36 and not on any economic model. But the statutory words provide no explanation as to the distinction between conduct which does and conduct which does not constitute such use." Now, that problem is recognised in all the cases, which is why there's, A, so many cases and, B, so many words. Both the High Court and the Court of Appeal proceeded on the basis, with which their Lordships agree, that if the terms Telecom were seeking to extract were no higher than those in a perfectly contestable market, it was not using its dominant position. So the counterfactual, as the Privy Council perceived it, was a matter that the New Zealand resident Courts were happy to adopt in this case, and it was implicit in the Baumol-Willig rule itself, which goes back to my reference to Professor Hausman yesterday, but that's the way an economist might think about it. And then that paragraph or that section concludes, "The Baumol-Willig rule is a closely-reasoned economic model which seeks to show how the hypothetical firm would conduct itself," i.e. it's a way which one assesses and analyses the counterfactual question which it was thought all the Courts agreed was appropriate.

And then we come to point 4 and the now well-known phrase, "It's legitimate and necessary to consider how the hypothetical would act in a competitive market." Its point is that you have to then focus on the particular circumstances of the firm in question. And one of the reasons why that was important in this case was because it comes to the question of opportunity cost. If you didn't take into account that Telecom was readily integrated, you didn't understand the opportunity costs that were relevant. And that was a fundamental distinction between the Court of Appeal's approach and the Privy Council's approach.

And then at point 5 their Lordships expressed reservation about the view that it – in the end asked whether the defendant had acted reasonably or with justification, and then we come to the clarity point, "If this were in itself the test of use of a dominant position then the monopolist firm would be placed in an impossible position. If asked by a competitor to provide an essential service, the monopolist could have little idea what in the future a Court would find to be reasonable or justifiable. Different minds can easily reach different views on what it reasonable or justifiable." And in terms of an ex-post and ex-ante analysis, in our circumstances we would be discussing today what it was that Telecom should have thought was justifiable something like 11 years ago. And so that section concludes, "In their Lordships' view, section 36 must be construed in such a way as to enable the monopolist, before he enters upon a line of conduct, to know with some certainty whether or not it is lawful," and then there's the phrase which had the inaccuracy in it and which when corrected is regarded as a standard proposition that comes from the Privy Council decision. My learned friend Mr Jagose wanted me to point out that Justice Blanchard was the first person to correct the Privy Council, in a case about private hospitals in 1994. So…

TIPPING J:

You mean, he read "unless" as meaning "if".

MR HODDER SC:

He did, he did. Now, before I move off this, can I deal with the question of certainty and clarity. Now, there's a tension in the law always between certainty and clarity in advance and ex-ante decision-making, and examining all the facts with great care and coming to an ex-post conclusion, and in the Intervener's submissions, the Court will recall, there's a reference to say, "Well, that's overstated. Why should there be any great certainty for monopolists?" Well, the answers are largely in what the Privy Council says, but one of the things that the Intervener's submissions say is, "Well, look at tax and look at this Court's decision in *Ben Nevis* of recent times." Now, in part, we suggest that there's any answer to that, that there is a clarity available in the tax area by virtue of the Part 5A Binding Rulings Regime. That was devised, as the Court will be aware, after a long process presided over by Sir Ivor Richardson of reforming that area, and it was designed to enable just that, that commercial clarity was thought to be important in this area. Under the Commerce Act, it is not possible to do that. Section 58 of the Commerce Act provides for authorisations, but not for matters that may be covered by section 36. So, in those circumstances, we'd suggest that there is a meaningful and important distinction to be made there.

Beyond that, the question of certainty is regarded as important in other jurisdictions. In this field of anti-trust, I just mention to the Court without taking it to it, the recent *Pacific Bell Telephone Co v LinkLine Communications* 555 US decision of the United States Supreme Court, which follows its earlier decision of *Verizon v Trinko* – that's in our materials at tab 40 of our volume 2, and the pages I invite the Court to consider are pages 12 and 13 of the report. As I say, I want to take the Court there, but that's really what it's discussing. The same –

McGRATH J:

The problem I suppose, Mr Hodder, is the problem of the very general language that's used.

MR HODDER SC:

It is, and what the Courts, we say, have been doing over a period of two decades and through a whole series of decisions, is attempting to refine some guidance out of that very general language. And that's been an issue not only in the United States and Australia but also in this jurisdiction.

TIPPING J:

In the tax case the Court said that Parliament hasn't chosen to go beyond the general, it doesn't behove the Courts to do so. I understand your point about binding ruling, but is there something in that in general terms?

MR HODDER SC:

Again, there's always going to be a tension for the Court. Their entire jurisprudence is full of situations where the Courts have taken a piece of apparently very broad language and have refined some ways of making it have some clarity. That's an ongoing part of the judicial role, is to clarify legislation that's framed in broad terms.

TIPPING J:

Well, yes and no. Sometimes it may be appropriate, but in other times it may not, it may be better to leave it as Parliament has written it, rather than gloss it in a more focused or sharper way. It may be very convenient on some sides of the ledger to have it sharp, but the other side of the ledger doesn't necessarily support that.

MR HODDER SC:

Well, I don't think I can disagree with the yes and no part of proposition that Your Honour's put to me. Inevitably there is going to be a question of judgment in relation to this, so if one thinks that one wants to leave the language broad for application then one criticises other things as a judicial gloss, if one doesn't want to do that because some clarity is useful then it becomes a helpful judicial refinement of the broad language of the statute.

TIPPING J:

But as long as the sharpening is wholly consistent with the purpose of the legislation.

MR HODDER SC:

Yes, that's an entirely acceptable proposition.

TIPPING J:

Yes.

MR HODDER SC:

That then comes back to the question, "What is the purpose of this legislation?"

TIPPING J:

The purpose of it is to draw a line which Parliament has chosen to draw very elusively between good and bad competition.

MR HODDER SC:

Yes, and in deciding how to do that and whether it's appropriate to give some guidance on it, then the various factors that the Privy Council sets out on this, page 403, and that are in the cases such as *LinkLine* in the United States jurisdiction, give it a clue as to which way the New Zealand Courts can and should go. So, that's a matter of judicial policy. To describe it as an error, with respect, is a difficult proposition to sustain. It's a conscious matter of judicial policy, it happens to be one that's been consistent throughout all the cases that I'm referring the Court to, from *Queensland Wire* through to *NT Power*. No case says, "Don't worry about any of this intermediate reasoning, just stand back and tell us whether there's been a breach of the statutory language." Ultimately, as the Court, the Privy Council accepts at line 14 on page 403, that is what the Court does. But the question is, what reasoning process is going to assist the Court to come to a just and principled result? And that's what the rest of the effort is focused on.

TIPPING J:

In the end – and this sounds a naïve proposition, Mr Hodder – it's how much use you've made of your dominance, isn't it? You want it to be that the overriding thing, the "but for" thing, your opponents want it to be at a lower level of threshold.

MR HODDER SC:

I'm not sure that it's quite in terms of quantum, it's simply a matter of having a clear connection, and the clearest way of connecting it is to isolate the fact that it is and isn't.

TIPPING J:

Well, that's where I'm challenging you.

MR HODDER SC:

Yes.

TIPPING J:

I don't think the connection is designed to be as bright line as that, as implied in the "but for" concept. Well, when I say I don't think it, my mind is completely, some would say, at sea, at the moment. But I don't think it necessarily follows that it's a sort of all or nothing thing, there must be matters of degree, I would have thought.

MR HODDER SC:

I don't think I want to argue against the idea, there are matters of degree in relation to various aspects of this –

TIPPING J:

Yes, but in relation to use the Privy Council is a naked “but for”. “But for the dominance, this wouldn't have happened.”

MR HODDER SC:

Well, I would attempt to persuade you that it doesn’t go quite as brutally at that, that when you come to the concept of “could rationally”, which is the formulation that’s more explicit in *Carter Holt,* that's not quite so brutal as “but for”.

TIPPING J:

It’s very close.

MR HODDER SC:

It’s close, but if you don’t have a clear distinction between what happens in a competitive market and what doesn’t happen in a competitive market, you don’t have a line at all, you’re just driven back to the general language with nothing else, apart perhaps from some intuition. That's why this entire jurisprudence is built up. It’s also one of the reasons why “materially facilitated” is not the most useful of language.

TIPPING J:

Well, your purpose has got to be substantial, why shouldn't your use be a substantial? In other words, the idea of “substantiality” rather than “but for”?

MR HODDER SC:

Well, I think the idea – I’ll come to this in relation to the *Melway* language, but “could rationally” is entirely consistent with a proposition that it may not be completely impossible to do something without the relevant market power.

TIPPING J:

Yes.

MR HODDER SC:

And that may be the point on which Your Honour and I can agree in relation to that area, and that may be a matter of degree. But broadly, if there is going to be some assistance in this approach to it, then there has to be a reasonably clear distinction between what does and does not happen in a competitive market.

TIPPING J:

I acknowledge that in the end it’s got to be administrable.

MR HODDER SC:

Yes.

TIPPING J:

Parliament has given us at the moment something that on its face is very difficult to administer.

MR HODDER SC:

Yes, well not just this Parliament.

TIPPING J:

Well –

MR HODDER SC:

The United States Congress and the Australian Parliament –

TIPPING J:

Yes, but parliaments have –

MR HODDER SC:

Yes.

TIPPING J:

– because it's so difficult to pin down in language.

BLANCHARD J:

Mr Hodder, are you going to be arguing, as you appeared to be saying a moment or two ago, that the *Carter Holt* decision in the Privy Council still leaves it open to New Zealand Courts to follow *Melway*?

MR HODDER SC:

Yes, but I need to explain *Melway* to you as part of that proposition at the moment.

BLANCHARD J:

Melway as you interpret it.

TIPPING J:

As explained by Mr Hodder.

MR HODDER SC:

As opposed to explained among my learned friends, at least. Can I turn to *Melway,* if that's convenient to the Court. I think there may be something to be said for dealing with these matters in a chronological sequence, and *Melway* is the next on the list, as it were, coming sometime later, almost 12 years after *Queensland Wire* and seven or so years after *Telecom v Clear.* So, *Melway* is at tab 6 of the Commission's bundle of authorities.

Now, in our submission, the essence of *Melway* as a decision is in 62, paragraph 62 on page 26 of the report, 61. I'm assuming the Court's –

ELIAS CJ:
We don't have the report.

MR HODDER SC:
Sorry?

ELIAS CJ:
We don't have the report, we don't have Commonwealth Law Reports.

BLANCHARD J:
We do.

ELIAS CJ:
We do?

TIPPING J:
Tab 6.

MR HODDER SC:
Tab 6?

BLANCHARD J:
Must be the other bundle.

ELIAS CJ:
Oh, I'm looking at the other bundles.

TIPPING J:
In volume 1, I think

ELIAS CJ:

Thank you.

MR HODDER SC:

I'm at para 61.

ELIAS CJ:

Sorry, I was looking at the appellant's bundle.

MR HODDER SC:

Most of these cases that I'm looking at are in the appellant's bundle, that is to say they're in –

ELIAS CJ:

Yes.

– the Commission's bundle.

ELIAS CJ:

Yes.

MR HODDER SC:

So, if we're all in the Commission's bundle at tab 6, then I was inviting the Court to look at paragraphs 61 and 62 on page 26 of the Commonwealth Law Reports.

ELIAS CJ:

I think I've got an earlier version. I might have the leave bundle in front of me for some reason, that's all right.

MR HODDER SC:

Does Your Honour have *Melway* in some form or other?

ELIAS CJ:

Yes, I have it in front of me.

MR HODDER SC:

All right, well, the paragraphs will be –

ELIAS CJ:

If you refer to the paragraphs, that's fine.

MR HODDER SC:

Right, paragraph 61, Your Honour. I'm sure the Court's been considering *Melway* prior to this, so the facts will be known. Bearing in mind that the refusal to supply the respondent was only a manifestation of *Melway's* distributor system, the real question was whether, without its market power, *Melway* could have maintained its distributorship system or at least that part of it that gave distributors exclusive rights. That question was not specifically addressed by Merkel J. It was, however, addressed by Healy J in the full Court. So that's the counterfactual proposition.

And then it goes on to say, first sentence deals with the other Judges in the full Court and then refers to the fact that Healy J dissented. He observed that *Melway* had adopted its segmented distribution system before it secured its position in market dominance and there was no reason to believe it would not be both willing and able to continue that system in a competitive market. And then it goes on to say, to point out, it was not denying itself sales, no justification for assuming that a competitive market would be denying itself sales. The reasoning of Healy J is to be preferred.

So this case was one where the counterfactual didn't require learned economists. The history told us that. They had this system before they were dominant in the market. They still had it. It provided, by direct observation of that, the fact that there was a counterfactual scenario.

ANDERSON J:

Well the counterfactual was answered by facts, not hypothesis.

MR HODDER SC:

Yes, which is a rare situation and this is the only case that comes close to it but that's exactly right Sir.

McGRATH J:

You've got to read that in the context of what's said at paragraph 52, don't you, as well.

MR HODDER SC:

I'm just going back to 52 if Your Honour pleases. If I could just work my way up to 52. Going back, excuse me, to paragraph 8 on the point that I was touching on in relation to clarity. The end of paragraph 8 has the Privy Council's comments on that being endorsed by the High Court. And in terms of the overall object, and I refer the Court to paragraph 17, to describe the conduct as a refusal to supply involves an element of oversimplification. "Section 46 aims to promote competition, not the private interests of a particular persons or

corporations. If Melway was otherwise entitled to maintain its distribution system without contravention of the Act, it is not the purpose of section 46 to dictate how it chooses its distributors."

The discussion of *Queensland Wire* starts at paragraph 26 and then at 27 it refers to the reasoning of Deane J from *Queensland Wire* to discuss the importance of the relationship between them, the two aspects of the statutory prohibition, the taking advantage of, and the market power. And so Deane's J language is then set out that, "BHPs refusal to supply Y-bar was for the purpose of preventing QWI from becoming a manufacturer. That purpose could only be, and has only been, achieved by such a refusal of supply by virtue of BHP's substantial power in all sections of the market." That is the only phrase I was referring to before.

McGRATH J:

Where's that phrase? Paragraph?

MR HODDER SC:

27 and it's four lines into the quote from Deane J.

McGRATH J:

Thank you.

MR HODDER SC:

"Could only be and has only been achieved." Then at 28 the *Melway* Court, or the majority says, they saw the case as one which the identification of a purpose led directly to the conclusion that BHP was taking advantage of its market power. "That was because the nature of the purpose was such that in the circumstances of the case it could not have been achieved by the conduct impugned had it not been for the existence of the market power." And here we have the "had it not been" which is another way of drawing a comparison.

And so in broad terms what we say about the idea that there's some separate team from Deane J from *Queensland Wire* is simply that it's another way of stating the same point, it just leaves out the articulation and it runs the risk of starting with purpose which is the risk that's picked up by various other Courts.

TIPPING J:

Mr Hodder, in that respect I regard paragraph 25 of this judgment as one of the most important things said in it.

MR HODDER SC:

And I don't need to disagree with Your Honour in relation to that.

TIPPING J:

No, no. This is its – it's not a single formula. It's a horses for courses sort of approach, is what their Honours are saying there.

MR HODDER SC:

I think that's the ultimate assessment which, of course, relates back to the facts of the particular case and nobody has suggested in any of these cases that you don't have to pay careful attention to the facts of the case.

TIPPING J:

But isn't that antithetical to the idea that a counterfactual must always be used?

MR HODDER SC:

Is it antithetical to that, in a sense it is. The fact that the Court uses it here and in every other decision it has, and the High Court of Australia indicates the strength and utility of the purpose.

TIPPING J:

It may very well be a very useful test. No one is suggesting otherwise in most cases, shall we say, but it's the mandatory nature of it that is under attack.

MR HODDER SC:

Whether one says it's necessary or whether one says there is no other formula that somebody has yet found that it might be possible, is a reasonably, they're reasonably close propositions. Nobody has in these cases really come up with something that doesn't have a counterfactual element to it.

TIPPING J:

Yes the rigidity of the counterfactual that I think is, for me anyway, at the heart of the problem but you must employ it however difficult it is to hypothesise appropriately.

MR HODDER SC:

Well the proposition that I'm putting to the court is that when in the Privy Council it says "legitimate and necessary" necessary means there's nothing else that's been found that gets you to the same point of isolating the fact that you're considering which is "use". Unless you go through that mental process you have a risk that you run too quickly from purpose to a

conclusion of liability which is antithetical to the purpose of the legislation as a whole. And we say it is telling that across almost two decades, actually more than two decades now, and across numerous Judges and seven appellate decisions, no one is saying, in effect, there's something quite different to a counterfactual which is going to give you the answer to these things.

So the point, if I can just pick up on that reference at paragraph 25, is that we accept that paragraph 25 is significant. We also respectfully suggest that it has to be read in the light of what's said in paragraph 31 which again is endorsing the general approach of the Privy Council in *Telecom v Clear*. "There are cases in which it is dangerous to proceed too quickly from a finding about purpose to a conclusion about taking advantage."

TIPPING J:

Yes and it all depends, as they say here, is that what the – the width or nearness of the defined purpose.

MR HODDER SC:

Yes.

TIPPING J:

There are a lot of slippery eels in this mix.

MR HODDER SC:

Yes and one of the things that I'm hopeful that we will persuade you before we finish, and partly by what my learned friend Mr Shavin will say, is that most of these could be fitted into a counterfactual analysis because they test these propositions rather than leaving them as a more impressionistic proposition. And again the point that we've just been traversing is picked up in paragraph 44. And after referring to *Queensland Wire* part-way through that paragraph, as it says, 'Much of the argument was directed to a consideration of how Melway would have been likely to behave, if it had lacked the power it had. Section 46 of the Act requires 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 its power." Now the Court goes to some – will say that again *Boral* which we'll come to and quotes itself from that passage. But it's a distinction between co-existence and connection which is another way of defining the same boundary that everybody is trying to find a way of identifying.

Then, working my way closer to paragraph 52, made by Justice McGrath, if we go to paragraph 50, the point is made is in about the second sentence, "Four of the five members of the *Queensland Wire* Court based their rejection of BHP's arguments upon a finding that if

there were a competitive market with other people offering Y-bar, BHP would have been forced to offer Y-bar to QWI. Whether that conclusion was well based is beside the point. A majority of the Court considered that the way to test whether BHP was taking advantage of its power was to ask how it would have been likely to behave in a competitive market."

If I can interpolate, Kirby J says the same thing at paragraph 107 which is notable in the sense that it's one of the few points in which Kirby J agrees with his colleagues in this entire sequence of cases in this area. At paragraph 107 he says, "This Court offered a practical test in *Queensland Wire* by posing the question, 'What would the corporation with a dominant market position have done in a competitive market?'"

Just carrying on from where I was in paragraph 50. "Exactly how competitive such a market might be and the assumed structure of such a market, were open questions." Our proposition is that that's exactly right but those can all be explored by using the counterfactual analysis and deploring those issues into that context and that framework.

Then paragraph 51 discusses Dawson J's reference to "made possible only" and at this point we get to a materially facilitated language. The Court says –

ELIAS CJ:

Are you going to come back to Justice Kirby at all?

MR HODDER SC:

I wasn't planning to, no.

ELIAS CJ:

Well it was just his view that this is a retreat from *Queensland Wire*?

MR HODDER SC:

He said that consistently in each of those cases and consistently the majority said it wasn't.

ELIAS CJ:

And you say it isn't, is that right?

MR HODDER SC:

I do say that.

ELIAS CJ:

Yes.

MR HODDER SC:

I do say that it was exactly right to say that the way in which it was approached in paragraph 50 in *Melways* summarises what's going on in *Queensland Wire*. The other thing that perhaps could be said about *Queensland Wire* is that *Queensland Wire* is an early case. The economic influence that Richardson J talked about in "*AMPS-A*" evolved gradually. I don't know that there was an enormous hot tub of the kind that is now commonplace in *Queensland Wire*. Now we have another couple of decades of jurisprudence the analysis has firmed up. Now Kirby J descents –

ELIAS CJ:

Is it the jurisprudence or is it the methodology? I mean, it's the evidential expansion, isn't it?

MR HODDER SC:

Well, hopefully the jurisprudence has been developing by refining itself as it goes forward. There's been plenty of opportunities for the appellant Courts to do that.

ELIAS CJ:

I had rather understood you to be saying they were right at the beginning and they've remained right –

MR HODDER SC:

Insofar as the –

ELIAS CJ:

– and they haven't deviated?

MR HODDER SC:

Yes, I'm not, I – commenting about *Queensland Wire* being an early case, I'm not suggesting otherwise. Our position is that *Queensland Wire* was rightly decided on a counterfactual basis, as have all the other cases since. Insofar as exploring some of these concepts and delving a bit further into what a counterfactual might require and some of the variations on language, I'm simply saying it's an early case. Apart from that, I have nothing to say about Kirby J, in terms of this area. I haven't counted up the number of judges who disagree with Kirby J in the High Court of Australia over this period but it appeared to be sort of up in, seven or eight of his colleagues, were not drawn to the same conclusions.

McGRATH J:

Do you have any comment on Kirby J at 109, about the language not obliging, et cetera, "not obliging the ascertainment of an answer to a hypothetical question"?

MR HODDER SC:

Well I recognise the argument for the appellants.

McGRATH J:

That's fine. If that's all you want to say, that's fine.

MR HODDER SC:

Well it just simply restates the same issue that one has to approach in relation to these matters. Do you helicopter back and take a long view, or do you wrestle with it through a form of a counterfactual analysis? In our submission, we wrestle with it through a counterfactual analysis. I'll come back to materially facilitated in a moment if I may. Paragraph 52 is partly related to that but again, it's still discussing *Queensland Wire*, "...reasoned by inference from the premise that BHP could not have refused supply to QWI in a competitive market to the conclusion that its behaviour was made possible by the absence of competitive constraint..."

Now those are – I have a suspicion that's slightly tautologist but the passage that's perhaps most relevant for our purposes is at the end of paragraph 52, "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 upon the assumptions that are thought to be required by s 46." What it's in part talking about, when it talks about assumptions, are the assumptions that are discussed in paragraph 58 of the judgment. Assumptions about the distribution arrangements and practices of Melway and in part, the case is decided on the fact that those assumptions are not appropriate. That's what paragraph 58 is about.

It is in this reading of that paragraph, the previous sentence, to say that if you can't do a cogent analysis then you don't do a counterfactual. That's made absolutely clear in *NT Power* where they come back to this point at paragraph 148 and say just that. Now we'll come to *NT Power* briefly at the end of this sequence –

McGRATH J:

When he refers to the assumptions though, isn't he talking generally rather than with reference to the specific case?

MR HODDER SC:

Yes, in part. I think that's right. My reading of the case is that what that is a preface to is to go on to criticise the assumptions made in the Court below because they weren't appropriate in the circumstances of the case –

McGRATH J:

Yes, that's certainly so, yes –

MR HODDER SC:

– that's how I read it –

McGRATH J:

– that's certainly so, yes but it's a general proposition that he's stating there?

MR HODDER SC:

Yes, well I think what it means in simple terms and I may have got this wrong, is that you have to have the counterfactual right. So you have to be asking the right questions in your counterfactual process and the criticism of the before Court was that they didn't and that's why the criticism is found in paragraph 58.

TIPPING J:

If it can be undertaken with sufficient cogency, implies that there will be some cases when it can't.

MR HODDER SC:

The *NT Power* – the language on its bear face carries that implication. The clarification comes in *NT Power* where they quote that passage and say, we're not saying –

TIPPING J:

I see –

MR HODDER SC:

– you don't do it. At paragraph –

TIPPING J:

– all right. See *NT Power* at – have you got a reference, or come to it?

MR HODDER SC:

We'll come to it. My handwriting is sufficiently that I'm – I think it's 145, possibly 146.

ANDERSON J:

Your point is that if the right assumptions are made, the analysis is cogent.

MR HODDER SC:

Yes, yes and that again, that paragraph 52 is setting up a preface to the next paragraph, 53, "In some cases, a process of inference, based upon economic analysis, may be unnecessary. Direct observation may lead to the correct conclusion." Then it goes on to say, "Deane J thought that *Queensland Wire* was such a case" and in this case, as it says, that that was argued as well and it was rejected in this case. Indeed, in relation to the paragraph I took the Court to beyond, paragraph 62, that could be thought of as a process of direct observation, i.e. based on historical fact. So we suggest that paragraphs 52 and 53 are in effect prefatory to the discussion that follows in this process.

The core question that the Court poses is at the end of 57, "What must be asked is whether Melways wholesale distributor system, involving, as it did, restriction of competition at the wholesale level, amounted to taking advantage of its market power?" The answer to that question is largely found in paragraph 61 and 62 which I took the Court to before, using the counterfactual analysis.

Now, the complicating part of *Melway* in our submission, is the reference to "materially facilitated". That is offered by ACCC which is intervening and this is at page 5 of the report, the Commonwealth Law Reports. There is a summary of counsel for the ACCC's arguments. It's about seven lines into the argument, "The expression 'take advantage of', it was submitted, may have various meanings in its context. It may mean that the conduct (a) was impossible without the relevant market power, (b) was not commercially rational without the relevant market power, (c) was more commercially attractive or would have been without the relevant market power, or (d) was facilitated by the relevant market power." We contend that (d) is correct. It then goes on, "Where a company produces market power that power facilitates the refusal to supply by insulating the company from the ordinary commercial consequences, it has taken advantage of its market power. It's not necessarily so that the conduct was impossible without the relevant market power."

ANDERSON J:

Sorry what paragraph is this?

MR HODDER SC:

It's from the submissions of counsel for the ACCC on page 5 Sir, of the report, and it's from about lines 7 to 20 of this.

ANDERSON J:

Thank you.

MR HODDER SC:

In particular covering the paragraphs (a), (b), (c) and (d). so when we get to paragraph -

TIPPING J:

Impossible is getting very close to “but for” isn't it?

MR HODDER SC:

Yes and (b) is really what the Privy Council says.

TIPPING J:

Yes.

MR HODDER SC:

So I want to take the Court back to paragraph 51 which is where the High Court comes back to this topic. The way it’s treated in paragraph 51 is that in a discussion of Dawson J in *Queensland Wire* saying that something was made possible only by the absence of competitive conditions, the Court goes on to say, “It doesn’t exclude the possibility that in a given case it maybe proper to conclude that a firm is taking advantage where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, that section 46 would be contravened if the market power had made it easier for the corporation to act for the proscribed purpose than otherwise.”

So that’s been suggested as being a stand alone test. In our submission it isn't and it is essentially another way of describing what the connection is. So “facilitate” is a verb describing a connection between two propositions, often between some conduct of an outcome. In legislation the operative verb in Australia is to “take advantage”, in New Zealand it’s to “use” or was at the time and as we saw in the submissions what the submission was trying to do was to flesh out the words “take advantage”, it wasn’t trying to do anything else in relation to those. And in the context of paragraph 51 what the Court was doing is contrasting with absolutely impossible which might be read into the concept of the words “only”. “Could only” may carry with it the connotation of “absolutely impossible”. In a later case, in the *Rural Press* case that we’ll come to, the Court discusses things on a somewhat similar way although it’s really referring to the concept of reliance, “rely on” and in our submission these are different ways of saying the same thing without creating a new test. So you have a series of words or here verbs which are being put in without necessarily gaining a greater clarity.

"Use", "take advantage", "connect", "facilitate" or "rely" but they don't take this away from the counterfactual test and with respect to this particular part of the discussion in the *Melway* judgment they don't us very much in any direction that's useful. The actual test being applied, the actual test being focused on in the judgment as a whole, is the counterfactual. So we say it's not a new and separate test and it doesn't help to distinguish conduct with damages competition or conduct which without damaging competition damages competitors.

ELIAS CJ:

Are you saying that the counterfactual is constant but how you establish it may vary?

MR HODDER SC:

Yes. The proposition broadly is that, to use a more appropriate metaphor, the phrase "could rationally" from Carter Holt is somewhat of a broach church. It has the degree of flexibility in it. It requires a degree of judgement, it requires a degree of assessment, and it does incorporate situations which fit within paragraph 51, that is to say, where something that had been absolutely impossible without the power, it still wouldn't – as a matter of business common sense or rationality that the relevant party would have done in a competitive market.

ELIAS CJ:

And you could get there by simply pointing to the history as in –

MR HODDER SC:

As in this case itself.

ELIAS CJ:

As in this case itself.

MR HODDER SC:

Yes, yes.

ELIAS CJ:

So you might not always have to hot tub.

MR HODDER SC:

Correct, correct, and undoubtedly picking up the language that Justice Anderson was putting to me, if you had some facts which established this then obviously everybody is going to be delighted. Unfortunately we don't normally manage parallel histories, it's a bit hard to do that, so *Melway* is unfortunately a relatively unusual case in those circumstances. So the language that could rationally –

ELIAS CJ:

Sorry, the fall back position, and I appreciate you're not answering – you're not taking the burden of this part of the argument, but the fall back position for the appellant is that in application of the counterfactual there was no other conclusion that could be drawn, that it was "but for".

MR HODDER SC:

Correct, that will be dealt with as my learned friend takes you through the beauty of the counterfactual analysis of the High Court and the Court of Appeal, and will embark upon.

ELIAS CJ:

Yes.

MR HODDER SC:

Now can I just – in terms of this linguistic discussion and it's intense but it's important as I said in terms of this appeal. We've been talking about "could rationally" from a Privy Council decision which I still haven't got to in *Carter Holt* but if we can just go to paragraph 50. And to reiterate the point of flexibility I was attempting to make before, if we look at paragraph 50 and what the Court says about halfway through, and I've taken you to it before, "A majority of the Queensland Wire Court considered that the way to test whether BHP was taking advantage of its powers was to ask how it would have been likely to behave." Now "likely" again is not an absolute phrase. "Only" is an absolute phrase. "Would" is an absolute phrase and we've seen that "would" has been watered down between *Telecom v Clear* to *Carter Holt* to "could rationally" and so our proposition is that "likely to behave" is very much the same thing as "could rationally behave", there's no real difference and both of them carry a degree of flexibility and reading 51 in the light of that it is a correction to the idea of "only" which itself lacks flexibility. But it's only to that extent that the ACCC's submission has been picked up.

But in fact the two cases in which this language has been picked up again, *Rural Press*, in fact in the Federal Court's decision in *Safeway*, the way in which it's applied is very similar to what I'm describing. There is a counterfactual test but incorporating this kind of language. Not as a separate test but as a way of describing, we suggest, the non-absolute nature of the way in which the test can be framed.

Now if it's convenient what I would do is then move on from *Melway* to *Boral* which is, in our submission, a particularly important case and which is remarkably free from attention by the appellant and the intervener and that's to be found at tab 16 of the Commission's bundle.

ELIAS CJ:

Is that volume 2?

MR HODDER SC:

I think so. Mine's in the single volume but I imagine so. Tab 16. The importance of *Boral* for the arguments before this Court, in our submission, is that *Boral* is the case that the *Carter Holt* Privy Council Board thought it was harmonising with and in our submission when one looks at both cases they are very much based on the same lines of reasoning and so the proposition that the *Carter Holt* has gone off on a frolic somewhere leaving the Australians behind is, with respect, must come as something of a shock to the Law Lords who sat in that case, at least the majority, who thought what they were doing was harmonising with the High Court of Australia's most recent statement on the subject, which was the *Boral* case.

So, *Boral* was a claim of predatory pricing, and it failed in the High Court and it has a whole raft of discussion about recoupment and all – which this Court is spared in this particular case. I should go back one step and say that it also indicates the way in which there are connections between the United States anti-trust law and here, because a major part of the *Boral* case reflects the *Brooke* decision in the United States, which says recoupment's a necessary part of a predatory pricing claim.

TIPPING J:

And the fact that it was predatory pricing, of course, gives it that immediate link with *Carter Holt.*

MR HODDER SC:

Yes, it was the obvious case to be referred to.

TIPPING J:

That's why they would focus on it.

MR HODDER SC:

Yes. As the Court appreciates, there are actually four judgments. The first one by the Gleeson CJ and Callinan J, the second by Gaudron J, Gummow J and Hayne J as a joint judgment, then one by McHugh J, and then a dissent by Kirby J. And the principal discussions that I want to take the Court to comes from the first two of those, which carried five of the Judges in that process.

If I can just pick the matter up perhaps at paragraph 86 and thereabouts. And paragraphs 86, 87 and 88, I just draw the Court's attention to briefly, because they're restating the basic principles that we started off with *Olympia,* in which it carried into *Queensland Wire* and quoted in *Telecom v Clear,* except there's a different case cited, it's the *A A Poultry of America* is cited, as opposed to the *Olympia* case itself. But the logic and policy reasons are precisely the same. One turns over to page 100, sorry, paragraph 100. There was a

quotation from QCMA which was referred to the Court earlier in this hearing, about markets, and at paragraph 100 the Court or this judgment of Chief Justice Gleeson and Justice Callinan, "The firm's ability to give less and charge more is an expression of the central idea involved in the concept of market power," and, in our submission, the counterfactual is one of the ways in which one explores those concepts, in some detail and with some care. 107, or 105 and 107, both use the language of rational business decision and rational and legitimate business response, now here the Court is citing from the Judge below. But those go back to what I said at the outset, that making those sorts of judgments itself implies a counterfactual analysis.

In the discussion of the judgment section 46 starts around 120. At paragraph 121 there's an acknowledgement that, "Matters of degree are involved, but when a question of the degree of market power enjoyed by a supplier arises, the statute directs attention to the extent to which the conduct of the firm is constrained by the conduct of its competitors or its customers." Paragraph 123 repeats what we saw from *Telecom* and *Melway*, concerned about being difficult to move too quickly from purpose to taking advantage, and the footnote 110 refers to both the earlier cases. Paragraph 125, "Ultimately, it's the language of the Act that must be construed," which is precisely what was said by the Privy Council in *Telecom.*

And particularly important to this decision itself was paragraph 138, "Financial strength is not market power." That became particularly important in a predatory pricing context, it's also a feature of the decision in *Rural Press.* And if I can interpolate there, that aspect of this case and also in *Rural Press*, that financial strength is not market power, is one of the issues again that can be explored, but it's the very thing that provoked a legislative reaction. For small businesses, the idea that financial strength was not market power was unattractive. It may be correct as a matter of economic analysis, but it has unfortunate consequences for small business, so Australian small businesses successfully claimed to the Senate inquiry.

Moving on to paragraph 141, the same point about beginning with purpose and reasoning from that is contrary to what was corrected in *Melway.* And in broad terms, at 148, that judgment of the Judges says that the reasoning of Healy J on taking advantage, among other things, was in accordance with the evidence in the statute and shouldn't have been reversed. That then takes us, beginning at 151, to the three Judges' judgments. Can I refer the Court briefly to paragraph 160, which sets out propositions, three propositions, again concerned with the protection of competition, the second referring to the *Brooke Group* case, that malicious intent doesn't matter, and the third is that there's an interest in vigorous price competition.

Then in paragraph 161, the proposition is that there needs to be a criteria – at the end of that page – "Criteria to distinguish beneficial from deleterious competitive practices," which, we all

appreciate, is the issue that has to be dealt with. The point about economic or financial strength, as opposed to market power, is addressed in paragraph 163 by reference to an article by Professor Breyer as he then was, now on the US Supreme Court, which is distinguishable between the position of a new entrant that has great financial strength entering, and somebody that's already been in there and obtained substantial market power.

Now, perhaps the point that I pick it up from is 170. At 170 they quote the first instance Judge, in terms of having a business rationale. And paragraph 171 they cite from the *Heydon* text on Trade Practices Law to the effect that there can be defensive conduct, which is the kind of conduct you would expect in a competitive market.

Now, I'm assuming the Court will have to consider aspects of this case, but the point I want to then move on to takes us through to paragraph 184, which in part goes to the sequence which the Chief Justice, I think among others, was querying with me earlier on. So the Court says, "In any event, as section 46 is framed and has been interpreted in this Court, what is required first is an assessment of whether the firm possesses a substantial degree of market power, and with regard to considerations such those referred to by the Trial Judge and, if so, then asking whether the firm has taken advantage of that power for a proscribed purpose. And then at 441, sorry, paragraph 194 and through to the end of the judgment, we get the conclusion from this judgment, "That maintaining its low pricing for a substantial period of time, showed that Boral Besser had access to sufficient financial resources..." I'm here at the top of page 441, "...may also suggest the alternatives of ceasing production were even less palatable but neither producing without selling or ceasing production is cost free. To appreciate those considerations, it has not found any conclusion as to the existence of a substantial degree of market power. Further to reason from purpose to the existence of substantial market power is to invert the reasoning process which consistently with the object of the provisions in section 46 is mandated by the decisions in *Queensland Wire* and *Melway*." So they go on and approve what was said in the Court at first instance.

TIPPING J:

The backwards reasoning is usually put reasoning from purpose to use but here I see they're talking about reasoning backwards from purpose to market power. That seems a rather curious...

MR HODDER SC:

Yes and that's –

TIPPING J:

But anyway, it may –

MR HODDER SC:

– I'm not sure it's relevant to our argument today –

TIPPING J:

– I don't think it takes us anywhere but it's an odd concept.

McGRATH J:

Sorry Mr Hodder, just to take you back to 171, just before you move on to the next judgment.

MR HODDER SC:

Yes.

McGRATH J:

I wondered if you – is part of your argument that Telecom was engaged in what Heydon J and his text Trade Practices Law, was describing as defensive, in that case price cutting, in response to – in other words, defensive conduct in relation to market circumstances. Is that part of your case here?

MR HODDER SC:

It is. If Your Honour recalls, I quoted to you, or read to you from Professor Hausman's analysis. What –

McGRATH J:

Yes.

MR HODDER SC:

– would happened, a firm would have to take out a series of defensive steps. You'd increase prices if you could, or you'd reduce costs were you could, et cetera. That's precisely what we mean by, that is seen as defensive conduct.

McGRATH J:

That's evidence but is there any further elaboration of this concept in the cases?

MR HODDER SC:

Not in the cases unfortunately, not in great detail. In a sense, the expectation, as I read the case is that those are the things that are teased out by the economists in their analyses of a counterfactual scenario.

McGRATH J:

Yes, I understand.

MR HODDER SC:

Rather than them being teased out in these judgments themselves.

McGRATH J:

Thank you.

ELIAS CJ:

You'd still apply the counterfactual on your argument, to whether it was anti-competitive defensive behaviour, as opposed to available defensive behaviour?

MR HODDER SC:

Yes, that's fair, you would but if it's defensive behaviour that you could rationally undertake in a competitive market –

ELIAS CJ:

Yes. Well, without using your dominant position.

MR HODDER SC:

Well if you're in a competitive market, I think the proposition is you can't have a dominant position. So that's the competitive market, why it comes in there.

ELIAS CJ:

Yes.

MR HODDER SC:

So, for our purposes, we say that paragraph 170 which is effectively approved in the result in this case and the discussion for the judge below about the business rationale which itself carries with it the counterfactual concept, is again at the heart of this decision. So it's at this point that I get to *Carter Holt* and I'm hopeful we can speed up the process through these cases now but *Carter Holt* which is at tab 4 of the Commission's bundle is, as I said, the case which was consciously seeking to align with *Boral*. One of the features of *Carter Holt* is what is submitted by, or seen by, the majority to be a distinction between the European approach and an Australian approach and the Privy Council majority believed it was applying an Australian approach in rejecting a European approach which is being contended for.

So, if one starts at page 147 of the report, we have the submissions made for the appellant. So Mr Sumption starts of by submitting that, "There has to be a causal link between the firm's dominance and the conduct by which it prejudices the interests of its rivals. There has to be a nexus between the alleged abuse of a dominant position. That's tested by posing the

question with a hypothetical firm could rationally have acted as the dominant firm did. If so, the dominance is irrelevant and the conduct is lawful. This is known as the counterfactual test –

ELIAS CJ:

Sorry, I'm lost, what page?

MR HODDER SC:

Page 147 –

ELIAS CJ:

Yes, thank you.

MR HODDER SC:

– and I've been reading from roughly lines –

ELIAS CJ:

Yes, I see it, thank you.

MR HODDER SC:

– 30 onwards. He puts, "The contrast between the counterfactual test and the alternatives taken the European community law, under which there's no need to prove any nexus and a dominant party has a special responsibility to act in a way which is not required of a non-dominant party. Such an approach is radically different from a counterfactual test and has been firmly rejected in the jurisprudence of New Zealand."

Then he goes on, the passage in his submissions, then goes on to refer the *Telecom v Clear* case down to line 5 on page 148 but then the passage in the submission that I draw, of course, attention to starts about line 7. "For obvious geographical and economic reasons, a strong family resemblance is between the statutory competition laws of New Zealand and Australia." Goes on to cite cases and then proceeds to cite to the Privy Council *Queensland Wire*, *NatWest v Boral* which is a case that focuses on the casual connection language, *Melway* and *Boral* and *Boral* is of course the most recent of these cases. *Boral* is February 2003 and this case is being argued well over a year later.

Now the complaint was that the Judge in the High Court in the *Carter Holt* case did – simply didn't apply counterfactual. In that sense that it simply missed an important step in the process and effectively that was upheld by the majority of the Privy Council. The Privy Council regarded it as being a matter of a single point of principle only. That is to say whether or not it was necessary to use a counterfactual approach to these matters and

that's what's described as the crucial point of principle, for example, in paragraph 8. At about line 6 they use the phrase "crucial point of principle" to which they find themselves in disagreement with the minority and then they repeat the proposition from *Telecom v Clear*, "The trader is entitled, before he enters upon a line of conduct, which is designed to affect his competitors, to know with some certainty whether or not what he proposes to do is lawful. The question which lies at the heart of the appeal to the Board is how, in this difficult area, lawful conduct can be distinguished among unlawful conduct."

In paragraph 9 the suggestion was that in the High Court it was seen as a matter of degree but the appellant submits, following Telecom, "It was both legitimate and necessary for the Court to test by asking whether when it introduced the particular arrangement the defendant acted in a way that a person not in a dominant position but otherwise in the same position would have acted."

The converse proposition at the end of the paragraph says, "That the High Court could only be justified on the view that the trader who is in a dominant position was under a duty to act in a way which would not be required of a trader who was non-dominant. That, it is submitted, is not what section 36 requires." And that echoes the concerns that go back to both *Olympia* and the High Court in *Telecom v Clear* as well as the Privy Council.

And the concern with stifling competition is picked up at paragraph 23 on page 156, at line 5, "The fact that a person has acted in order to achieve one of the proscribed purposes doesn't constitute a breach unless there's been use of a dominant position to achieve those purposes. The minority say that the purpose of section 36 is to prevent use of a dominant position for the purpose of stifling competition. But it has to be borne in mind, as the Board also pointed out in Telecom at 402, the monopolist is entitled to compete with his competitors. He is not required to stand idly by as he sees his market share being eaten into by others who are not dominant. That would be stifling competition, the very thing which the section is designed to promote, for the consumer's benefit. Moreover a breach will expose the dominant trader to a quasi-criminal penalty. The law would be failing in its duty if it did not make it clear to him what he can and cannot do when he is in that predicament." It's stated that point twice. Then *Queensland Wire*, then *Telecom v Clear* repeated again.

At paragraph 29 is where we find the "could rationally" language. It was in the submission for the appellant as we saw earlier but at page 158, paragraph 29, line 14 or thereabouts, "The test asks whether a hypothetical firm which was not in a dominant position but was otherwise similarly placed could rationally have acted as the dominant firm did." And that, we say, is the test that is now the test of this country's law, subject to this Court's view, and is properly so.

Moving on to paragraph 40 at page 161, just reiterating the point that goes back again to the earlier cases I have taken the Court too. At around line 13, "the effect of preventing a monopolist from competing with its competitors like everyone else would be to protect inefficient competitors." So the efficiency factors comes into it. So Your Honours I see it's about the normal time for an adjournment. I haven't quite finished discussing aspects of *Carter Holt* but I think we can move on reasonably quickly after that.

ELIAS CJ:

All right. Thank you. We'll take the adjournment.

COURT ADJOURNS: 11.31 AM

COURT RESUMES: 11.51 AM

ELIAS CJ:

Yes, Mr Hodder.

MR HODDER SC:

As Your Honours please. I have been drawing attention to aspects of *Carter Holt*. I appreciate that the Court will read *Carter Holt*, both judgments, with some care. I think it was possibly at paragraph 51, that I just want to draw attention to, where the Privy Council at line 9 is using the phrase "causal relationship" that has been the role in the nature of the use requirement. With reference to the *NatWest* decision of French J, as he then was, which has been cited in subsequent cases about that connection. At 54, there's the same passage from Henry J which was approved by the High Court judgment, engaged in commercial judgement and business rationale. Again, the concept of the counterfactual was there. That then leads on to paragraph 60, which summarises the propositions that are sought to be taken from the earlier authorities, the first of which is from Telecom, and the second and third of which are from *Boral*. The first of which is, of course, the one that's particularly in issue here, the legitimate and necessary language. Just as a footnote to that, if I could ask the Court to go back to page 149 for a moment. At the bottom of the page, and these are submissions of counsel for the Commerce Commission before the Board, the counsel for the Commerce Commission criticised Carter Holt for relying on a legitimate business rationale aspect, and said that this can be no more than a counterfactual test in another way, and takes the matter no further, with which, can I say, we respectfully agree.

ELIAS CJ:

Where are we?

MR HODDER SC:

I'm at line 45 on page 149. It's the counterfactual test in another way. Then counsel for the Commission refers to *Ball* and *Safeway* as well as *Queensland Wire*, and then says the correct approach was that stated by Lord Brown-Wilkinson in *Telecom*. Remove the characteristics of dominance, and ask whether a different firm in that position would have done the same thing. If not, the dominant firm has used its dominance. So the Privy Council was receiving submissions from both sides of the argument, that the counterfactual was the appropriate test to take in this country. And again, with respect, it's difficult to come to the view that this was a plain error by the Privy Council in the circumstances, that it was considering the *Boral* case, receiving submissions about the relationship between Australia and New Zealand, and both sides saying counterfactual is the way to do it.

The next section of the judgment, which takes us back to page 167, is dealing with the contrast I mentioned earlier, between the Australian or Australasian position and the European position. At paragraph 63, around line 24, the Court sites from ANZCO to emphasise the point that article 86 does not require the dominant undertaking should have used its economic power to bring about the abuse. That's directly contrary to what section 36 requires according to the New Zealand and Australian authorities. And then it quotes from *Bellamy & Child's* text at around line 33, "Dominant firms have a special responsibility". Again, you'll recall that was the submission made by counsel. That's not part of Australasian law.

At paragraph 65, over the page, the majority says that in the light of that description, the way it works, it's unsafe for any conclusions to be drawn in the context of 36 in relation to decisions of that Court in cases brought by the EC Commission. So at 66, around line 44, the public interest lies in preserving the ability of firms to compete with each other in a competitive market on price as well as on quality. The firm that has a dominant position is penalised for cutting prices, while that same conduct, if undertaken in the same circumstances by a firm which was not dominant would not be. At 67, around line 30, it discusses *Boral* and said that case reaffirms the importance of the counterfactual test. At the end comes the conclusion at 68. It indicates conduct in the face of strong competition was not any different from that which a non-dominant firm of equivalent financial strength, that phrase from *Boral*, would have resorted to in the same circumstances. The absence of a rigorous examination at that point is a significant part of the High Court's judgment, and that of the Court of Appeal. If there's a minority indicated, their findings led to the conclusion there was nothing effective that ANZCO could have done in the short term, and to uncertainty about what could have been done in the long term. They lead to the wrong answer.

TIPPING J:

Mr Hodder, at paragraph 67, sorry if I'm jumping ahead of you.

ELIAS CJ:

You're behind.

TIPPING J:

Oh. I'm behind. I was just trying to digest it. At 67 at line 38, their Lordships say that will not be so, in other words, there's no causal connection, unless the conduct has given the dominant firm some advantage that it would not have had in the absence of its dominance. Some advantage, not overwhelming advantage.

MR HODDER SC:

Well, there has to be an advantage that enables it to undertake what it is that's different between a competitive market and a non-competitive market.

TIPPING J:

All right, yes, I understand what you're saying.

MR HODDER SC:

Again, we suggest that is the role of the counterfactual, to tease out what it is that's different in the competitive market versus the non-competitive market.

TIPPING J:

There's some advantage there, as against what it would have had. Yes, I think I've misread it.

MR HODDER SC:

There has to be an advantage.

TIPPING J:

Yes, well, you've solved my problem.

MR HODDER SC:

The point I was referring to in paragraph 68, that if the minority were right, there was nothing that ANZCO could have done in the short term and certainly in the long term, they lead to the wrong answer. Why is it the wrong answer? It's the wrong answer according to the philosophy that runs through these cases, because even a dominant firm must be able to compete, and if the minority can't point to one which it could compete lawfully, then there was something odd in the process of reasoning that was deployed. But that's the debate that takes place. When we go through the minority's decision, there is, of course, the criticism at 78 about the counterfactual test, that it asks additional questions. Well, of course it does.

There are a whole series of variables and factors that have to go into the process to try and achieve the highest level of cogency that one can in the context of undertaking a rigorous examination. In the end, what the minority does, and this is on page 172 and the end of the paragraph 81 around line 40, the minority comes back to a comparative approach. After saying that the comparison seems wholly unreal and it's preferable simply to ask the statutory question, did ANZCO use its dominant position, was there a causal connection, well, as soon as they say causal connection, then we're back at the entire logic that starts with *NatWest* and leads through *Queensland Wire* and the rest of the Australian cases. And then at 82, it seems to us that economic reality demands the answer. Economic reality in the sense of economic analysis is what the counterfactual is designed to achieve. Then there is an attempt to say that this case is a matter of absolute inference, and that's the end of paragraph 82. On the facts of the case, we don't see how any other inference was possible. Well, obviously, the other Judges did. There will be, of course, differences in view. People will have different approaches.

At paragraph 84, they respond to the majority's concern that if there is nothing else that could have been done, then that doesn't worry them very much, using the phrase, "our withers are unwrung" at line 26. And so the parties, the majority and minority are disagreeing on what was actually stifling competition, whether it was a stifling of competition on the one hand by the defendant by its conduct, or whether it was a stifling of competition to prevent it from acting competitively when it was under competitive pressure. Then at line 34, the end of this thing, the proposition that it wasn't entitled to take steps that relied on its dominant position, or that would not have been taken by a non-dominant competitor, which looks remarkably like counterfactual language. So it's our contention, and I'm sorry to repeat this, that as at this point, the law under section 36 and 46 were in harmony, a conscious decision by the Privy Council to achieve harmony with *Boral* as the most recent expression of the High Court of Australia, and consistently with the earlier decisions of the High Court of Australia. And for that reason that we say that the fun stops at that point. It's difficult to say that the Privy Council made any kind of an error, or there's any reason to depart from the analysis that it was making as part of Australasian competition law.

If we move to the *NT PAWA* case which is at tab 17 of the Commissioner's bundle, this, again, features multiple judgments. Perhaps it's the easiest to say that Kirby J has a dissent, and then Gleeson CJ and Callinan J had a joint judgment, but for relevant purposes, they agree with the judgment of the polarity and so for our purposes the most important parts of the judgment in the polarity judgment starting on page 76, around paragraph 51. Now, this case, as the Court may recall, there was a concern that a large player had threatened to enter an adjourning market, in effect, and the question was whether that was or wasn't abuse of power, and the Court held that it was not, or the majority held that it was not. Paragraph 52 refers to criticism by the ACCC of the full Federal Court for asking whether Rural Press and Bridge could engage in the same conduct in the absence of market power. But that criticism

must be rejected, and cites *Melway* in terms of the counterfactual analysis, and says the Commission is not demonstrating that that did not mean what it said or that it should be overruled, that is to say, the testers could have maintained a distributive system.

Then at 53, we find the facilitative language. The Commission failed to show that the conduct of Rural Press and Bridge was materially facilitated by the market power in giving the threats a significance they would not have had without it. In our submission, that addresses the point made earlier. Perhaps before *Melway* one might have said only, rather than materially facilitated, that that's the degree of qualification that I'm suggesting that language involves earlier on. Everywhere else, this analysis is effectively a full counterfactual analysis. So 53 goes on –

ELIAS CJ:

Well, do you say that materially is different, in effect?

MR HODDER SC:

It simply brings it into a more flexible concept of could, rather than would, or would not.

BLANCHARD J:

But you see that as a species of counterfactual?

MR HODDER SC:

I do. And I think, in our submission, that's exactly the way in which it's being used here.

ELIAS CJ:

But isn't – is not the use of materially an invocation of but for, if it was material?

MR HODDER SC:

I think it is. It has to be materially, otherwise it doesn't give you the distinction from what you could rationally do and what you could not rationally do.

ELIAS CJ:

Yes. So is there a real difference?

MR HODDER SC:

Only in the sense – only as absolute. By absolutely impossible, then materially facilitated brings you back some degrees from absolutely impossible. That was the way in which it was discussed, the context which was discussed in *Melway*.

BLANCHARD J:

It's really almost, if I can put it colloquially, a concept of whether your market power gave you a leg-up.

MR HODDER SC:

A leg-up that would not be available to you at all in the competitive market, yes.

TIPPING J:

I think the expression gives you some advantage that you would not have had in the absence of your dominance is about as succinct and clear as one could achieve. But it does involve a comparison -

MR HODDER SC:

It does involve a comparison.

TIPPING J:

- with your position if you weren't dominant.

MR HODDER SC:

And it's going to be the leg-up or the advantage that's going to make all the difference. That's the critical point.

ELIAS CJ:

So why wouldn't you start with the statutory language? It seems to me we had this discussion yesterday.

MR HODDER SC:

Well, I was offering to finish on the statutory language, if you recall.

ELIAS CJ:

All right. We have that to look forward to.

MR HODDER SC:

What caused difficulty in this case, at least in the political sense, was the last line on that page, where it's endorsing the proposition that the defendants were in the same position that they'd be new entrants in the other market. They had financial strength. They just didn't have any market power in that market, because they were new entrants. 55 is, again, relating this decision bake to *Boral* and to *Melway* and the discussion of causal connection. Then at 56,

there's a discussion of the *NatWest* case I've referred to a couple of times, which is the authority that deals with causal connection, and there's a quotation set out from French's J judgment in *NatWest* at the end of that page. At the bottom of the page, "There must be a causal connection between the conduct alleged and the market power pleaded such that it can exert that the conduct is a use of that power. In many cases, the conduct connection may be demonstrated by showing a reliance by the market power". So that's that other verb that I talking about before, with relying language comes in here, and it's another way of linguistically trying to explain the difficult concept of take advantage or use –

TIPPING J:

But the rest of that is helpful, I think. A reliance to insulate it from the sanctions that competition would ordinarily visit upon its conduct, in other words, if there is competition, the sanctions would ordinarily inhibit you from doing it.

MR HODDER SC:

That's what happens in the competitive market. There are sanctions which inhibit that kind of conduct, and that's where you're looking. We say that, in the counterfactual, are always going to treat –

ELIAS CJ:

You always come to it.

TIPPING J:

You always come to it, yes. It's inherent in the counterfactual.

MR HODDER SC:

Yes. But the point that the judgment goes on to make just after the quote, the original question is, "Did the incorporation rely on the market power?" Which gets you back to that question of how do you deal with that distinction, and you understand what our answer is on that particular proposition. The last of the cases in the sequence from the High Court of Australia is at tab 7 of the Commissioner's bundle, that's the *NT Pawa* case. Perhaps I could start again by saying that this has a dissent by Kirby J, except that it's the other way around this time. Kirby J thought that there should have been a non-liability finding when there was a liability finding, because it was effectively a state operation. The relevant passages for our purposes are paragraphs 143 to 150. These deal with criticisms of the Courts below in terms of language that applied the counterfactual. As you see the heading to 143, there was failure to make correct assumptions about a competitive market, and the criticism at the end of 143 were the assumptions that take the analysis beyond the realms of reality and then, as mentioned earlier, at paragraph 144, the appellant draws attention to the *Melway* proposition which goes to the question of the cogency of analysis. You recall we looked at that

paragraph earlier, that paragraph 52, and then paragraph 145, which was the note I think I may have given incorrectly as 146 earlier, is the paragraph that comes to that. "The 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* proceeded, that BHP lacked market power and was offering a competitive market, was highly unrealistic but no later cases held that it was wrong to make it. The statement in *Melway* was only urging the need for cogent analysis on the basis of the assumptions. The reasoning that follows the quoted passage demonstrated that cogent analysis is not in that case supported and concludes that an advantage had been taken of market power."

Now 147, "If PAWA's criticisms were sound, it would be very difficult ever to demonstrate that a firm, whose monopoly power depends on infrastructure, which it is, in practice, very difficult to duplicate, had taken advantage of the market power." The Court then goes on later in the next paragraph to say that you can assume an alternative infrastructure which is an appropriate way of testing because the objective of the section is to test whether the monopolist is, in fact, going to be using its power. And if you don't make assumptions then you run the other risk which is that you don't have an effective section 46.

Paragraph 149 sets out a passage from *Melway* which quotes from *Queensland Wire*, paragraph 150 says, "That reason is applicable here. The decision to refuse access to the infrastructure had the purpose of excluding NT Power from the market, and that purpose could not have been achieved by its refusal had it not been for PAWA's market power." So for those reasons we say this is again an illustration of the counterfactual analysis being applied by the High Court.

I won't take the Court to it in the interests of time but our written submissions make reference to *Safeway* which does use the materially facilitated language again in the context of an application of the counterfactual test in relation to these matters. So that concludes my trawl through these cases. They are, in our respectful submission, coherent and consistent and they reflect what I was attempting to submit to the Court yesterday the concept of economic law that's discussed in the "*AMPS-A*" judgment of Richardson J. The proposition is that economous analyses illuminate the issues underlying section 36. What is desirable aggressive competition on the one hand and what is undesirable damage to the competitive process on the other? What would a non-dominant firm do in the particular market circumstances i.e. are the market circumstances the same as otherwise except when moving the dominance factor? And in this particular case that's before the Court, at 12 Professor Hausman, Professor Evans for Telecom gave their evidence in relation to that matter, were tested in various forms including the hot tub in cross-examination. Dr Bamberger had his analysis, and allows it to be explained by my learned friend Mr Shavin, but in the end the Court came to a view. The view was that the approach indicated that Professor

Hausman's evidence, advanced by Telecom, was correct. And there was a significant discourse between the lay member of the High Court and the economists in relation to these matters on particular issues, all in the context of a counterfactual process or counterfactual approach.

So the proposition, in simple terms, is that given this an economic law, considering there is consistency with two Privy Council and five High Court of Australia decisions, the proposition before the Court that is should reverse tack entirely shouldn't be taken in the case law. If there's any basis for doing it, it has to be found somewhere else. The result is that, in our submission, the Privy Council requirement for a counterfactual is necessary, is appropriate, having regard to the fact that it has its own inherent degree of flexibility in the purpose that it's trying to achieve. The Australian Courts, I acknowledge, have not gone as far as to the use the word "necessary" but in reality, on every occasion, they have decided the case on a counterfactual basis. That tells us something.

If the Court pleases there's two other matters before I turn to some legislation. The first is the certainty factor which is criticised as being either unnecessary or overstated and the registrar has a copy of the House of Lords decision in *R v Rimmington* which, if I can just draw the Court's attention to, that in terms of what we suggest are genuine rule of law issues in this area which are appropriate, both in terms of considering the merits of the counterfactual approach in its terms and when we get to the question of departure from precedent. And not the only reason for citing this but every case probably deserves some Jeremy Bentham so what this case has, at paragraphs 33 and 34 –

ELIAS CJ:

I've been reading some really insightful criticism of Bentham.

MR HODDER SC:

Ma'am utilitarianism is clearly at the heart of the law in this context. So paragraphs 33 and 34 are, which I won't take the Court to in detail, but it starts off by discussing dog law. I'm not suggesting that's quite what we've got here but it's an interesting –

ELIAS CJ:

It's what Judges do, isn't it?

MR HODDER SC:

Well that's what Judges are not supposed to do. That's what farmers are supposed to do.

ELIAS CJ:

That's what Bentham thought Judges did.

TIPPING J:

He called Judge's dog law didn't he?

MR HODDER SC:

Well depending what it was, whether it was alone to start with, that was the point he's making. So if you want to teach a dog, you wait until the dog does something wrong and beat it. Human beings in the rule of law was supposed to have a slightly more anticipatory approach to it, that's the point he's making, and it goes to the point of clarity which –

TIPPING J:

Dogs can't read the statute book unfortunately.

MR HODDER SC:

That explains why we –

ELIAS CJ:

Beat them.

MR HODDER SC:

That we beat them, yes. All the bound volumes of the High Court of Australia for that matter, dogs also have a problem with those too but, yes. The guiding principles are set out on page 482 at the very bottom, Lord Bingham picks out from those, and we say those are appropriate factors to be taken into account in this context and they are echoes of what the Privy Council has said in both the cases that we have looked at and which the High Court of Australia also picked up in *Melway*. Those same points are applied beyond just the criminal context. At the top of page 482, for example, there's reference back to *Black –Clawson* in terms of the rule of law in a series of cases discussed in that part of the report.

I don't propose to take the Court's time on it but there's another case called *Norris* in 2008 volume 2 of the weekly law reports at 673 where Lord Bingham on behalf of the House of Lords takes up the same themes at paragraph 52.

BLANCHARD J:

Is that the extradition case?

MR HODDER SC:

It is, yes. Lord Bingham's Court lecture which is in our bundle also has similar themes and it cites, I think, *Rimmington* in a footnote.

ELIAS CJ:

This case you're really just bringing to our attention for its admonitory –

MR HODDER SC:

It's reinforcement of the approach that the Privy Council in *Telecom v Clear* takes. That you're entitled to know where you are before you start.

ELIAS CJ:

Yes.

MR HODDER SC:

Rather than be the dog.

ELIAS CJ:

Yes.

MR HODDER SC:

The last point is just to, on this topic, is perhaps just to indicate, if I can ask the Court to turn to our volume 3 of our authorities and to tab 75. These are extracts from the Commission's opening and closing at trial, at tab 35 – tab 75 sorry. Now, so on the first page which is extracted there at page 11, around line 17, "Counsel for the Commission opened on the basis that we accept that section 36," it should be, "should not capture conduct which a non-dominant firm otherwise in the same position would rationally have engaged in." And so on down to about line 25. "We accept there must be a causal connection between the dominance and the conduct alleged to be in breach of section 36."

On the next page, which is much later in the process, page 180, at line 28, we say, "We'll lead expert economic evidence on counterfactual scenarios in which a non-dominant firm attempts to impose your 0867 package or take similar action and that evidence will be that a non-dominant firm could not profitably have introduced the 0867 package. Over the page, at page 351, in the closing submissions, there's reference from line 19 onwards to *Carter Holt,* and the submissions go on to say, "Well, Dr Bamberger's got it right in terms of the counterfactual," at page 352 around line 23. And then later on in the closing there's some debate goes on with the lay member. And so if you go on to page 613 of the transcript.

TIPPING J:

Is your point that they didn't say, "And by the way we're saying all this subject to reserving our position as to what it might look like in the Supreme Court?"

MR HODDER SC:

It is. So, at page 613 line 16, after an exchange with Mr Copeland who was a lay member, counsel says, "The counterfactual has to do something that's almost impossible, it's to assume a non-dominant Telecom." "Are you saying to the Court that we shouldn't use the test that we've spent some time arguing about?" "Not at all, I'm saying to you, you should use that test, but use it precisely, change the dominance and nothing else." And then over the page, at –

ELIAS CJ:

Change the dominance?

MR HODDER SC:

To non-dominance, remove the dominance.

TIPPING J:

Remove the dominance.

MR HODDER SC:

I'd assume that's what it means. And over the page –

ELIAS CJ:

While saying you can't.

MR HODDER SC:

Assuming then the counterfactual will be not dominant, so Telecom was not dominant

ELIAS CJ:

Yes.

MR HODDER SC:

But change nothing else, it says. And then at 615, as opposed to the lay member, Hanson J says –

ELIAS CJ:

615?

MR HODDER SC:

This is the last page in this collection.

TIPPING J:

Printed upside down, no doubt.

MR HODDER SC:

Mine looks all right, Sir. So, "Where are you taking us to? Is it we throw the counterfactual out of the window in this case?" "No." "What do you contend?" "I contend the counterfactual doesn't necessarily have to have supra-normal profits, but it has to have a margin above costs," then debate carries on. So, there's two positions in which there's a question mark as to whether the Commission is wishing to abandon the counterfactual. The Commission doesn't say, the point that Justice Tipping raised, you mentioned, that, "We actually think there could be a problem with counterfactuals and we want to rely on something else and specify what it is." The case was run entirely on that basis, the evidence, cross-examination, et cetera, was all run on that basis and, frankly, it's too late to start a new case at this basis of the process. That, in our submission, the nature of the evidence and the way in which it works will be developed in part, and the way in which my learned friend approaches the counterfactual.

But, if it's convenient, what I propose to do now was to turn to the legislation, or the Australian legislative history, in particular, and the themes that we say emerge from that and which is why the general proposition that there should be a harmonisation with Australia is a difficult proposition is because originally the legislation did have a counterfactual concept in it, and the preparatory materials indicate that. There was a distinction being sought between legitimate and illegitimate competition. The word "counterfactual" isn't "use" but that's kind of behind it. The Australian Parliament has – and its various committees have been slightly more active than the New Zealand Parliament in this process, and there've been a few amendments along the way – but in the result, where we're getting to, is that after *Boral* and after *Rural Press* there was a reaction to the concept that economic power or financial power wasn't market power. And you will recall that in both those cases the plaintiff was unsuccessful, and it was a case of small failing to prevail over the big, and effectively was the way in which it was seen, although the *ACCC* in part was representing itself on behalf of small. And it's a reaction to *Boral* and *Rural Press* that underpins the legislation which now has been enacted in Australia. So, the harmonisation submission to this Court has that problem. Harmonisation with what? In the ordinary course one would expect, and it has happened, as we have seen in relation to *Carter Holt,* that New Zealand Courts will pay considerable respect and be mindful of the advantages of a combined jurisprudence, and that's happened consistently in the cases that I've taken Your Honours to. But when the Australian legislature changes the legislation markedly, that does create a problem. What is it?

BLANCHARD J:

But that's all something that's happened subsequently, and no-one's asking us to try somehow judicially to pick up the most recent Australian amendments.

MR HODDER SC:

In effect, Sir, they are.

BLANCHARD J:

Well, they may be out of luck if that's what they think.

MR HODDER SC:

Well, the point that we make is that the harmonisation occurs at the point of *Boral* and *Carter Holt,* that has achieved harmonisation. What's happened in Australia since is a political reaction to the *Boral* and *Rural Press* cases, which has been manifested in explicit provisions, including in relation to "use" or "take advantage", which is where you find the section 46(6)(a) in the material that had been put before the Court. And so that is the signal that something is wrong in relation to the approach of the Courts. The 2001 amendment then is a rather different position, and I'll come to that in terms of the New Zealand amendment. But in terms of the Australian position, it is clearly a reaction to those cases.

Now, just to pick up a number of those points. There's a substantial history in the material that's traversed in the Intervener's submissions. In the early stages, and going back to the very beginning – and I might take the Court to it – but in the original 1974 discussion in the Parliament, what was being sought was normal competition by big enterprises, that's at page 229 of the discussion at tab 19 of the Intervener's volume 1. And that raises the question about what does normal competition big enterprises mean? Inevitably, that was when broad concepts and the broad language, and the language was changed on a couple of occasions before we got to something approaching the current wording of the Australian legislation. In more modern times – perhaps if Your Honours have volume 1 of the Intervener's bundle, picking it up at tab 22, this is the Swanson Review Committee in 1976, it's tab 22.

ELIAS CJ:

I think this may have escaped me.

BLANCHARD J:

I don't think I've got that volume.

MR HODDER SC:

Well, if I just give the reference.

BLANCHARD J:

I couldn't find it the other day, but it didn't seem awfully relevant so I didn't go looking for it.

MR HODDER SC:

Well, I just want to point out – in there is a –

BLANCHARD J:

Do we really need to trawl back that far?

MR HODDER SC:

Well, I was going to say that as far back as Swanson in 1976 at paragraph 6.7, there's a discussion of what I'd say is the counterfactual concept already there, back as far as that. It's not something which was unknown until –

BLANCHARD J:

Well, I don't think you'd have to prove that.

MR HODDER SC:

Well, let me pick it up at Dawson, if I can, which is slightly more recent, in 2003.

BLANCHARD J:

Which volume's that in?

MR HODDER SC:

That's in volume – that's actually in volume 3 of our bundle, just to make life more complicated, at tab 62.

TIPPING J:

Volume what?

MR HODDER SC:

Volume 3 of Telecom's bundle at tab 62, Sir.

TIPPING J:

Thank you.

ELIAS CJ:

At tab 63?

MR HODDER SC:

62.

ELIAS CJ:

62, the review?

MR HODDER SC:

This is the review that was undertaken after *Melway.*

BLANCHARD J:

And after our 2001 legislation, obviously.

MR HODDER SC:

Yes. Much of the discussion in relation to section 46 is about whether there should be an effects test built into section 46 and that discussion leads to a conclusion there should be –

ELIAS CJ:

Sorry where is this submission going Mr Hodder. Is it, are you saying that we shouldn't be looking to the Australian authorities? I'm just trying to fit it into your overall argument.

MR HODDER SC:

The proposition is that in this context the preparatory work is recognised and that the role of the Courts is to refine the broad terms of the legislation and the initial proposal was that should continue and in particular I'm referring to page 84 of the Dawson report which says just that.

ELIAS CJ:

But what use do you suggest we can make of this material? Or should make of this material?

MR HODDER SC:

That there is no need to change because the position reflected in the previous cases was a refinement in a way which was consistent with the principles up to that point. The only thing that has changed in Australia is a political change in relation to 2007/2008 amendments which are explicit reactions to *Boral* and *Rural Press* and those specific reactions include asking the Courts, in effect, to revisit the approach to taking advantage.

BLANCHARD J:

I'm having real difficulty understanding the relevance of this argument. It seems to be a long way away from where we were.

MR HODDER SC:

Well I'm facing –

BLANCHARD J:

We're talking about at most what was the significance, if any, of the change made in New Zealand in 2001. And of course we're dealing with something that was before that anyway.

MR HODDER SC:

Yes. The proposition that I'm addressing in effect is the idea that there should be a change, a departure in the Privy Council because it is out of step with Australian law and I apprehend that it has two limbs to it. The first is it's out of step with Australian case law which I've attempted to address –

ELIAS CJ:

We're not going to harmonise through case law with Australian legislation not adopted in New Zealand Mr Hodder.

MR HODDER SC:

Well that's – well I'm partly building up to answer and I think Justice Tipping made a comment yesterday about section 36(a) which is what I'm partly coming to. The reason why we don't have or why we would suggest that if there is a case that arises under section 36(a), it would be governed by *Boral/Carter Holt*. It's because – and we say that has to happen because that's what the law is. There is a difficulty in Australia because there maybe a difference between their domestic approach and their trans-Tasman market approach because what's conspicuous is there was no change to section 46(a) –

ELIAS CJ:

I see.

MR HODDER SC:

Only 46 was changed so their 46 remains the same as our 36. Their 46(a) remains the same as our 36(a).

BLANCHARD J:

Sorry, when was that change made?

MR HODDER SC:

The change to?

ELIAS CJ:

46(a).

MR HODDER SC:

It hasn't been changed.

ELIAS CJ:

No sorry, 36 –

BLANCHARD J:

When was the occasion in which it might have been changed but wasn't changed?

ELIAS CJ:

46.

MR HODDER SC:

When 46 was changed –

ELIAS CJ:

Yes, 46.

MR HODDER SC:

– in 2007 and 2008.

ELIAS CJ:

Right.

BLANCHARD J:

Yes but that's all again years later.

MR HODDER SC:

I agree. I'm responding to a proposition that I think, I don't want to allocate any responsibility to anybody, but I thought I was responding to a proposition that the fact that there could be a discrepancy between Australian law applying, the approach in Australia and New Zealand was a matter of some difficulty. That wouldn't happen because Australian Courts will now have to apply section 46(6)(a) if it's –

TIPPING J:

The obvious solution is for our Parliament, if it wants to, to make us have a (6)(a) as well.

MR HODDER SC:

That's my submission.

TIPPING J:

Yes.

BLANCHARD J:

There's nothing very unusual –

TIPPING J:

We can't do that.

BLANCHARD J:

– about it, the Australian approach to harmonisation is we do things, you harmonise with us.

MR HODDER SC:

The submission that's being put forward by –

BLANCHARD J:

I'm not just being facetious about that. That's the reality, they're bigger than us, they don't always act in complete harmony with us. But where they make a legislative change then we don't necessarily follow that change. We wait, often, well most of the time we would simply wait for our legislature to decide whether it's going to make the change as well.

ELIAS CJ:

Isn't your point really that it is significant that section 46(a) wasn't changed?

MR HODDER SC:

Yes.

ELIAS CJ:

Yes.

McGRATH J:

That provision came out of a bilateral agreement, did it not?

MR HODDER SC:

Which one?

McGRATH J:

46(a).

MR HODDER SC:

Yes.

McGRATH J:

So one would expect the change to come also from a bilateral agreement in New Zealand?

MR HODDER SC:

One would hope so. I'm responding to a submission from the Commissioner at paragraph 318 that says, "Section 46 of the Trade Practices Act has been amended to incorporate the judicial tests to be found in the High Court of Australia."

BLANCHARD J:

And you're saying it hasn't been amended?

MR HODDER SC:

I'm saying 46 has been amended but not in that way.

ELIAS CJ:

And for a different purpose.

MR HODDER SC:

Yes, quite different purpose.

BLANCHARD J:

Yes.

MR HODDER SC:

We say it's quite wrong, the submissions for the Commission and for the Intervener, to say that what has happened is that those amendments clarify the existing law from the cases. They are explicit reactions against them and –

McGRATH J:

Well they're cautioning us because there are particular political forces at work –

MR HODDER SC:

Yes.

McGRATH J:

– you say so this wasn't a sort of pure attempt to codify principles to date in the case?

MR HODDER SC:

And all that is reasonably obvious in the Senate References Committee which is at tab 24 of the Intervener's bundle. I anticipate the Court doesn't need to be taken to it but I'll just tell you that that's the bundle that has the Senate Report in it. The terms of reference are sort of set up to succeed in terms of making life easier for small businesses. There was consistent criticism of *Boral* and *Rural Press* in that report. But I'm happy to take the proposition that this Court has no real ability to harmonise with the moving legislative target across the Tasman in the absence of a bilateral agreement and it was also –

ELIAS CJ:

And in the face of the existing section 36(a) and 46(a).

MR HODDER SC:

Yes. And also resisting strongly the proposition that the new 46(6)(a) and the other amendments to it somehow represent prior Australian law which is the purpose of the traverse through the cases.

BLANCHARD J:

Well if the Australian Courts were to say that that's what they do then we might be in a position to say yes and the New Zealand law is the same but in the absence of anything like that, and I'm not suggesting that they would or could say that, the Courts in New Zealand can't just effectively adopt a state of legislation.

MR HODDER SC:

That's our submission and I'm happy to move off that topic. That I think brings us back to the essential question, should this Court rule that the counterfactual is not necessary and obviously our submission is that it should not on the reasons for that will be reasonably obvious what is aid but just to summarise those. The counterfactual enables the articulation of the issue of the appropriate connection between the section 36 factors as opposed to their mere coexistence, if you recall that language from the Australian cases, and we say that the Privy Council *Carter Holt* version of the counterfactual test, that is, "could rationally" effectively incorporates the could or "could only" test and the legitimate business rationale tests and for that matter, insofar as it's part of the overall scheme of things, whatever materially facilitates means in this context, the advantages are picked up by the counterfactual process as well.

But what it does do is it ensures a careful economic analysis of the issues that arise in the way in which one tests whether what is going on is behaviour to be found in a competitive

market or behaviour that would not be expected to be found in a competitive market. Now all of that is obviously informed by the factual context and so this case, that's before you now, had six weeks of trial. We didn't have six weeks on the counterfactual because the rest of it provided a great deal of context which was obviously relevant to the overall question which is where I come back to the idea of the statutory language is what happens at the end of that process in the face of all the evidence including the counterfactual which is a necessary part of the analysis the question is whether or not the section 36 claim has been made out by the party advancing it.

Insofar as the suggestion is that there should be some change because it would be easier for the Commission to win cases, which I think is inherent in some of the Commission's submissions, we suggest that isn't a helpful guide of anything and indeed this is a particular area where caution is required, and that's one of the reasons why written submissions make reference to the, you know, the State Supreme Court decisions in *Trinko* and in *LinkLine.* And in fact, when one reads the *Metranet* decision, which my learned friend's handed up to you, which we haven't seen before, that also says the same things effectively. It is suggesting that caution in this area should be appropriate by reference to the earlier cases, and I won't take you on his tour, but if one goes to pages 1386, 693867 it enumerates the economic efficiency arguments in favour of eliminating arbitrages. But the point is that it's an area in which the line of authorities in Australia and New Zealand and the United States suggest caution in expanding liability in this area. All of those, we say, are matters that have nothing to do with precedent, we simply say, "That's a matter of principle, all those things are virtuous features of the counterfactual argument."

Then there's the question of whether this Court should depart from the Privy Council as a matter of precedential policy, and our submissions deal with that at some detail, and this Court has, I think since we wrote those submissions, dealt with *Couch*, the *Couch* case, and expressed views in relation to that. Our arguments, we submit, are entirely consistent with what was considered by this Court to be appropriate in *Couch,* so we submit there were not compelling circumstances here which require a departure, that the stability of the law which is part of the rule of law is enhanced by not departing from the Privy Council, that there hasn't been any significant change in the law or any undermining of the intellectual foundations of the previous law. What is actually being invited is a difference of either intellectual preference or doctrinal disposition to be applied to come to a different result, and there's the thought experimented, now what reception these arguments you've heard from the appellant and the Intervener might have if they'd been raised in front of the Privy Council for, effectively, the third time? I don't take it any further than that.

So, in our submission, there's nothing in the counterfactual test which inhibits the proper development of the law, it isn't clearly wrong and it does conduce to certainty in a way that the

alternatives being offered do not. And for the reasons that we've referred to in the written submissions, this is an area where there is scope for the matter to be left for the legislative process to operate. And we resist the Intervener's submission that there's nothing more that the legislature can do, it had already spoken in 2001. If it wishes to do so, it has a model in Australia in the form of section 46(6)(a) and the like.

Now, the 2001 amendment, we accept that Parliament meant to make some change. In our submission, we shouldn't really be arguing what it meant in this case because it has nothing to do with the claim facing Telecom in this litigation. It certainly made at least one change in terms of changing the threshold from dominance to substantial market power, the most immediate significance of which is the concept that you may have two parties with substantial market power, but you can't have two parties with dominance. So it's not an empty gesture. Whether it goes anywhere beyond that is not entirely clear.

TIPPING J:

But the "take advantage" change is not linked conceptually to that, is it?

MR HODDER SC:

Conceptually, no, but if the proposition is, we don't want to leave a piece of legislation being absolutely useless, it does absolutely nothing, then the proposition is it does do something, it changes the core threshold, which is significant. Beyond that, we suggest, it's not necessary to go in this case. In a relation to reliance, insofar as that's relevant, I'm not sure there's much else I can add to the discussion that's taken place between the earlier counsels' exchanges in the Court. There is a difficulty about proving reliance in relation to these matters. I think I mentioned earlier on that in-house counsel have an important role in these areas, to give advice and some clarity in that context is appropriate but, inevitably in these circumstances, as you saw from some of the redacted discovered documents, there will have been legal advice in these processes, it is privileged, it isn't a matter for evidence in a case like this, and the matter really can't be taken any further than that in relation to reliance. It's part of the general law, any advice would have had regard to it. So, the overall proposition of the Privy Council was consciously seeking to achieve greater certainty that has appropriate rule of law connotations, it was seeking to promote competition and it was seeking to promote harmonisation with Australian law in this area. And all of those things, we say, are entirely appropriate and provide no basis for departing from it as a precedent.

Now, the only other matter that I wanted to mention briefly was the question of dominance, where Telecom has in effect other grounds, which are dealt with in our written submissions from pages 43 onwards. And both of them come back to the theme of regulation, which I attempted to explain when I was introducing the role of the Minister under the KSO yesterday, and we say they are significant in relation to both the findings of dominance which are

challenged by Telecom in its written submissions. So, just to pick up the point at paragraph 5.9 of our written submissions, we submit that the Court of Appeal erroneously held it was Telecom's fear of regulation rather than Clear's economic power that changed since the 1996 Interconnection Agreement. The evidence that goes to Clear's economic power we've referred to in various forms and I don't propose to go into it, but just to take the point about the fear of regulation, that isn't an irrelevant factor in relation to either matter, that was part of the regulatory regime that was in place.

ELIAS CJ:

Sorry, can you just expand on that a bit?

MR HODDER SC:

I'm at paragraph 5.9 of our submissions, and I'm suggesting in part that it was a false dichotomy to talk about Telecom's fear of regulation rather than Clear's economic power that had changed. That wasn't a sufficient basis for reversing the findings of the High Court in favour of Telecom in this matter.

TIPPING J:

Are you attacking the findings of dominance in both markets –

MR HODDER SC:

Yes.

TIPPING J:

– or only in the wholesale market?

MR HODDER SC:

Both.

TIPPING J:

Both?

MR HODDER SC:

Both. In both of them the only point I want to address –

TIPPING J:

And what's the king hit, if there is one, what is the key feature?

MR HODDER SC:

The key feature of the markets we're talking about is the fact of the KSO and the requirement to provide free local calls. Saying that you don't have regard to that in deciding whether there's dominance, we say, is the classic performing *Hamlet* without regard to the prince. You cannot conceive of the market and all its features unless you take into account the fact that the KSO mandates free local calls. To say that you don't take into account of that because it's not conduct by a competitor or a customer misses the point that the KSO is meant to represent the collective interests of customers. We say the High Court was simply wrong on that and we referred to Professor Hausman's evidence, from an economic perspective Professor Hausman's evidence was that it was a major constraint and therefore the general proposition about market power, the ability to give less and charge more, was answered by the KSO. You couldn't reduce the scope of the coverage under the KSO, that was required to be maintained, you couldn't increase the price, except with permission of the regulator, as in fact happened. To say that's got nothing to do with dominance was what the High Court said, we say there's an error. And insofar as the wholesale market doesn't give weight to the fear of regulation, that's another aspect of regulation.

ELIAS CJ:

Yes, I am a little troubled by the wider climate. I wonder whether it's correct to say that the High Court was entirely incorrect? Because is the KSO a total answer?

MR HODDER SC:

To dominance in the market?

ELIAS CJ:

Yes.

MR HODDER SC:

In the local –

ELIAS CJ:

I mean, are you –

MR HODDER SC:

Yes.

ELIAS CJ:

– suggesting that?

MR HODDER SC:

Well, the question is, does Telecom have freedom of action in the residential market? The answer is, no, we suggest, not quite self-evidently.

ELIAS CJ:

But it obtained an adjustment. As soon as it had the agreement of the Minister that it could up its prices, it was able to move its customer base over

onto the oh whatever.

HODDER SC:

0867.

ELIAS CJ:

0867.

HODDER SC:

It was able to impose a two cent charge on the Internet traffic.

ELIAS CJ:

Yes.

HODDER SC:

Only with the regulatory approval.

ELIAS CJ:

Yes, but does –

HODDER SC:

And the very fact that –

ELIAS CJ:

Does that – you may not be suggesting this, but are you suggesting that that exhausts the section 36 concern?

HODDER SC:

That's a slightly wider question. The concern I was addressing was simply dominance, but I think the answer has to be, yes, because you don't get to dominance on the argument I'm advancing to the Court. The question is to be asked in advance, not afterwards. Before

Telecom goes down this course, does it have the power to do what it wants? Answer, no, it has to get the regulatory approval. What's regulatory –

TIPPING J:

Is the argument that what would otherwise be constraint from the market is constraint from a regulator?

HODDER SC:

Yes. This is a market where, in effect, the consumer interests are focused into the Minister's power under the KSO.

ELIAS CJ:

But only part of the consumer interest. It's the consumer interest in getting free domestic connections.

HODDER SC:

That's part of the factors that are taken into account by the ministers in deciding whether to allow this to go ahead.

ANDERSON J:

Can you have a monopoly in the wholesale, in the retail market, for example, and not be in a dominant position?

HODDER SC:

Yes.

ANDERSON J:

But what about the choice –

HODDER SC:

Well, if by monopoly you mean market share, Your Honour, I'm not quite sure –

ANDERSON J:

Effectively, Telecom had a monopoly in the residential market.

HODDER SC:

It had almost all the lines.

ANDERSON J:

Yes.

HODDER SC:

That's not the same thing as a monopoly, we'd suggest. You can have 100 percent of the market and not be a monopolist. Monopolist depends on what you can do in that market. If you're wholly regulated, you don't have monopoly power, and the point here is that you don't have that. Market share does not determine market power if there's a countervailing factor, such as a regulatory regime. What about customer choice, does that have any relevance?

HODDER SC:

When you say the customer, well, there are a variety of choices in there, but the customer interest is picked up in the decision by the regulator whether to allow this to happen or not.

ANDERSON J:

That's the economic interest, not the choice of supplier. I mean, in a non-dominant market or a non-monopolistic market, a consumer theoretically has a choice of supplier.

HODDER SC:

Yes, and that was preserved under the 0867 initiatives.

TIPPING J:

We're going to have to look at, if we're going to go into this, we're going to have to look at the evidence of what the economists said about this, too, aren't we? If they said anything relevant. Your proposition seems to be that the KSO insulates you from being dominant in either market.

HODDER SC:

But the point I'm building up to in relation to this is this reflects the way in which the US Supreme Court has approached this area, is that where you have a regulatory regime, an anti-trust law has less of a role to play because the regulator has the ability to deal with these things in a way that the Courts can't in advance.

ELIAS CJ:

It depends what you're regulating.

HODDER SC:

Sorry?

ELIAS CJ:

It depends what's being regulated. It wasn't the market in which suppliers of lines were competing, it was simply the ability of the domestic customer to obtain access to the Telecom market.

HODDER SC:

But, in effect, that was the market, and as I mentioned yesterday, the very thing that happens with some regime such as this is there is not going to be anybody else in the residential market because how do you compete with free calls for the local residential market? So the KSO creates that market, it creates the nature of the market and it regulates the behaviour in the market, and we say that the High Court erred on the basis of simply disregarding that. In effect, our proposition is a relatively narrow point.

TIPPING J:

Yes, it is. The High Court regarded it as irrelevant.

HODDER SC:

And we say it's entirely –

TIPPING J:

It's at least relevant, if not decisive.

HODDER SC:

We say it's decisive –

TIPPING J:

Yes.

HODDER SC:

– when we say the analysis is simply set up very briefly in Professor Hausman's evidence. But it's a yes or no answer on that proposition.

TIPPING J:

What did the Court of Appeal say about the KSO? Forgive me for not being completely on top of this.

HODDER SC:

It didn't really address it.

TIPPING J:

Didn't address it?

HODDER SC:

No.

TIPPING J:

So, the finding of dominance is, in your submission, flawed by the failure to take account of a relevant consideration?

HODDER SC:

Yes.

TIPPING J:

At worst, from your point of view, you say –

HODDER SC:

Yes.

TIPPING J:

– it's a decisive consideration?

HODDER SC:

In the face of that, it had to be proven in some other way it wasn't. If Your Honours please, unless there's any questions on the topics that I was addressing, then –

ELIAS CJ:

That's a good time to take the lunch adjournment, then we will hear from Mr Shavin after lunch.

HODDER SC:

As Your Honours please.

ELIAS CJ:

Thank you.

COURT ADJOURNS: 12.55 PM

COURT RESUMES: 2.15 PM

ELIAS CJ:

Yes, Mr Shavin.

MR SHAVIN QC:

What I seek to do this afternoon is to start with a brief overview as to the counterfactual and then take the Court through the counterfactual analysis that was put to the High Court and accepted by them, and by the Court of Appeal.

Our learned friends did address the counterfactual very briefly in their outline, primarily at paragraphs 5.5 and 5.9 E. They don't seek to take the Court through and demonstrate what they would otherwise put to the Court in forms that we would say are no more than assertion and slogans. It's very easy to say, oh, Telecom did this because we bullied or Telecom forced someone to do it, or people would have gone somewhere, but when one gets past the assertion and the slogans, one finds that in the detailed analysis of the counterfactual, what was demonstrated to each of the Courts below was that, in fact, that's not what has happened, that, in fact, there was no credible threat of people leaving Telecom and going to another network, because there was no incentive either for them to do so or for the other network to accept them.

And that's why the High Court approached it in two parts. First was to assess whether or not Telecom faced a significant risk that, in fact, it would lose customers, and then to ask, would it worry?

What our friends have done has been to concentrate on the second of the two propositions, rather than on the first, so we'll start with the first proposition, the counterfactual. Then we'll look at the question that has been raised by our friends, in any event, even if Telecom was at risk of losing customers, would it worry? Because, at the end, in our respectful submission, the High Court and the Court of Appeal both correctly reached the conclusion that, in fact, what Telecom was doing was what any competitive firm would do, confronted with an increase in costs, no ability to derive revenue to cover the increase in costs in circumstances where it was suffering a loss of dynamic efficiency in its network, unable to fulfil what it had to do with the network without incurring substantial capital expenditure, most of which was likely to be stranded.

Our friends have said that the counterfactual is too hard, too difficult, too complicated. In our respectful submission, that's simply not made out. In fact, the counterfactual that was put by the Commission to the High Court, ultimately refined in the High Court in October, is on all fours with the counterfactual in *Queensland Wire* and in *NT Power*.

In *Queensland Wire*, the counterfactual was very brief. The whole submission in the High Court was less than eight pages, because it was founded on a simple proposition. You have a very large steel company had 97 percent of the Australian steel market. No one was suggesting that you're going to create another company, but as was said in paragraph 145 of

NT Power, to which my friend Mr Hodder took the Court before lunch, you assume that there's an alternative source of supply. The reason, the primary reason, that, in fact, *Queensland Wire* was concerned about an inability to obtain supply of Y-bar from BHP was because there was nowhere else to go, so assume an alternative source of supply. You don't have to identify where, you assume it. That means BHP faces competition, and you simply undertake the analysis from that point. In *NT Power*, you assume an alternative infrastructure. You don't have to identify precisely how or where. The High Court said in paragraph 147, High Court of Australia said in paragraph 147, it might be quite unrealistic to think there would actually be a second set of infrastructure but you ask yourself, if there was, what would happen?

Now, all that happened here was that the Commission, and it's repeated it in paragraph 4.3(a) of their outline to this Court, it is accepted that the essential performance source of dominance which it asserts against Telecom was that it owned some 99 percent of the retail access lines. So the way in which you approach the counterfactual is, you assume another network. You don't have to work out precisely how you do it, and that's what Professor Hausman said. You don't need to work out how you do it. There are all sorts of ways in which you might do it, under bundled, local loop, however, that doesn't matter. What you need to do is, you must take away the primary source of dominance. So you say, all right, let us assume that there are endless suppliers of residential local access.

TIPPING J:

When you say, Mr Shavin, take away the primary source of dominance, are you making a studied distinction there between primary sources and subsidiary sources of dominance?

MR SHAVIN QC:

We're not seeking to establish, and no one has, a perfectly competitive market. In a workably competitive market, which is how the case was put below, you can have, and will have, some elements of power. What you're looking at is the principal source of power, that is, the thing which gives you the dominance. You don't have to strip everything out. When you say, well, what is the relevant source of power, the relevant source of power here that is asserted is that Telecom controlled 99 percent of the residential access lines. Once you say, oh, there are N number of networks, and the additional network was called W. So you had X for Telecom, Y for Clear and W1, W2, W3 to WN of other networks. Then you say, all right, there are substitutes. That's all you need to worry about. And then you ask whether, in those circumstances, Telecom could engage in the conduct in which it did engage.

And so, the High Court said, we have the characteristics of a workably competitive market, we have at least three dominant firms, X, Y and W… (audio stops 14:22:01)

COURT ADJOURNS: 2.22 PM

COURT RESUMES: 2.34 PM

ELIAS CJ:

I'm sorry about that.

MR SHAVIN QC:

These things happen. Technology is wonderful when it works.

ELIAS CJ:

I don't know which network we're on.

BLANCHARD J:

It probably couldn't cope with the accent.

MR SHAVIN QC:

Yes, I wondered whether it would be my fault. Sorry about that. Perhaps it would be helpful for me to briefly refer the Court, before progressing further, to the relevant passages in the High Court.

BLANCHARD J:

Could you just go back to the couple of sentences you were uttering before we got interrupted? I didn't really get a note of it. Were you saying that we also need to assume that there will be a disproportionate number of consumers as between these networks?

MR SHAVIN QC:

Yes. An assumption that was made by each of the economists and by the Court was that there was a disproportionate number of residential customers on network X compared to network Y.

BLANCHARD J:

So that's the kind of situation which would exist if network Y had only just been built?

MR SHAVIN QC:

Or if it had targeted a particular type of customer. And the reason for that was that it was necessary to replicate the asymmetry, because it's the asymmetry that's driving the conduct, and if you don't replicate the asymmetry, then you don't replicate the pressure.

BLANCHARD J:

Yes, that's what I thought.

TIPPING J:

What degree of asymmetry do you replicate?

MR SHAVIN QC:

Simply something that was disproportionate. This was discussed with Dr Bamberger. I can get the Court the reference later, but Dr Bamberger – and we accepted this – simply said it had to be disproportionate.

BLANCHARD J:

Would it matter whether it was – is it 97 or 99 percent?

MR SHAVIN QC:

Or whether it was 70, no, I don't think so. Because what one needs to establish, to establish the pressure, is that it has to be disproportionate so that there is an asymmetric flow of terminating access payments. Where the ISPs, there is a second disproportion, there is a disproportionate number of ISPs on network Y. There has to be a call sync created, and by a call sync we mean that when you had an ISP, it receives a very large number of incoming calls and makes, effectively, no outgoing calls, because all of the Internet access is coming into its servers, and we'll explore the nature of the network access servers by which that happens a little bit later in the analysis. So you need to have call syncs on one network with a disproportionate number of residential customers on the other, creating the pressure of the terminating access charges flowing from one direction to the other, and then one asks oneself, if, in fact, network X in the factual is in a dominant position, would the absence of dominance mean that it could not have proceeded to introduce the 0867 scheme? And that's the counterfactual that was discussed in each of the authorities, to which my learned friend Mr Hodder took the Court this morning. We do that by simply creating competition for Telecom or network X by assuming additional networks, and then saying how does that change the actions and the reactions, and we look at that from each perspective. We look at that from the perspective of network Y. We look at it from the perspective of network W, and we look at it from the perspective of network X. We take it in that sequence.

Now, the High Court set out the characteristics at paragraph 77, which is case on appeal volume 1, page 61. It set out the matters to which I've taken the Court, and so the Court can see where we end up. At paragraph 83, the case on appeal volume 1, page 63, going to 64, the Court concluded from the counterfactual analysis that, in fact, Company X is as likely to acquire new residential customers from Company Y as it is to lose customers to Company Y or another carrier's network. The net loss in residential customers is accordingly likely to be

small or a net gain could even result. So on this first issue, that is, before we look at whether or not Telecom would be concerned at the loss of customers, one asks if one was in a competitive environment, would it actually lose them, and on that level, the High Court answered no, but nevertheless went on to consider even if it did, would it worry Company X?

Now, as we understand it, my learned friends challenged the statement in paragraph 77 that there was general agreement on the characteristics of the competitive market. In our respectful submission, it is clear that there was. Could I take the Court to volume 5 of the case on appeal, page 1651. I will be taking the Court to a number of aspects of the cross-examination of Dr Bamberger during the course of the afternoon. At page 1651, lines 7 to 17, I asked Dr Bamberger, "So the counterfactual which has the non-dominant firm confronting a KSO, confronting the ICA in the form of the 1996 ICA, confronting the asymmetry, but otherwise in a market which was competitive, Dr Bamberger, and you've asked me to assume that in that counterfactual, they would successfully implement 0867?" "No". "We're going to explore that. I'm just trying to get the preconditions for the counterfactual". Answer, "It sounds to me like that's a plausible counterfactual, to analyse the issues we're interested in, in this case". And perhaps if I could take the Court also to page 1653, at lines 13 to 19, in the midst of an answer, Dr Bamberger – at line 13, the sentence commenced, "Key characteristics of an appropriate counterfactual, in my view, is that there is an asymmetry, there's an asymmetric traffic problem that can arise because there are no ISPs on Company X's network, or because they just have fewer ISPs than Company Y. It is just that it is the asymmetry that's critical".

So we have there most of the elements of the counterfactual. It was also dealt with in response to questions by the lay member to Dr Bamberger, and if I could simply refer the Court to it, without taking the Court to the transcript references. In the same volume, volume 5, case on appeal, page 1722 line 5, and page 1726 line 17 and following. So that we say that in terms of general agreement with the counterfactual, it is clear that Dr Bamberger was not dissenting. Now, my learned friend in oral submissions suggested that the Court stripped out all the monopoly profit of the ICA, and as will be seen, that's not what happened at all. What the Court did was that it took the minimum step, the step that was taken in *Queensland Wire*, the step that was taken in *NT Power*. The Court simply took the core issue and created a competitor, and otherwise left the ICA in place. Because the critical thing was what was going to happen if you had substitute networks.

Dr Bamberger accepted at volume 5 case on appeal, page 1648 at lines 15 to 33, he's responding to some comments by Professor Hausman, and says, "I guess I would just reiterate, maybe we're having something else in mind. I'm frankly not sure at this point, but I think in workably competitive markets, however you want to define those, firms often sell

products, a bundle of products, where the price for any individual component won't cover the cost because sometimes that price is zero".

And then if I could take the Court down to line 30, "So you have this kind of peculiar situation where you're asked to assume a competitive market, but also you have to assume that there's this asymmetric traffic problem". And so he's assumed the asymmetric traffic problem. It is also clear that Dr Bamberger, and we'll come to this in a little bit more detail in a moment, accepted that a firm might charge prices above cost without earning supra-normal profits. Now, Dr Bamberger vacillated in terms of what he'd understood to be supra-normal profits. In his first brief at case on appeal volume 4 page 1372 paragraph 55, he, in fact, defined a supercompetitive price as a price that was above marginal cost. As the Court heard on Monday, my learned friend Mr Farmer disclaimed this as not having any sensible application in telecommunications markets. And we would respectfully agree. But Dr Bamberger had a very flexible approach to what constituted a monopoly price. What he did say was that he would regard some prices as above cost as not being supra-normal profits. But, of course, he couldn't accept that there was – he couldn't deny that you would not have an absence of supra-normal profits if you've got a workably competitive market with no dominant firm. Professor Hausman, and I'll just give the Court the reference if I may, in his brief at case on appeal volume 4 page 1437, defined above competitive prices as one where a supra-normal profit was derived which equated to profits above a firm's weighted average cost of capital.

It might be best, actually, if I do take the Court very briefly to that. That's volume 4 at page 1437, 1438, I'm sorry. In paragraph 42, Professor Hausman said, "The competitive price is equal to the cost of producing a product or service, including a risk-adjusted rate of return for the capital employed. So you have a supra-normal price if it is giving you a return above a risk adjusted rate of return, in colloquial terms, above its weighted average cost of capital". Now, Dr Bamberger accepted that a firm might charge prices above cost without earning supra-normal profits, and that can be found at page 1662 in volume 5 of the case on appeal at lines 11 to 23, where he said, "In the same market, there is also extracting a price for access to its services above cost?" Answer, "I think I've agreed to that several times. I'm happy to agree to that again, yes". But he then denies dominance. At page 1681 at lines 30 to 33, in the midst of answering a series of questions, Dr Bamberger said, "First, I just want to – I know that this is a continual objection, but I'm not calling it a monopoly price. It's a price substantially in excess of costs". So he was drawing a distinction between a price substantially in excess of costs and a monopoly price, but he doesn't anywhere say that in the counterfactual you will find monopoly prices. We would refer to the Court to – without taking the Court to it – volume 5 page 1645 at line 21 to page 1646 at line 4.

Now, in paragraph 5.5 of my learned friends' outline, in dealing with the criticisms of the characteristics identified by the High Court and agreed by the Court of Appeal, that's at page

30 of our friends' outline – they identify three matters. The first is a supra-normal profits to which I have just referred.

TIPPING J:

Could you just slow down a little, Mr Shavin, please. I'm finding it difficult to manage the documents at the speed at which you're proceeding.

MR SHAVIN QC:

Yes, I do apologise.

TIPPING J:

I've got so many documents here. Now, which is the one you say to look at?

MR SHAVIN QC:

If you have our learned friend's outline?

TIPPING J:

Yes.

MR SHAVIN QC:

And at page 30.

TIPPING J:

Yes.

MR SHAVIN QC:

And at paragraph 5.5.

TIPPING J:

Thank you.

MR SHAVIN QC:

And first sub-paragraph our friends say, "The reference to no firm any supra-normal profits. Neither the Commission's counsel nor the Commission's expert economists, except in the counterfactual, that no firm would be earning revenues well in excess of costs," and we've just drawn the distinction between costs and supra-normal profits, that although Dr Bamberger said there might be some pockets of prices above cost, he hasn't at any stage said that there

would be supra-normal profits. And any relation to sub-paragraphs B and C, what he said in response to the statement by the High Court and the Court of Appeal that the experts –

BLANCHARD J:
Can we go back to Dr Bamberger? I need to check this.

MR SHAVIN QC:
Yes certainly.

BLANCHARD J:
You're moving too fast.

MR SHAVIN QC:
I'm sorry Your Honour.

BLANCHARD J:
Because we've got lots of different documents.

MR SHAVIN QC:
Yes.

BLANCHARD J:
Now you're saying that Dr Bamberger didn't say what?

MR SHAVIN QC:
I'm saying that Dr Bamberger at no stage asserted that there would be supra-normal profits in the counterfactual but he did assert that there would pockets of price above cost. So that, if I could take the Court back to 1681, at lines 30-33 –

BLANCHARD J:
And supra-normal profit, is that said to derive simply from a monopoly?

MR SHAVIN QC:
Yes, supra-normal profit, Professor Hausman stated, and we don't understand there ultimately to have been any disagreement, was a profit where you are deriving a return greater than your risk adjusted rate of return, or a weighted average cost of capital.

TIPPING J:
But at 1681, and this is Dr Bamberger, isn't it?

MR SHAVIN QC:

It is indeed Your Honour.

TIPPING J:

Where he says, "It's a price..." What is he calling a price substantially in excess of costs?

MR SHAVIN QC:

When one looks at – if I can say it in two ways Your Honour, at times he talked about cost without defining the type of costs. He didn't say whether it was variable cost, average cost, long run, short run. He talked about cost. There was a general acceptance that the terminating access charges exceeded any measure of cost. He was drawing a distinction between suggestions by me that there were monopoly profits, derived by Clear on the terminating access charges and responded as he did at this point by saying, "I don't accept monopoly profit but I am asserting that there is a price substantially in excess of cost." So he wasn't taking the further step of accepting, in the concept of the terminating access charge, that it necessarily equated to a supra-normal profit. He was simply saying, "I accept it's above cost."

TIPPING J:

"Substantially in excess of cost," is a very elastic concept.

MR SHAVIN QC:

Yes, it is.

TIPPING J:

Now when does it become monopolistic?

MR SHAVIN QC:

Right.

TIPPING J:

When it's above the weighted average cost of capital.

MR SHAVIN QC:

That is Professor Hausman's evidence now. For the purpose of the counterfactual, it may not matter much because there was no evidence in the factual as to what was Telecom or Clear's weighted cost of capital, and all that was accepted.

TIPPING J:

Well I'm hoping this doesn't matter because it seems to be angels dancing on the head of a pin to some extent.

MR SHAVIN QC:

Yes, and all we're seeking to do is, we're seeking to say, in response to what our friends have asserted at paragraph 5.5(a), they've drawn the distinction themselves and we are simply seeking to say, yes we accept that Dr Bamberger said that the terminating access price would be a price substantially in excess of costs and he drew some distinction between that and supra-normal profits. But what we say in response to our friends is that nowhere can we find in the record a statement by Dr Bamberger asserting that in a relevant counterfactual there would be supra-normal profits and it appears that our friends in paragraph 5.5(a) are asserting that the High Court and the Court of Appeal were in error.

TIPPING J:

Well all this debate about the interstices of the counterfactual is starting to put me off the counterfactual frankly.

MR SHAVIN QC:

Can we say yes in response. I had to meet what was in our friend's outline but the core elements of the counterfactual were clearly not in issue and that is why I took the Court in the first instance to page 1651 where Dr Bamberger clearly accepted the counterfactual.

TIPPING J:

Yes.

MR SHAVIN QC:

Can I recite to the Court the history as to why we had this problem? Dr Bamberger in his first brief presented two counterfactuals, not one. In the early stage of his cross-examination he accepted that the first counterfactual didn't comply with the principles articulated by the Privy Council, and so he said, "Put the first counterfactual to one side and we'll deal with the second."

Professor Hausman presented his view of the appropriate counterfactual. In Dr Bamberger's brief he sought to join the two counterfactuals together to create what he thought was an agreed counterfactual, and so when this was distilled during the hot tub, what came were the core elements that the High Court summarised in paragraph 77 of the judgment. And it is our contention that those core elements were generally accepted and were not in dispute. I've sought, before going into the detail of the analysis, to simply meet the propositions in paragraph 5.5 of our friend's outline.

The first one we say is immaterial. The second two we say go nowhere because all that is asserted is that our friends, the Commission's council may not have acquiesced but the Court didn't talk about what counsel acquiesced in. The Court only talked about what the experts agreed to. So that if we say that when one looks at the state of the evidence, the core characteristics of the counterfactual set out in paragraph 77 of the High Court judgment, and accepted by the Court of Appeal, was generally agreed by all experts and that's the starting point. And it's a very simple counterfactual. All it seeks to do is to introduce a competitive network and make some assumptions which we'll now proceed to test and then relax about the existence of a 1996 ICA as the basis of interconnection between W and Y or the use of bill and keep between W and Y, and we also introduce into the counterfactual the counterfactual assessed with a KSO and without a KSO.

TIPPING J:

But competing of the other network that you assume into the counterfactual is similarly ubiquitous presumably.

MR SHAVIN QC:

Yes, yes, because there's no dominant network.

TIPPING J:

Yes, okay, thank you.

MR SHAVIN QC:

We don't need to worry technically how it can happen.

TIPPING J:

No, no. I understand that.

MR SHAVIN QC:

Now as to the KSO, the Court made a finding as to agreement by the parties three experts, and in fact, Dr Bamberger accepted the company should be subject to the KSO and indeed said that in those circumstances it would be academic as to whether the KSO applied to Company Y because it would in any event have to meet it, and that can be found in volume 5 of the case on appeal at page 1787, line 26 to page 1788, line 12.

McGRATH J:

So, just, which paragraph – so which bullet point I suppose in 77 are you on at the moment I put it to you.

MR SHAVIN QC:

5.5(b) of our friends outline.

McGRATH J:

Yes.

MR SHAVIN QC:

They say, "The Commission's counsel in closing submissions did not accept that Company X or Company Y should be subject to the KSO."

McGRATH J:

Sorry, you're on that. I'm sorry I thought you'd moved back.

BLANCHARD J:

Are we back on the submissions again?

MR SHAVIN QC:

I was simply meeting the KSO.

BLANCHARD J:

You're jumping around so much and moving so fast, it's very difficult to follow you.

MR SHAVIN QC:

I do apologise Your Honour. I will slow down.

BLANCHARD J:

Can you remind me which page we're on in the submissions?

MR SHAVIN QC:

Our learned friend's outline, paragraph 5.5, page 30, little (b), is an acceptance by Dr Bamberger of the KSO and there are two transcript references that I give the Court, to only one of which I'll take the Court. The first is case on appeal, volume 5, 1787, line 32, to 1788 line 12 and page 1790 at line 11 where Dr Bamberger said, "I am happy to accept Professor Hausman's assumption that everybody is subject to the KSO."

TIPPING J:

Would it be possible at some stage, Mr Shavin, for my assistance, not necessarily now, and maybe you're going to move to this, to tell us two things. What are the essentials of the counterfactual market and why would Telecom have acted in the same way in that market?

MR SHAVIN QC:

Right. I'm going to –

TIPPING J:

Isn't that the guts of it?

MR SHAVIN QC:

That's exactly what I'm going to proceed to do.

ELIAS CJ:

Is it the case that you accept paragraph 77 –

MR SHAVIN QC:

Yes.

ELIAS CJ:

– as a correct statement and the submissions you're addressing to us are to rebut the point that's been made that there wasn't general agreement?

MR SHAVIN QC:

Yes.

ELIAS CJ:

Yes, thank you.

MR SHAVIN QC:

We are upholding without any attempt to change at all the characteristics accepted below as the counterfactual. We are simply seeking to suggest to the Court that our learned friends, in stating that there was not general agreement –

ELIAS CJ:

Yes.

MR SHAVIN QC:

– are in error.

ELIAS CJ:

Yes.

TIPPING J:

So the counterfactual would look like the description in paragraph 77 of the High Court's judgment.

MR SHAVIN QC:
Absolutely.

TIPPING J:
Right.

ELIAS CJ:
That is it.

TIPPING J:
That is it.

McGRATH J:
And when you say, "general agreement" you mean general agreement between Dr's Bamberger and Hausman?

MR SHAVIN QC:
Professor Hausman, Professor Evans and Dr Bamberger.

McGRATH J:
Right.

TIPPING J:
Are there any particular aspects of what the High Court has found here that you think are particularly significant because I don't want you to move quickly over that to the next step. It's just I was trying to, sort of, confine it in my own simple mind.

MR SHAVIN QC:
We think that there is less significance in paragraph 77 to the second sentence of the fourth dot point. That is the assumption of an agreement with Ihug. It's there. There was agreement – there were references to it by Dr Bamberger but it's not central to any of the analysis.

BLANCHARD J:
What is the significance of that?

MR SHAVIN QC:

In terms of the analysis, the counterfactual?

BLANCHARD J:

Yes.

MR SHAVIN QC:

We don't think it is significant Your Honour. We don't think it's wrong but –

BLANCHARD J:

Because it's not immediately obvious to me.

MR SHAVIN QC:

Yes. The whole of the analysis –

BLANCHARD J:

And as extra replicated in this as well?

MR SHAVIN QC:

Yes, in their first sentence, in the fourth dot point.

BLANCHARD J:

Oh, right, yes, right.

MR SHAVIN QC:

Each of Telecom and Clear had their own ISP. That's recognised in the first sentence. That's significant, but whether you reach agreement with Ihug or not doesn't impact on the counterfactual.

McGRATH J:

And that's really in response to 5.5(c).

MR SHAVIN QC:

Yes. We don't say – we're not going to take the Court's time as to whether it was agreed or not.

McGRATH J:

No.

MR SHAVIN QC:

We really don't think it's significant or material.

McGRATH J:

Don't worry about it you say.

MR SHAVIN QC:

And our friends don't identify themselves how it would affect the analysis. Now, what we say will be drawn from the counterfactual is that first, Telecom's introduction of 0867 did not involve a use of market power. Secondly, a firm, not in a dominant position could rationally have introduced 0867. Thirdly, that Telecom's conduct was not motivated by an improper purpose because it was seeking to deal, cope with both, the extraordinary additional traffic on the PSTN, stimulated by the perverse incentives created by Clear to maximise Internet usage, and secondly, to stem the flow of millions of dollars of terminating access fees.

Now Your Honour, Justice Tipping, raised I think, yesterday, the proposition that it was Clear who was acting in a pro-competitive way and there was nothing pro-competitive about 0867, but this morning Court will recall, there was a discussion about the impact of efficiency on competition, and the nature of the conduct that was engaged in from late 1998 through 1999 was to encourage people to stay on the Internet 24 hours a day. That is, for people to leave their computers on all day just for the purpose of generating terminating access fees not for any efficient purpose. And, of course, the Court will immediately appreciate –

ELIAS CJ:

But how was that accomplished?

MR SHAVIN QC:

By paying people. The ISPs had a negative charge. They paid people to use the Internet. So, you had a trickling down of the terminating access fees.

TIPPING J:

You mean they were actually being paid to leave them on all day?

MR SHAVIN QC:

Yes.

TIPPING J:

And all night?

MR SHAVIN QC:

Yes and there's evidence of this. In Mr Parkes' evidence at paragraph 133 in volume 3 of the case on appeal.

ELIAS CJ:

Volume 3, page?

MR SHAVIN QC:

Page 938, if Your Honour pleases?

ELIAS CJ:

Thank you. I'm sure nobody ever offered me this.

MR SHAVIN QC:

In paragraph 133 Mr Parkes said, "There is only a small step from free ISPs to ISPs that actually pay customers to access the Internet through them, thus being able to contractually, to fulfil full-time Internet access. This is not some fanciful motion. In 2000 an organisation announced a proposal to pay customers to stay connected to the Internet," and the Court will find that in volume 15 of the case on appeal at page 6234.

ELIAS CJ:

Is it 15? It says here 18.

MR SHAVIN QC:

That's in the casebook below.

ELIAS CJ:

Oh I see, yes, thank you, of course.

MR SHAVIN QC:

The internal references weren't updated in the case on appeal. So it's volume 15, page 6234 and also the following page, 6236. And what the Court will see here is a report in Computer World in a week where free ISPs have hit the headlines. "A scheme that pays people to surf the web has announced its extension to New Zealand," and it is discussed. I don't want to take more time with it to the Court but to indicate to the Court that actually what was going on here was not pro-competitive. This was an arbitrage opportunity which was rendering the network inefficient. When we look through Mr Benson's evidence and we'll come to it shortly, Mr Benson was an engineer, formerly working for Telecom who was called by the Commission, and when we look through his reports, because he was responsible for developing, from the early 1990s, Telecom's investment in switches and the traditional planning, provisioning of a network, prior to the advent of the Internet, was that you expected

a growth of about three percent a year and so the object was to provision a network that would cope with your peak hour traffic without having too much excess investment which would be wasteful and an inefficient allocation of resources.

So there was quite a science to provisioning the network and from 1995-1996 Telecom saw that. In fact the usage on the Internet was exploding and exploding faster than it could estimate so there was a substantial project undertaken by Mr Benson to try and devise a strategy for Telecom as to how it should provision its network. What should it do, should it switches, should it get new switches, should it look to different methods and it did. It saw, in the future, but not in the present, ADSL and we'll come to that as to why a little bit later. It looked at a hybrid fibre cable network which is where Telecom started in 1997. So there was an attempt to provision the network to cope with the growth but given that there were new technologies evolving and given that switches often lasted up to 20 years, there was enormous care being taken not to strand investment, not to waste millions and millions of dollars on switches that would then be rendered completely useless. So that when you suddenly had someone imposing loads onto the network it was very significant in network terms because if you've got a line where someone is being paid to leave the line open and leave a connection through all the switches in the network, almost all day, it's a very different load on the network, to a series of three minute calls which is the average voice call, almost around the world actually. Some people talk for a long time but an enormous number of people actually talk for about 60 to 90 seconds and so your average call, as the evidence showed, was three minutes and thus this change in loading on the network had enormous implications for the efficiency of the network and it had implications for Telecom's obligations because Telecom has an obligation to maintain access for voice. People depend upon being able to make telephone calls, both personal and emergency calls, by voice, and if you enable the network to collapse then you fail to perform your obligations under the KSO.

So the network congestion issue was very real. I'm going to come to the detail of it shortly but we note that when we're looking at the purposes this is a key issue which the Courts below took into account and we say properly. Now our friends sought to say, oh well, we're overplaying this. There was only a small number of dollars involved in March 1999 but they had also, the Court will recall, referred to the evidence of Mr Dick who talked about his own ISP gaining 10,000 new customers a month which was an enormous growth rate. So that when one looks, even at the material to which the Court has already been taken, one can see that this advent of free ISPs was dramatically changing the landscape in terms of the volume of calls over the Internet and the loading factors this created on the PSTN in addition to the blending to the terminating access fees.

ELIAS CJ:

Mr Shavin, this is probably quite off the point, but I did seem to remember in some of the materials we've been referred to that these termination payment arrangements were seen in other jurisdictions. Is it –

MR SHAVIN QC:

Professor Hausman in the hot tub –

ELIAS CJ:

Yes.

MR SHAVIN QC:

– talked of the American experience and said that in America the regulators had moved it to a bill and keep.

ELIAS CJ:

I see, yes.

MR SHAVIN QC:

And we'll see that, although it is asserted that in 1996 Clear had wanted bill and keep in the ICA, but we don't know what happened in those negotiations because no evidence about them was adduced from anyone who participated in them. By 1999, in some passages I'll take the Court to tomorrow morning, Mr Forsyth was very frank. Clear didn't want to negotiate. It wasn't prepared to engage in bona fide negotiations at the end of 1999 in the absence of political pressure and it was only when the new Minister in about May, April/May 2000, unequivocally stated to Clear that the new government would not interfere in 0867. That they came to the negotiating table with agreement and an agreement was done in two weeks.

So that one can see, and we'll trace this through tomorrow, that throughout the period when Telecom announced 0867 and sought to have meetings with Clear, and sought to discuss it, there were two letters by Telecom offering to have a meeting and offering to fly to Clear to have the meeting and Clear's response, as Mr Forsyth accepted, was a press release. There was a meeting between chief executives where there was a promising of an olive branch. Where they were going to stop the hostilities, not stop the litigation, stop the hostilities and try and have a more commercial relationship and the response of Clear to that was the next day to file a 60 page submission with the Commerce Commission. And when asked by Mr Forsyth, well would – that wouldn't have assisted, would it, the feeling of let's seize hostilities and his frank answer was, "No."

In 1999 Mr Forsyth conceded that Clear did not want bill and keep where it wasn't to its advantage. So when we're listening to what our friends are talking about, about oh how Telecom should really have sat down and negotiated with Clear, we do have to understand what the evidence was. You need two to tango.

McGRATH J:

Mr Shavin, can I just say that you're putting your emphasis at the moment on the extraordinary traffic problem but the documents we saw yesterday, the historic document, the reports, as I recall them rather indicated that it was really the terminating access fee problem that was driving Telecom in the preparatory stages. You certainly don't sense, well I didn't sense from those, a level of concern about the networks being about to blow up. There is, I think, a reference to fragile networks or something like that but I didn't sense it was quite as dire a position as you're suggesting it was today.

MR SHAVIN QC:

The Court hasn't been taken to all of the network management documents. Our friends didn't take it and I will, we're going to run short of time, which I'm sorry is why I've been trying to move quickly because we are going to run short of time tomorrow. We will seek to take the Court –

McGRATH J:

I just wanted to let you know that that was by seeing a little bit of asymmetry between what you were saying and what I saw yesterday.

MR SHAVIN QC:

Could I draw Your Honour's attention to paragraph 99 of the High Court judgment, volume 1, case on appeal, page 69. I needn't take the Court to it at the moment but in that –

ELIAS CJ:

What page?

MR SHAVIN QC:

Page 69, volume 1, case on appeal, paragraph 99. On this issue Your Honour Mr Parkes was cross-examined and in considering the purposes the conclusion in the last sentence, at paragraph 99 by the High Court was, "We agree with Mr Parkes' observation. The traffic management and the elimination of termination payments were two equal ranking and inseparable objectives, the two feeding on each other."

McGRATH J:

Thank you.

TIPPING J:

It's not so much solving that problem or those problems that are attacked but the way you did it.

MR SHAVIN QC:

Yes.

TIPPING J:

So you don't really have to hammer the fact that you had a problem. I'm very, very comfortable with the fact that you had a problem.

ELIAS CJ:

Two problems.

TIPPING J:

Or two problems.

MR SHAVIN QC:

I was seeking to respond to Justice Anderson's concern expressed I think it may have been earlier this week, that the conduct of Clear appeared to be pro-competitive and 0867 appeared to be anti-competitive and I was simply responding back to the efficiency issues that Your Honour had referred to at that time.

ANDERSON J:

I'd forgotten.

TIPPING J:

Well it's either me or him. You accused me the first time around and him the second time around Mr Shavin so it's probably best to move on from that.

MR SHAVIN QC:

I will. I'm not meaning to accuse anyone.

TIPPING J:

No, no I'm speaking colloquially.

MR SHAVIN QC:

Absolutely. Can I move on to get to the key issue? Dr Bamberger consistently maintained that the combination of wise bottleneck control, the disproportionate number of ISPs here soon would be located on that network, would enable X by threats and – would enable Y by threats and otherwise to apply sufficient pressure on a non-dominant Telecom to prevent Telecom implementing an 0867 package. It is our contention that he was never able to explain why and when we go to the counterfactual analysis, which I'm about to do now, we'll see that in fact in cross-examination he was unable to explain that and as a matter of logic, it doesn't follow.

BLANCHARD J:

If anybody overdid the bottleneck, everybody would migrate elsewhere. They wouldn't put up with it.

MR SHAVIN QC:

And this was a non-trivial part of the wholesale terminating access case because what has to be understood is going on here is that Y has the ISPs on its network and it's charging an above cost price and saying, we wont agree to any other arrangement, we want to have two cents a minute to terminate, and what you then are confronted with is trying to get around that. In other words, Clear in a relevant sense is exercising power, as Dr Bamberger accepted. Whether it's relevant dominance is not relevant to this case but what is actually going on is an attempt by Clear to exploit its bottleneck to extract rents which it would then share with other people.

TIPPING J:

It was exercising power under the ICA, is that another way – or is that expansion a fair one? I'm not saying that harms you.

MR SHAVIN QC:

Clear's source of power was the ICA.

TIPPING J:

Well exactly.

MR SHAVIN QC:

Yes.

TIPPING J:

Exactly.

MR SHAVIN QC:

Yes. Now can I move to the counterfactual itself? Let us look, may we, at Company Y, which is Clear. The starting assumption is that under the counterfactual conditions, Company X has introduced the 0867 scheme with the Internet dialing charge of two cents a minute, roughly, two cents a minute after 10 free hours as in the factual. The position of Y that has to be considered is what happens if as a consequence of 0867 it was to receive customers from Company X. If the former customer of X moves to Y in a bid to avoid the IDC, first, Y will no longer be in a position to provide a subsidy to ISPs on its network because Y will no longer receive the above cost terminating access charges without, as Mr Copeland put it, putting its hand into its own pocket. Thus the transaction –

TIPPING J:

Sorry, I don't understand how you can receive something by putting your hand in your own pocket?

MR SHAVIN QC:

Okay. I'll take it more slowly. We've got Company X, it introduces 0867.

TIPPING J:

Yes, I understand everything up to the point of receiving something so maybe I'm being pedantic Mr Shavin.

MR SHAVIN QC:

No, no.

ELIAS CJ:

You can't offer a subsidy.

MR SHAVIN QC:

You can't offer a subsidy.

TIPPING J:

Ah.

MR SHAVIN QC:

Without putting its hand in its back pocket because it's not receiving the terminating access charges.

TIPPING J:

I'm sorry, I'm probably getting a bit –

MR SHAVIN QC:

No, it's not easy and we've had the advantage of more years than I like to think about this.

ELIAS CJ:

We thought it's an advantage.

TIPPING J:

You've taken advantage of that.

MR SHAVIN QC:

Grey hair and all sorts of other things that happen after these sorts of cases but –

TIPPING J:

Well it's just won't receive the termination charges, that's all you need to say.

MR SHAVIN QC:

But it follows not only getting, is getting the customer unprofitable, but the ISPs on line will lose all, or a substantial proportion, of their terminating access payments because if Y isn't receiving a terminating access charge unless it puts its hand into its back pocket, has nothing to give to the ISP and that means the ISPs risk the customers located on X might decide to change ISPs rather than change networks. Now it was very important, as we'll see in a couple of minutes, Dr Bamberger said, X will never be able to implement 0867 because the ISPs will give all this support to Y and X will be too scared of losing customers and therefore X will capitulate. To understand why this just doesn't work can I take the Court first to paragraph 35 of Dr Bamberger's reply brief because it is on this that he is cross-examined. That is to be found in case on appeal, volume 4, at page 1418.

TIPPING J:

1418?

MR SHAVIN QC:

That's correct. And I'm directing the Court's attention to paragraph 35. Furthermore, Dr Bamberger says, unlike in a factual scenario, Company Y knows that Company X's retail customers can avoid paying the IDC even if their ISP does not have an 0867 number by switching local providers. Perhaps by switching to Company Y's local residential servers. Indeed Company Y would have an increased incentive to compete for Company X's residential customers if Company X attempted to introduce the 0867 package. As a result ISPs located on Company Y's network would be relatively unconcerned about losing business from Company X's residential customers. Company Y's ISP likely would prefer to stay on

Company Y's network and receive a share of termination payments rather than to move to another carrier's network, take an 0867 number, and give up a share of those payments." Now he was cross-examined on this.

Could I ask the Court to go to volume 5 of the case on appeal, at page 1681? I'm afraid I'm going to have to seek the Court's indulgence to take the Court through about, parts of about four pages or five pages of transcript because really it is only in this way that one can understand why what is said in paragraph 35 of the reply brief, fails and why indeed this stem of the Commission's counterfactual analysis failed and why, in fact, on the contrary it demonstrates why at least in relation to this aspect of the counterfactual, as indeed in all aspects of the counterfactual, it can be seen that in a non-dominant X would have been introduced to 0867. Could I ask the Court to start at line 6? Dr Bamberger is saying, "But what I had in mind was that Company X would be faced with the threat of losing retail customers and that would be important to it. Let's look at that proposition. If Company X is to lose customers to which network will they go? Well they won't necessarily lose them. The point in my mind is the threat of loss is what prevents Company X from implementing an 0867 solution. They could go to Company Y. They could go to Company Z. They could go to a variety of places but company X isn't going to run that risk. Let's take the example which is posited in para 35, that the Company X customers go to Company Y's network to avoid the cost of the IDC. That's why they'd move isn't it? Correct. Because what's happened is that Company Y will continue to supply terminating access to Company X as long as Company X pays the monopoly price so the IDC would lock them in so that Company X could get some revenue to pay that price? No. Why not? First I want to, I know that witnesses don't get a continuing objection but I'm not calling it a monopoly price to price substantially excessive costs. I accept that. So I want to be clear on that.

Second, if in this counterfactual Company X says, "I'm imposing 0867," that means it's not paying those two cents or whatever for termination fees. So Company X in this example, Company Y's already lost those termination payments if it accepts 0867, so at that point it has the ability to try to threaten to take those customers away. And because that's a credible threat, again that would defeat the imposition of 867. I'm exploring how credible the threat. That's where we're having a discourse at the moment. Before we get to the exercise of the threat, there are two parts to 0867 out there that are relevant. One is that a customer on Company X has two choices. They can use dial-up Internet. Dial up the Internet via a seven digit number in which case Company Y gets terminating access charges on that but the customer has to pay Company X two cents a minute. The alternative to the customer on Company X is that they can use 0867 for free.

Now we clarified it as residential customers and take the Court to line 26. "In paragraph 35 you posit that the residential customer under the credible threat would go to Company Ys

network to avoid the cost of the IDC don't you?" "That's one possibility, yes." "Because the only reason that they'd go to Company Ys network is that they can't access and ISP who's located on Ys network through 0867 if Y hasn't accepted an ITA for 0867?" "Correct." "Right. Indeed you assert that Company Y has an increased incentive to compete for these customers?" "Correct." "But if the customer migrates from Company Xs network to Company Ys network, Company Y has a problem doesn't it? Isn't it going to have to either provide that customer with free local calls or charge them for local calls?" "I'm not sure what you mean by 'they have a problem.' If they get them, yes. They will either charge them or not charge them for local calls." "But if you charge them, isn't the customer back where it started? The reason the customer will have migrated is because it wanted to avoid the two cent charge?" "Correct, but the customer doesn't have to migrate. In my view it's the threat that the customer will migrate is a problem. You're looking. You're saying Company Y has a problem, Company X has a bigger problem." "But we're assuming that Company X is intelligent aren't we, rational?" "Profit maximising, sure." "So Company X has the process of the power to reason how credible the threat is." "Sure." "If Company Y charges a new residential customer for local calls, that means that the customer gets no benefit from moving networks. I mean they could charge them less, they don't have to charge them two cents for example." "If the customers are likely to face a charge they're unlikely to move." "Depends what the charge is." "If it's less they might move to get a smaller charge." "If the customer moves to Ys network then, when Company Y delivers the call from the residential customer, now located on its own network, to an ISP located on its own network, Company Y doesn't receive a terminating access charge does it?" "In that example, that's correct." "And if it doesn't receive a terminating access charge that's above cost, it doesn't have a surplus to share with the ISP on its own network." "You're assuming they're not charging the residential customer. If Company X charge two cents and Company Y charges one cent, they'd have one cent they could share with the ISP. So that's one possibility. Another possibility is that there may be some profit associated with having Company Y as a residential customer." Can I go to line 25? It goes to the key of it.

ELIAS CJ:

That's a reference to the sort of add on services that counsel for the appellant were referring to?

MR SHAVIN QC:

Yes. There's no doubt there are add on services. There are two issues on which the appellant led no evidence at trial. It led no evidence to show that people bundled them and it led no evidence to demonstrate that any of those services were supplied at supra competitive prices. Our friend had an amusing anecdote of buying shaving cream at Boots in London, but

they didn't run evidence to show that the prices at which these other services were being offered were at supra-normal profit levels.

Now even if you look at the Boots example, it didn't establish that. We don't know what the comparative costs were to Boots of the no name shaving cream and the branded shaving cream. We don't know what its weighted average cost of capital was. We don't know what the relative returns were. The fact that it's profitable to sell a product doesn't mean it's being sold at a monopoly price. No assumption can be made of that. If the Commission had wanted to run that case they had to adduce evidence, and they didn't adduce any evidence.

ELIAS CJ:

Well why do you have to have a snapshot? I mean markets are dynamic and the securing of this large customer base, the tying up of this large customer base is a prize in any event is it not?

MR SHAVIN QC:

Well –

ELIAS CJ:

I mean, it may be the case isn't run on that basis and it's beside the point but –

MR SHAVIN QC:

We're looking at a counterfactual where you've got N networks.

ELIAS CJ:

Yes.

MR SHAVIN QC:

We have on company access network a number of customers. It is being said, "Oh well, Company X would incur a loss, or Company Y would incur a loss," because there are other benefits to be obtained from getting a residential customer or retaining one. But the only way in which the other benefits, in a workably competitive market, are going to justify the incurrence of a loss is that there's a supra competitive return to be derived from the rest.

ELIAS CJ:

Yes, it's the timing, it's the timing element that I'm wondering about.

MR SHAVIN QC:

Well there's no evidence of a timing element either. You see, the Commission ran a case where it simply looked at the bare facts. It didn't seek to establish, what are the profit levels derived from these other services. It didn't seek to establish what is the price elasticity of demand or the cross elasticity of demand. So, it didn't seek to establish as a matter of evidence whether people would move for a very small price difference or just a large price difference. It didn't seek to move, to prove whether people were more likely to change network or ISP. At one stage our learned friend yesterday was saying, "Oh, it was very hard for people to move networks," but in fact, it was Dr Bamberger's evidence that people move networks more readily that move ISPs. But, if one's running a penalty proceeding, call me old fashioned, but normally you run it on evidence, not prejudice, not inference and none of these core facts, which would be necessary to sustain the propositions that came up here and later by Dr Bamberger. Oh, he's speculating, maybe there were sufficient scale economies that it would justify. There was no evidence about that, and our friends said, both in the High Court and in the Court of Appeal and here, "We shouldn't have to produce that evidence."

The Court of Appeal considered this in considerable detail, paragraphs 94-98 of the Court of Appeal judgment, which we'll come to later, and said, "There's just no evidence to support this." May I continue Ma'am?

ELIAS CJ:

Yes, thank you.

MR SHAVIN QC:

Okay. My learned friend has asked me to read the rest of the lines in the middle and I was thinking I was at line 15, line 16. I asked, "Residential for customers on the facts as we know them, we're trying to make these counterfactuals realistic. What possible profit can company Y get from having a residential customer on his network who wants to make up dial-up calls to an ISP on his network?" Answer, "You'll get the monthly access you know, the monthly line charge which in urban areas could be substantially above cost." Question, "You looked at the evidence as to the number of hours that a heavy user uses, haven't you, in this case?" "Several people have eluded to it, yes." "And the people who are most likely to move networks for and ISP are likely to be heavy users aren't they?" "It seems plausible." "Moving networks is a non-trivial thing isn't it?" "For a customer, yes, it may just involve calling a different phone number." "It would be a much more dramatic step for the customer than simply changing a dialling number on his modem dial-up wouldn't it?" "Not necessarily." "Would it involve substituting company Y for all of its telecommunications relationships that it previously had with Company X?" "That's true but I thought you were asking me about the difficulty of switching ISPs." "I'm trying to work out Dr Bamberger, why you assume that the residential customer on Company Xs network would move networks rather than change ISPs?" "It might be induced by a lower price for example." "So we have a customer on Xs

network that has two choices. Dial an ISP on any network that will accept 0867 or pay two cents a minute to access the ISP on Company Ys network?" Answer, "Well it has a third choice. It can move to become Company Ys residential customer." "And I'm trying to work out why Company Y would have an incentive to take on its network a residential customer who's a heavy user of Internet when what it's seeking to do is maximise its terminating access charges." "Well I disagree with the premise. It's not seeking to maximise terminating access fees. It's seeking to be a profitable firm and if this gives it an advantage in competing for residential customers, that's part of the equation as well, plus, and I think it's important not to lose sight of it, they're negotiating or they're battling Company X and when Company X says, 'We want to change the way, you know, we want to stop paying you termination payments,' I think it's valuable for Company Y to be saying, 'Well then, let go of all these customers of yours that call our ISPs.'" "Why couldn't it have gone after all the customers anyway?" "It didn't have an incentive to before or it didn't have much of an incentive to." "Now it has a larger incentive. What's increased the incentive?" "Now this will help them beat back 0867." "You mean it will help them preserve their above cost receipts for terminating access?" "Sure." "You say that the ISPs will be quite indifferent about all this. They'll be relatively unconcerned." "They'll be relative unconcerned because they'll realise that Company X is unlikely to be successful in implementing 0867." "But under your scenario Company Y has an incentive to go out and poach Company Xs residential customers to locate on Company Ys network." "It certainly has an incentive to threaten to do that. Whether it will actually go and do that will depend on how Company X responds. Company X may not believe it. Company Y may take a bunch of customers. Company X may realise the cost of implementing 0867 as they've just lost a lot of customers and then may decide that wasn't such a good idea. So exactly how it will – exactly what the path is I don't know but I conclude that 0867 won't be successfully implemented in the counterfactual."

Now in our respectful submission, that interchange exposes the absence of a logical chain of reasoning by Dr Bamberger. He never is able to answer the question. Why would Company Y wish to get customers off Company X's network where those customers are heavy Internet users, where there's a consequence it will lose the terminating access charges and thus it will have, from those customers, no revenue stream with which to subsidise the ISPs? And thus from that at the first stage in our respectful submission, what we see is that there is in fact no pressure on Company X in relation to Company Y's reaction in a competitive market by introducing 0867. We'll come to Company X in a minute but at this stage we don't have any strong incentive for Y in fact to get Company X's customers, nor do we have a strong incentive for the ISPs to want them to move. The ISPs don't want the customers to be on the same network as them because they won't get a share of the terminating access charge.

Now, if we vary the counterfactual slightly and say, "Well let's assume that Y is subject to the KSO." That is an option for free calling and I've I think already given the Court these

references but Dr Bamberger accepted this in case on appeal 1787, line 31 to 1788, line 5 and 1790, lines 5 and following. If customers leave X because they wish to continue using ISPs on Y's network and don't wish to pay the IDC, Y would be required to offer them a free local call option for the first 10 hours like 0867. Thus, if Y attempted to charge a fee equivalent to, but lower than the IDC, the customer would take the free option instead and one would find a discussion of this in the hot tub with the Court. I won't take the Court to it now, case on appeal volume 5, page 1790, lines 5-25, this would deprive Y of the revenue screen needed to subsidise the ISPs on its network. Thus, whether Y is or is not subject to the KSO is a matter of competitive necessity. It has to max the free local call option the KSO required X to offer. Were Y not to do so its offer for local calls would be less attractive than that of X, so the KSO has to be taken into account to the extent that it shows that Y has to offer the same extent of a free option.

Now, we've looked at Y. Let's look at W. We need to look at W in two perspectives. There are two ways in which W can interconnect with Y. It can interconnect under a 1996 type ICA.

TIPPING J:
Who is W in the factual?

MR SHAVIN QC:
It's the non-existent network.

TIPPING J:
The non-existent network?

MR SHAVIN QC:
Yes.

ELIAS CJ:
Assumed?

TIPPING J:
The assumed.

MR SHAVIN QC:
The assumed network.

TIPPING J:
So there's no W –

MR SHAVIN QC:

– in the factual.

TIPPING J:

In the factual.

MR SHAVIN QC:

No. W is any number of networks that preclude Telecom from being dominant.

TIPPING J:

I see, thank you.

MR SHAVIN QC:

It is the assumed infrastructure in *NT Power*. It is the other source of Y-bar in *Queensland Wire*.

ELIAS CJ:

Is the answer to the question I put it to you before, which was probably totally off the point, about the residential base that the total answer is the KSO because it has a neutralising effect?

MR SHAVIN QC:

Yes. There's two parts, and I will come to it again later but, –

ELIAS CJ:

All right.

MR SHAVIN QC:

– Your Honour is quite right in talking about the KSO because if you take the base, you have to offer them the KSO either competitively or by law.

ELIAS CJ:

Yes.

MR SHAVIN QC:

And that means the only charge you're getting for local calls is the access charge which is regulated. It was about $32 or thereabouts in 1999, and you might be able to sell them other services, valuated services of the type that our friends discussed, but if you're going to incur costs because they're high Internet users, and we'll see tomorrow that there's evidence that in fact, it's a very small proportion of all Internet users that used in 1999 more than 10 hours of

Internet a month. In fact, it was about 25 percent of Clear's customers on the cross-examination of Mr Forsyth and probably lower, much lower over the Internet as a whole, but if you go back to 11 years ago when we didn't have broadband, you didn't surf the Internet, well most of us didn't, in the same way that people might today. And so you have to be able to offer the 10 hours free. You have to be able to offer the free call so if you're going to incur other costs by subsidising out of your own pocket the ISPs, to give them free Internet service, then you have to have super competitive profits on the value added to make it worthwhile.

ELIAS CJ:

I see.

MR SHAVIN QC:

And that's where we say –

ELIAS CJ:

No evidence.

MR SHAVIN QC:

– the question's given no evidence.

ELIAS CJ:

Thank you.

MR SHAVIN QC:

Now, can we look at Company Y? Assuming –

TIPPING J:

W.

MR SHAVIN QC:

W, I apologise.

TIPPING J:

Who's doing what to who?

MR SHAVIN QC:

Yes, W.

TIPPING J:

W.

MR SHAVIN QC:

W is the notional alternative network. Let's assume W has an ICA with Y like the 1996 ICA. Accepting X's former customers would involve W taking on traffic that would cause it to incur terminating access payments to Y, two cents a minute, but they would not be met by its receipt of comparable termination payments from Y because of the asymmetric traffic. It's plain that W would also have to implement a package comparable to 0867 with a free local call option because it has to have a process by which either it has an 0867 type number with no terminating access charges, or it has to recover from the new customer the cost, at least, of the terminating access charge that that new customer is going to cause it to incur. So, if it fails to –

BLANCHARD J:

You're going rather fast on that and I haven't a hope of taking notes at that speed.

MR SHAVIN QC:

I'll slow down Your Honour.

BLANCHARD J:

Is it in the voluminous written submissions?

MR SHAVIN QC:

Not in enormous detail Your Honour.

BLANCHARD J:

Everything else is, I don't know why you didn't put this in.

MR SHAVIN QC:

We tried to keep the length down.

BLANCHARD J:

Well it was too long, far too long really. One's eyes started to glaze at about page 40.

MR SHAVIN QC:

Yes, let me take this very slowly because it's very important. We have Company W. It has an ICA with Y like the 1996 ICA. A customer wants to move to W to escape the Internet dial charge because it wants to access an ISP –

BLANCHARD J:

It's moving from X?

MR SHAVIN QC:

From X to W with two objectives. One, it wants to avoid Company Xs Internet dialling charge of two cents and it still wants to maintain its relationship with the ISP on Y. So it's on X. It's got an ISP on Y. 0867s introduced. It says, aha, I will escape 0867 and the Internet dialling charge by moving to W. Does W want it? If W accepts the customer, taking on the traffic will cause it, W, to incur a terminating access payment to Y. So it will have to pay, make the same payment to Y that X had been making, but W will not have a receipt from the new customer comparable to the terminating access payments because at this stage, you have X, which has just introduced 0867. It's to avoid the two cent a minute charge, the customer's moving to W. So if W doesn't charge it two cents a minute, W is going to take on a customer that will incur its terminating access charges to Y but W is getting no income from it.

TIPPING J:

Well that was the one cent point with Dr Bamberger wasn't it? It might not be getting – it might get away with charging half but you can't say it would be getting no income but the point is there's no reciprocity.

MR SHAVIN QC:

There's no reciprocity, yes.

TIPPING J:

Yes.

MR SHAVIN QC:

And we don't know what the price elasticity at the moment is.

TIPPING J:

No.

MR SHAVIN QC:

So what would W have to do? W would have to implement a package similar to 0867. It would ideally of course, want to eliminate the terminating access charge that the new customer is causing it to incur, or it would want to recover the cost or create an incentive for the customer to go to a number that wasn't incurring it the charge. If it failed to implement something like 0867, it would incur losses because of the obligation to pay Y terminating access fees.

Now, let's vary our assumptions in relation to the KSO. If W was subject to a KSO obligation, that obligation would require it to offer a free option to the customer, or meet Xs free offer. So it has to offer a free option, thus it would be facing the same terminating payments and traffic management problems that X is facing, where it simply can't have, simply a charge with no free alternative. So it has to have both the 0867 part as well as the IDC part. If it failed to give a price incentive to move the customer to 0867 it would incur losses, and if it levies a charge, what's the incentive on the customer to move from X? Remembering the customer's got other options. It doesn't have to move network, it can move ISPs.

Now, let's make a further change. Let's assume that W has an ICA –

ELIAS CJ:

Sorry, another slightly – just thinking about, in some of the materials we were shown, to the indication that on the 0867 number there would not be any fee charged for the moment but it wouldn't be indicated that there would never be a fee charged.

MR SHAVIN QC:

Under the KSO Telecom was required to give an undertaking.

ELIAS CJ:

I know, but with these gears, the smart things for diverting calls, what do they call them?

MR SHAVIN QC:

The call redirect.

ELIAS CJ:

Yes, the call redirect. Is the KSO simply limited to the voicemail, voice – I mean, in other words, is there the capacity for this device to be split?

MR SHAVIN QC:

Okay, can I take it in two parts?

ELIAS CJ:

Yes. I was thinking of it in terms of your example with Company Y.

MR SHAVIN QC:

Can I deal with both the KSO and the technical?

ELIAS CJ:

Company W sorry?

MR SHAVIN QC:

I'll deal with both the KSO and the technical.

ELIAS CJ:

Yes.

MR SHAVIN QC:

With the KSO, it was Telecom's contention that KSO applied only to voice traffic. The Minister, the KSO shareholder said, "No, but we'll deal with the Internet traffic in a slightly different way to preserve public interest," and so there was as Mr Hodder, my learned friend, Mr Hodder, took the Court to yesterday when going to the contract, there was a differential in quality between Internet calls and voice calls, but Telecom was still required to provide a free Internet option and that was dealt with in two ways. First, that before it could charge the IDC there had to be 10 hours free and, second, there had to be an undertaking there was a charge for 0867. That's the KSO part.

Technically, Mr Milner's evidence, Dr Milner's evidence and particularly, a large document that's referred to, and I'll take the Court to tomorrow, showed that it is actually possible, technically, to separate voice and data because they're different spectrums. So, voice only goes up to 3.4 kilohertz, yes, from 300 to 3.4 kilohertz and data is up at a different level of the spectrum, a much higher level of the spectrum and so you can have a series of filters. You can – it is technically possible to put filters, this is ultimately now how you multiplex. You put a filter in which blocks all the high frequency and that. It's a voice through, and then you put a filter in that blocks the low frequency and lets the data through. It's a complicated process but it can be done, technically.

ANDERSON J:

You see it in loud speakers.

MR SHAVIN QC:

Pardon?

ANDERSON J:

You see it in loud speakers. Block the low frequency to the tweeter and the high frequency to the woofer.

MR SHAVIN QC:

Exactly. Doing it in a switch with very large numbers of transactions –

BLANCHARD J:

That's what you call dog law.

MR SHAVIN QC:

My dog likes the low frequency, not the high one.

BLANCHARD J:

It's a woofer not a tweeter.

ELIAS CJ:

I was prompted to think of that by your assumption that W would be subject to the KSO and I was just wondering what that really meant so I'm sorry to have diverted you onto that.

MR SHAVIN QC:

No, I noticed that it's 4 o'clock.

ELIAS CJ:

Yes and we will take the adjournment now but did you wish to finish anything?

MR SHAVIN QC:

No, it will take me more than two minutes to finish the section.

ELIAS CJ:

Yes, yes. We will take the adjournment. What sort of progress do you think we're making?

MR SHAVIN QC:

Slightly exacerbated by the little technical glitch that we had, the arrangement that we had with our friends was that we would finish by lunch time tomorrow to give him half a day to reply. I am frankly going to be in difficulty finishing with the amount of material that I have to cover by 1 o'clock tomorrow.

ELIAS CJ:

Yes, we might have to consider how we will handle this. Sorry, Mr Farmer did you want to just...

MR FARMER QC:

That was the arrangement and my learned friends have, we'll have had two full days and I do have a difficulty. I must get on a 5 o'clock plane out of Wellington tomorrow to connect with an international flight which leaves –

ELIAS CJ:

We have a difficulty too. Unfortunately we're not able to sit early tomorrow. Well, we may just have to see where we get to and if we're not completed we may have to adjourn.

MR SHAVIN QC:

It's regrettable I know but I've obviously been moving too fast this afternoon and I appreciate that the matters that I'm dealing with at the moment are complex. I'm over half way through the counterfactual analysis and it does get easier. I can move more quickly with the balance but because our friends have challenged the counterfactual and their primary argument is that, they say the counterfactual analysis below is wrong, it seems on us, incumbent to demonstrate to the Court why it is that both the High Court and the Court of Appeal reached the fight conclusion on the counterfactual analysis.

ELIAS CJ:

Yes, I'm not, and I'm sure no-one's suggesting that it isn't appropriate for you to develop this submission fully.

MR SHAVIN QC:

Thank you Your Honour.

COURT ADJOURNS: 4.01 PM

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COURT RESUMES ON THURSDAY 24 JUNE 2010 AT 10.00 AM

ELIAS CJ:

Yes Mr Shavin.

MR SHAVIN QC:

As the Court pleases. Overnight, in an attempt to try and assist the Court to understand the simple elegance of the counterfactual, we've prepared two visual aids each of which is one page if we might hand them to the Court?

One of them is a simplified diagram and the other is in a single page a summary of the points which I was seeking to make yesterday and if I can take the Court through those we're hopeful that – we know the Court doesn't like additional pieces of paper and we apologise for that –

ELIAS CJ:

No, anything that helps is fine.

MR SHAVIN QC:

We hope that this will be of assistance to the Court. If they could perhaps be handed forward. What the Court, we hope, has in front of it is a diagram, or a page with two diagrams on it, and a summary sheet. Could we walk through this? The essence of the diagrams is to demonstrate that whether a relationship between X and Y and W and Y is one similar to the 1996 ICA or one of bill and keep. The incentives that confront X also confront W. May I approach it in this way? If X is faced with a terminating access cost or two cents a minute to terminate Internet calls to an ISP on Y's network it has no marginal revenue from its customers to cover that charge so it has three things to do. It has to reduce its costs. It does that by seeking to achieve bill and keep. It has to increase its price for those who don't go to the 0867 option. It does that by imposing an Internet dialling charge and all the time it seeks to maintain quality. If W receives a customer from X who is seeking to avoid either having to go onto 0867 or paying the two cent a minute Internet dialling charge, W faces the same dilemma. If the relationship between W and Y is like the 1996 ICA which was the standard form of ICA prevailing at that stage, between Telecom and all of the networks, it is confronted with a two cent per minute terminating access charge on Y but it has no source of revenue because it has to match in the market the position in which X finds itself. So it has two things to do if it is going to be commercially sensible. It either has to increase its charges to cover its costs so it would impose an IDC or it has to reduce its costs by going to an 0867 equivalent with bill and keep. If W is otherwise to survive in a workably competitive market it can do nothing else. It must reduce its costs where it can, increase its prices where it can't, seeking to maintain quality, Professor Hausman's evidence. But it is, in fact, commercial common

sense. You cannot take a customer, who is going to cost you two cents a minute for every minute that they use the Internet, without getting revenue otherwise you wouldn't take on the loss-making customer.

Now if the customer goes to Y or if it goes to W where W has a bill and keep arrangement, Y receives no termination access revenue. If it has no terminating access revenue it has no money with which to subsidise the ISPs. So in those circumstances ISPs on Y, (a) risk losing customers on X who either decide that they will change ISP rather than change network. In other words, the customer on X has two choices. The customer can say, I will go to an ISP who has no 0867 number rather than changing network and there's nothing in the evidence that establishes that all of the customers will have such a strong affinity to an ISP that they will always change network in preference to changing the ISP. Indeed, such an outcome would be counter-intuitive. If they are following the ISP because they are price sensitive, then it shows the price is driving their decision making and they'll be very price sensitive to any price changes in the market and one way of avoiding the cost of the IDC, if their existing ISP is going to involve any charge at all, or any hassle, will be to change to an ISP on an existing network. So the first thing that the ISP located on Y's network is going to confront as a risk, is that they will lose some of their customer base to another ISP. Secondly, they know that there's a significant risk that they're going to lose the subsidy because if the customer changes network from X to W, ultimately on W's network it's going to end up with no terminating access charge because W will have to go to bill and keep or impose a charge on the customer which deprives the customer of any incentive to move in the first place. Alternatively, the ISP will be worried about the customer coming to Y because if the customer comes to Y, Y internally terminates the access so it doesn't receive a charge from another network and if Y is internally terminating the access and not receiving a terminating access charge, there's no subsidy left for Y to pay to the ISP. That is why Mr Copeland, in the passages we referred to, talked about Y having to put its hand into its own back pocket to subsidise the ISP.

In those circumstances the ISP has got two choices. It either moves to a network which will offer it 0867 so it can continue to service the customers on X or alternatively the ISP will put a lot of pressure on Y to offer 0867 and accept that it's going to have a bill and keep arrangement and no longer receive the above cost terminating access charges which Y is seeking to enforce. And that means that as a matter of logic the evidence that was given by Dr Bamberger, to which we took the Court yesterday afternoon, lacks credulity. He was asserting that the ISPs on Y will always pressure Y to support its opposition to 0867. But as the Court will recall, and if it has an opportunity in the fullness of times to reconsider those passages of the transcript to which I took the Court yesterday afternoon, will see that he's unable to give any logical explanation for it. So that contrary to Dr Bamberger's evidence, and our friend's submissions, there is no likelihood that in fact a significant number of

customers will leave X forcing X to abandon 0867 and the reason is that there's nowhere for them to go because in a market in which no one is dominant, no company in a workably competitive market, can afford to take on a customer, every minute of whose Internet usage is going to cost it money where there is no prospect of recouping an income to cover the cost. That was the conclusion reached by the High Court. It was the conclusion affirmed and accepted by the Court of Appeal. It is founded well on the evidence. It is founded in logic. It is founded, in our respectful submission, in common sense.

The only way in which our friends' argument could be right is if the drivers confronting a network other than Telecom, in a workably competitive environment, faced different drivers. But they have been unable, at any stage, to articulate why and that is why, in our respectful submission, when one examines the simple counterfactual, a counterfactual which is flexible enough to accommodate each of the major options, that is a 1996 ICA type of interconnection or a bill and keep type of interconnection. All that is really being done is exactly what the Australian High Court did in *Queensland Wire*. The Australian High Court did in *NT Power*. It looks at the major source and says, let us assume a competitor. That competitor introduces competition. When you have two competitors able to supply either in this retail case residential access, in *Queensland Wire* the Y-bar, in *NT Power* another power infrastructure, you no longer have a dominant firm. Now dominance wasn't the test in Australia, let's assume there's no practical difference for current purposes, there probably isn't, but if you have competition, whether it's one, whether it's 20, it doesn't matter. You simply look at the core issue which will ensure there is competition. Once you have competition you ask in that environment could a non-competitive firm do that which it is said the defendant has done. In this case would W, whether it's W1 or W21, introduce 0867 with bill and keep and an Internet dialing charge, if it received a customer seeking to escape that conduct by Telecom. The answer, in our respectful submission, is yes. The reasoning applied below is in substance that which we have articulated and that can be found in the High Court at paragraph 77 to 88 of the judgment at case on appeal, volume 1, pages 62 to 65 and in the Court of Appeal in paragraphs 80 to 98, case on appeal, volume 1, pages 100 to 101.

TIPPING J:

Is the counterfactual reduced to its probably ridiculously simple terms Mr Shavin, that you simply assume into the market another Telecom?

MR SHAVIN QC:

Yes. And you then, the other part of *Telecom v Clear* Privy Council is that he has to face the same conditions that Telecom –

TIPPING J:

Yes, of course, of course.

MR SHAVIN QC:

That's why you assume a 1996 ICA. That's why you assume an asymmetric mix of residential customers and ISPs. So you follow the Privy Council which as my learned friend Mr Hodder identified yesterday, is entirely consistent with every decision in Australia from *Queensland Wire*, which was the first decision of the Australian High Court that unequivocally affirmed the application of economic principles, to Part IV of the Trade Practices Act, which is why it's so significant.

McGRATH J:

Whether or not that's so Mr Shavin your argument is really being presented on the basis that even if you have to apply *Melway* approach, cogency approach requirements in a counterfactual, you meet that anyway?

MR SHAVIN QC:

Absolutely. You take the assumptions and you have a cogent argument and indeed when you look at what is being said none of it goes to the heart of the issues articulated in the counterfactual analysis as applied below. Could I take the Court please to our learned friend's outline at paragraph 5.9(e) on page 34 of their outline. They are attacking in (e) the holding in the Court of Appeal at [98] which was to say that there was no use. That they say, "Holding at [98] that there was not, in any event, likely to be a significant loss of customers by Company X (on the basis that customers would more likely switch to Xtra or to an ISP with an 0867 number than change networks). That assumption is wrong…" and can we look at each of the four dot points? They say first, "The number of Company X's customers who were using ISPs on Company Y's network must be assumed to be significant, otherwise there would not have been a significant traffic imbalance."

Well that's not an error by the Court of Appeal, that's what's been assumed. It's what's been assumed by the High Court. It's part of the counterfactual analysis. The second point is, "It is assumed that retail fixed-line telephone service is less differentiated than ISP services, so many customers would prefer to keep their ISP and switch telco supplier (which, by assumption, is easy to do) to avoid the two cent charge." What the Court of Appeal said to that is, there's no evidence and there is no evidence that is pointed too. There's no footnote in these notes and if the Court will recall the Court's been taken to paragraph 98. If it would assist the Court we can go back there now. The Court just said, it's a long bow in the argument, there's no evidence. It's not demonstrated. Just as the High Court found, it wasn't demonstrated.

The third dot point is, "ISPs would be aware that Company X's residential customers could easily switch telcos to avoid the two cent charge and so would face little pressure to acquire

an 0867 number." Let's stop there. They haven't demonstrated any flaw in the reasoning of the counterfactual, the conclusion of which is, that in fact there's nowhere for them to go. Certainly technically they can change telcos but why would W have them? If W was going to accept a customer from Telecom, from X, it's not going to take the customer and incur a loss on every minute of Internet traffic generated by the customer. It will either reduce its costs by having bill and keep, increase its price by imposing an IDC, otherwise seeking to maintain the quality of its service.

Let's look at the next sentence. "This is turn would encourage more of Company X's customers to switch telcos, in order to retain their preferred ISP." Why? They haven't demonstrated, other than by assertion, any flaw in the logical analysis adopted by the High Court and affirmed by the Court of Appeal.

Let's go to the fourth dot point. "Even if some customers were indifferent to switching ISP or telco supplier to avoid the two cent charge, it cannot be assumed that most would switch to Xtra. Those customers already could have chosen Xtra but did not. That indicates a preference for an ISP other than Xtra." Certainly that might be so but that ISP is going to have to be on a network that can deal with the customer without incurring a loss on every minute of Internet usage. So again although there is implicit in our learned friend's attack an assumption that a customer would simply leave Telecom or in the counterfactual leave X, they don't explain, at any point, why each of the High Court and the Court of Appeal were wrong in the counterfactual analysis. It is at the heart of the counterfactual analysis that although technically a customer could leave X in a workably competitive environment no non-dominant firm could take that customer and not do as Telecom did. Introduce a scheme, 0867 with its technical facility and bill and keep, and impose the carrot or the stick of an IDC to cover their costs. Because in a competitive environment there is no profit in acquiring a customer every minute of whose Internet usage is going to cause a loss.

And that's the fundamental difficulty that confronts our friends and which the High Court and the Court of Appeal said our friends had not overcome. In our respectful submission, they point to no error. They point to no reasoning process which challenges that accepted below. They point to no reasoning process which challenges the logic and the commercial common sense of the analysis which we've articulated here and which has been articulated before. So their conclusion is flawed. They say Company X would not rationally have risked losing these customers. There are two elements to that. The first is, that they would go, that's not demonstrated. And the second is, that there is some other reason why Telecom would wish to retain that. As to that, and I think Your Honour the Chief Justice raised this question with me yesterday afternoon, there are two responses which we'd seek to advance. The first is that if you've got non-dominant competitors, let us assume you have three telecommunication suppliers. Let's assume that one or the other services is toll bypass. You've got multiple

suppliers in the market competing for toll. As you had in New Zealand from early in the 1990s. What's going to happen? They're going to compete the price down. So there's no rational explanation where you have a workably competitive market with no dominant firm all competing in residential access, that's the core assumption, why they won't also be competing for all of the value-added services, gradually and inexorably driving a price down closer to a competitive price. So there is no logical explanation as to why it would be that there would be any value left on the table. That was the conclusion of the High Court. No one has demonstrated it can be wrong.

Secondly, our friends, as we noted yesterday, have failed to establish that these value-added services had supra-competitive prices. This was a matter considered extensively by the Court of Appeal. Could I ask the Court please to turn to volume 1 of the casebook, case on appeal, at page 104. In paragraphs 94 to 98 the Court of Appeal carefully considered this argument advanced by the Commission. "Mr Farmer submitted," they said in paragraph 94, "that the High Court findings were wrong for these reasons. Company X would lose the opportunity to earn other collateral revenue such as toll calls, mobile services, mobile interconnections and so on. He also questioned the "lost revenue" argument on the basis that when a firm with substantial fixed costs loses customers, the revenues associated with the lost customers will generally outpace the cost savings from no longer serving those customers. Associated with this could well be "stranded" assets which cannot readily be redeployed or sold (they are sunk costs). Further, Company X would, in any event, have been earning revenue well above costs on toll interconnection and local interconnection charges for calls to those customers from other networks. As to the argument that there was no evidence or evidential basis to show that the economies of scale referred to by Dr Bamberger might arise, and that these economies would outweigh the benefits of introducing the 0867 scheme, Mr Farmer submitted that the Commission should not be expected to call evidence in this sort of setting which is merely a hypothetical construct and that appropriate assumptions may be made. Some assumptions have been made in favour of Telecom. More generally Mr Farmer suggested that the telecommunications industry is dynamic with rapidly developing technology and that in a general way Company X would want to keep and expand, if possible, the number of customers on its network to whom it could in turn sell new innovative technologies such as ADSL. He also pointed to some internal evidence in Telecom's documents that Telecom generally didn't want to lose customers. This led him to submit overall that in a competitive retail market Telecom could not have profitably introduced 0867 and that there was a real likelihood that it would have incurred a significant cost in the form of loss of residential retail customers. For Telecom it was emphasised that generally speaking if there was a competitive market in which the parties were getting normal rates of return, X would have no interest in retaining those customers. The evidence of Dr Bamberger which was relied upon heavily by the Commission was no more than "speculative" as to the availability and comparative size of scale economies. Further, relying

upon the evidence of Professor Hausman telecommunication services cannot be treated as a bundle: consumers could, to take only one instance, buy local access from X and toll calls from Y."

And I could interpose here of course the Court will have judicial notice of the fact that it has been possible in New Zealand for a long time to have local access from Telecom and tolls from – bypassed from Clear or Compass.

The Court continued, "Cable service could come from another party. It was said that the Commission could not simply assert that the fact that scale economies might exist (if in fact they did) provides no foundation for a comparative analysis of the type the Commission was belatedly seeking to have the Court make." May I interpose. This suggestion of scale economies came at the end of the oral evidence in the hot tub, was raised in answer to a question from Mr Copeland, the lay member. "Further," the Court continued, "it could not be said, on the evidence in Court, that the advent of new technologies would justify Telecom incurring increasing losses on Internet customers in the hope that the losses would be recouped in the future."

And 98, this is where the conclusions are reached, "In our view it is vital to recall the basic question the High Court was having to address here. 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. There were powerful reasons going to the avoidance of termination charges and the overcoming of network congestion to be considered, along with the implications of any loss of customer base which might be incurred by the introduction of the 0867 scheme. To argue, as the Commission has done, that on any rational consideration 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. That has not been demonstrated. As we have noted, on an appeal of this character, it is for the appellant to demonstrate that the High Court was wrong. On the law we have to apply, the evidence which was in Court, and in such inferences as could reasonably have been drawn from it, we are not so satisfied. This appeal point too is dismissed."

Now in our respectful submission on a second appeal, where our friends (the appellant) are seeking to overturn both the Courts below, it was incumbent upon them, in their primary submissions on Monday and Tuesday of this week, to identify the evidence that was overlooked by the Court of Appeal, that was overlooked by the High Court. To identify the

flaws in the analysis, articulated in the High Court as to the counterfactual to which we have referred. That was not done. There is no such evidence. There is, in our respectful submission, no basis upon which this Court can conclude or could properly conclude that the Court of Appeal in paragraph 98 has fallen into error. In the second sheet that we handed to the Court, which I wasn't proposing to go through in any detail now, we have simply sought to assist the Court by putting in a summary form the matters which I articulated, or sought to articulate, yesterday afternoon and again this morning. If the Court, just quickly, glances at it, we simply sought to summarise the propositions, because I know that in trying to watch the clock yesterday I was moving very quickly, and although the counterfactual is simple, it's an intense piece of reasoning. So we hope that that sheet is of some assistance, and we would rely upon that, if we may, as part of our submissions. In our written submissions –

TIPPING J:

In the very bottom two, you adopt the phraseology of acting rationally "would" behave in exactly the same way.

MR SHAVIN QC:

Could I amend, that, please, to "could".

TIPPING J:

I thought you might want to.

MR SHAVIN QC:

I'm sorry, it's my fault. It was settled last night, and I didn't pick it up. I apologise. If that could be amended to "could".

ELIAS CJ:

Although you are, really, making the submission that they would.

MR SHAVIN QC:

Yes.

TIPPING J:

But you don't want to be bound by that height of test.

MR SHAVIN QC:

No. The Privy Council didn't require me to go that far. The fact that, in practical terms, we can shows the strength of the argument.

TIPPING J:

Well, you clear the hurdle.

MR SHAVIN QC:

Yes.

TIPPING J:

By a country mile, you would say.

MR SHAVIN QC:

We do. But we would hope, not only to have said it, to have established it, as Your Honour pleases. Can we simply draw the Court's attention to the fact that this has been dealt with in our written outline at paragraphs 5.26 to 5.29. We have sought, because of the significance of this, to spend some time in our oral submissions, because if the Court accepts that the High Court and the Court of Appeal were not in error on this issue, that is dispositive because it demonstrates that there was no use of any power the Court might conclude Telecom had. So that if the Court upholds the finding of the High Court that, in fact, Telecom was dominant in the residential access market, notwithstanding the matters that have been advanced by my learned friend yesterday, this analysis demonstrates there's no use of that dominance. There can, therefore, be no question of any contravention of section 36.

Now, the next issue is that even if, contrary to the conclusion of the High Court, and the inexorable logic of the counterfactual, there was a material loss of customers for reasons which cannot be yet understood and have not been explained. Our friends have raised a further question, which we deal with in paragraph 5.34 and following of our written submissions. And that is – I'm sorry – yes. That is, our friends say that Telecom would, in any event, be deterred from introducing 0867 in a competitive environment, because of its fear of losing customers. Now, we deal, in paragraphs 5.34 to 5.49 of our written outline why, in fact, the Commission is in error in its attack on the finding of the High Court that there would, indeed, be no concern by Telecom. That conclusion by the High Court is reached at paragraph 84 of its decision, which can be found at volume 1 of the case on appeal at page 64, where the High Court concluded, "Assuming, however, that Company X lost customers, it does not appear that there would be a cost to it. It saves termination charges, that it would have been obliged to pay Company Y while foregoing only the per minute charge payable after 10 hours use per month. As the per minute charge is equivalent to the termination charge, there is a net saving equivalent to the termination charges for the first 10 hours per month. If other services, such as local voice calls and toll calls, were also taken away, there would be no additional cost to Company X. As there are no supra-normal profits being earned in the counterfactual, lost revenue would exactly match the cost of capital and lost profits could be recouped by investing elsewhere", and that's the logical economical analysis. But even if it's not mathematically precise, it doesn't matter. As the Court of Appeal said,

there would have to be such an overwhelming likelihood of loss, and such a significant excess profit to be earned, that they would outweigh both the termination and access charges and the additional capital that would have to have been invested, the 205 million in the network to cope with the congestion, the traffic management issues.

And what one needs to keep in mind, in our respectful submission, is that our friends talk about sunk costs in capital, where if there's a loss of scale, you have some existing capital investment rendered redundant. Of course, sunk costs don't affect future investment decisions nearly as much as stranding of those future investment decisions, and at a time, as we will see, that Telecom knew that within a relatively short number of years, it was going to have to move Internet traffic off the PSTN into some form of broadband, probably ADSL, which was then a nascent technology. Any significant investment in the PSTN was likely to be stranded within the life of that investment, and that has to be taken into account. As the Court of Appeal said in the passages to which I've just taken the Court, that was a matter which had to be demonstrated by evidence, not by assertion, not by some implication or inference from a statement made by their economist, not in either of his briefs, but in response to questions from the Court at the end of cross-examination.

TIPPING J:

Would it be fair to say, Mr Shavin, that quite a lot of the conclusion reached, at least by the High Court, depended upon its assessment of the weight to be given to the evidence of the experts? In other words, it appears that the High Court was more attracted to the evidence of Dr Hausman than it was overall to the evidence of Dr Bamberger.

MR SHAVIN QC:

Yes. And that's something where the Court did have the advantage of looking at the credibility of the witnesses and *Austin, Nichols* paragraph 13 was a matter which this Court, of course, noted there should be real caution in an appellate Court interfering with that assessment, because it doesn't have the natural advantages of the –

TIPPING J:

Well, going back to my own experience, albeit 20 years ago in *Magic Millions*, I remember thinking that quite a lot depended on what I saw as almost the instinctive reaction, whether one accepted or didn't accept the theses being put forward by the various experts, and I would have thought that this was a rather similar situation here, where you have competing experts putting up different theories or theses and the Court is put in the position, to a significant extent, of having to weigh them and choose between them.

MR SHAVIN QC:

With the benefit of a lay member.

TIPPING J:

With the benefit of a lay member, exactly.

MR SHAVIN QC:

Yes. We would respectfully adopt what Your Honour has said, and could we support it by this. The reason I took the Court's time yesterday to read a few pages of Dr Bamberger's evidence, and, of course, we'd suggest that the Court read all of the transcripts of the hot tub, but particularly those pages that I took the Court to yesterday as an example of the reasoning process.

TIPPING J:

It's very difficult, on first appeal, let alone second appeal, to get the flavour, and the sort of ambience, if you like, of a debate like this.

MR SHAVIN QC:

Absolutely, particularly in a hot tub where this was an interchange, and we would respectfully adopt what Your Honour has said, and that is why, in our respectful submission, it was incumbent upon our friends, in their principal submissions, to demonstrate clear error.

McGRATH J:

In the end, though, Mr Shavin, it is the force of the reasoning of these witnesses, rather than any question of credibility that's important, isn't it?

MR SHAVIN QC:

And that's why in the passages to which we took the Court yesterday, in that long passage of Dr Bamberger's evidence, the Court will see, we would respectfully submit, that when you look carefully at how Dr Bamberger was trying to respond to the test I was putting him to, there was no logic.

McGRATH J:

I'm only raising this because you've introduced credibility a couple of minutes ago, and I'm just suggesting it's not really credibility. It's more the force of the arguments, and when my colleague makes the point about the difficulty of doing this later, it's really a difficulty in getting to understand the true force of the argument.

MR SHAVIN QC:

And somehow, when it's live, it's easier than when it's on paper.

TIPPING J:

Well, despite *Austin, Nichols*, one has to draw a line, in some ways, I would have thought in this sort of case, between reassessment and demonstrating error.

MR SHAVIN QC:

And particularly, if I might say in response to both of Your Honours, given the presence of a lay member below, six weeks of trial to assess the evidence and to assess the economic analysis in the context of that evidence, very detailed submissions, very much more detailed written submissions than is appropriate in this Court for a second appeal, and eight months to consider them. And in our respectful submission –

TIPPING J:

I'm just floating this, Mr Shavin. I'm not necessarily putting it out as a firm thesis, but I'm just – it's just going through my mind, and I think it should be on the table, because, you know, it is quite important, in a way, that's what the technique is, both on first appeal and second appeal.

MR SHAVIN QC:

And accepting absolutely that Your Honour is placing an issue on the table without indicating pre-judgment, we would, nevertheless, respectfully adopt what Your Honour has said, and suggest that it's well-founded.

ANDERSON J:

Every case like this has experts who disagree with each other. That's always been in the case in criminal law, everything. And the Judge has to decide.

TIPPING J:

And he's normally looking for either an error of principle in the trial or first-level appeal Court, or some clear, demonstrable failure to appreciate some evidence, or something like that. But I notice it's controversial.

ELIAS CJ:

Well, it is. And I would have to say that if you are placing much stock on this argument, you will have to develop it more for me. But your main thesis is that if the Court understands, as one would think the Court must make the effort to understand the evidence, that the counterfactual is not laid out.

MR SHAVIN QC:

The other way around.

ELIAS CJ:

I mean, the counterfactual is made out, yes. Negatives and positives.

TIPPING J:

Well, it depends where you're sitting.

MR SHAVIN QC:

Can I clarify that so that when the Court comes back to it is that what we are saying is that the counterfactual demonstrates that a company facing the same conditions as Telecom but in a competitive market would have acted as Telecom did by introducing successfully 0867. And we say that that is demonstrated on the evidence. We say it is demonstrated as a matter of logic. It is consistent with the economic evidence, and putting to one side any question of credit, when one looks carefully at the cross-examination of Dr Bamberger, and we use, as an exemplar only, the few pages to which I took the Court yesterday, because there's not enough time to take the Court exhaustively through it all, and the Court considers the credibility and the logic of the way in which he approached the questions put to him, at the end, there was no logical explanation as to why there was a credible threat raised by Y, and Your Honours will recall I said to him, but isn't Telecom intelligent, can't it do the same reasoning process I'm putting to you? Yes, he said, but I still believe there'd be a threat. And in the end, it came down to assertion.

TIPPING J:

It's a question of whether there's a rational threat, isn't it?

MR SHAVIN QC:

Yes. And we have to assume that people running these corporations are rational, at least in the commercial sense. We don't have to assume that they're all Nobel laureates. But we can assume that they can undertake basic economic –

TIPPING J:

An amiable set of lunatics, as Lord Templeman once famously described a board of directors.

MR SHAVIN QC:

Yes. I'd be cautious before I described my client as an amiable lunatic.

TIPPING J:

I'm not suggesting that applies here.

ELIAS CJ:

Mr Shavin, can I just ask you to give me the reference to the hot tub evidence? I'm not sure that I've got a note of where it extends from and to, although we've been taken to bits of it.

MR SHAVIN QC:

Yes. If I could take the Court to the index to one of the volumes of the case on appeal. If I can ask the Court to look in volume 4 to the antepenultimate line. Does the Court see the third bottom line, "Brief of evidence of Bamberger"?

ELIAS CJ:

Yes.

MR SHAVIN QC:

That is his first brief at 1359, with his second brief at 1406. And then if one continues down to volume 5, you get up to the joint propositions, so you've got all of the briefs of the experts, two of Dr Bamberger, one of Professor Hausman, one of Professor Evans, the latter at 1471 in volume 5. Then there was a joint proposition statement by all three at 1512, then in the hot tub they each gave orally a summary of their evidence. That is set out, first, Dr Bamberger, at 1526, then Professor Hausman on remaining live issues at 1530, and then Professor Evans at 1539. And then the cross-examination and the interplay within the cross-examination commenced at 1553, which is the transcript of hearing hot tub day 1, and that continues through to 1713, which is transcript of hearing hot tub day 2.

ELIAS CJ:

Thank you.

TIPPING J:

So it's effectively most of volume 5.

MR SHAVIN QC:

Yes, I regret to say. Now, we have, in our written outline, drawn attention to some passages. I'm not saying that the passage that I took the Court to is the only passage it can have regard to. But we do use it as an exemplar of what we say was a deficiency in Dr Bamberger's reasoning, which would be a foundation for a trial Court with a lay member, or this Court to accept that the conclusions by both the Courts below on this were well-founded, and that there is nothing to which our friends can point that demonstrates serious error in the fundamental principles.

If I could then move to the next topic. My learned friends have said, well, look, Telecom didn't need to introduce 0867. They had other options to deal with the commercial issue, and they had other options to deal with the network management issue, and we would seek to confront

each of those options, and demonstrate to the Court that they simply weren't real and viable options. Certainly we put it at this level, that the only relevance of there being other options is if they were so clearly and demonstrably overwhelmingly superior to the course adopted by Telecom that the only inference you could draw from Telecom's decision to proceed was one that it was engaged in an illicit purpose or abuse of power. It's not for this Court, we would say, with respect, or any Court to second-guess management in day-to-day commercial decisions. For this Court to say looking at the events 11 years after they took place, we might have formed the view that there was another course that might have been preferable. Our friends have to go very much further than that. They have to show that they were so overwhelmingly obviously better that you draw an adverse inference from the fact that 0867 was introduced, and as we now would seek to establish, they don't get to that; indeed, the so-called options weren't options at all.

McGRATH J:

That's by reference to a better way of dealing with the two problems that Telecom has identified.

MR SHAVIN QC:

Yes. And our friends say, and this does raise a credit issue, our friends say that this Court ought to look sceptically on the evidence of Mr Parkes about the equality of importance of the money issue, the terminating access revenue cost, and the traffic management issue. The High Court made a definitive assessment. They accepted the evidence of equal balance, and that, in our respectful submission, is a consequence both of looking at what he said, and looking at the cross-examination, which, I think, took place over something like two days.

Now, could I take the Court – this is dealt with, by the way, in our written submissions at paragraphs 2.13 to 2.16. But if I could deal with the options in this way. The first one that was advanced by our friends is that it was open to Telecom as a substitute for introducing 0867 to compete to attract ISPs. Now, this wasn't, in fact, an option at all, because what it amounts to is this. It is to say that although Telecom received no marginal revenue from local calls because of the KSO, and received no revenue from residential customers for delivering Internet calls from that customer to an ISP, Telecom should nevertheless make a payment to the ISP to encourage it to stay on Telecom's network. That's what they mean by competing for ISPs. This payment would be to compete with the subsidy given by Clear to the ISP out of the proceeds of the monopoly rents it derived from the terminating access charges it would have received if the ISP was on Clear's network. But the residential customer remained on Telecom's.

TIPPING J:

You mean offer them the same subsidy?

MR SHAVIN QC:

Yes. That they've got a revenue stream, and we don't. Now, just let's think about that, because what it means – and this is the most extraordinary proposition for a competition regulator to advance to a Court that it's possible to conceive – it is saying that a company which it says possesses market power should price below its cost of providing services to an ISP by giving the ISP a negative price on the basis that it will recoup these losses from future profits. I ask the Court to consider that in the context of the definition of predatory pricing in *Brooke* in the United States and *Boral* in Australia. So what the Commission is suggesting is that Telecom, as a preferable alternative to 0867, should engage in predatory pricing. Do I need to say more, or can I go on? Then it says that Telecom should compete through Xtra to gain users. Well, what this is, is that Telecom, it's saying, through its subsidiary ISP, should provide services to its customers that is either free Internet access or negatively priced Internet access. The Court will recall that some of these ISPs were paying the customers to stay on the Internet. My learned friend says it's not established. I took the Court to the passages that I took it to yesterday. I don't put it any higher than those passages.

ANDERSON J:

There was a suggestion that someone might come to New Zealand to do that.

MR SHAVIN QC:

Yes. And there was Mr Parkes' paragraph 33. Whether or not there was negatively priced Internet use, what it is being said is that Telecom should compete through Xtra to gain users by free Internet access, presumably based on subsidies given by Telecom to Xtra where, unlike Clear, Telecom is receiving no corresponding income. So we have the same problem. What is being suggested by the Commission is that the competition should take place where Clear has a revenue stream to fund the users. Telecom doesn't, so Telecom, again, is being encouraged to put subsidies in where it's got no corresponding revenue stream. And it is being suggested that this is so obviously a more – a preferred course, that the failure of Telecom to adopt this strategy instead of 0867 entitles this Court to draw an inference adverse to Telecom. Now, any competent competition advisor confronted with this proposal by a client would, in our respectful submission, have to think long and hard about advising a company to do this where it knows that the competition regulator believes you've got a dominant position.

TIPPING J:

Where would it get the money from to do this, on what the Commission says?

MR SHAVIN QC:

It would be recouped from future profits.

TIPPING J:

That could only be it. It's similar.

MR SHAVIN QC:

Yes, it's predatory pricing.

ANDERSON J:

So you're saying that they're saying address your cost problem by increasing your costs without any prospect of revenue?

MR SHAVIN QC:

Yes. And the only basis on which one could rationally engage in that is that you're going to recoup it from future profits. I ask the Court to consider *Brooke* and *Boral*.

ANDERSON J:

I suppose theoretically if you knew how much subsidy was being given by Clear to its ISPs, you could fix a reduction on Xtra's costs that would be of more benefit to customers.

MR SHAVIN QC:

But then you'd have to subsidise somewhere.

ANDERSON J:

If you could capture people from the other network, then you'd be reducing your loss to the difference between them.

MR SHAVIN QC:

It would be a very fine mathematical exercise.

ANDERSON J:

Well, you'd have to know, wouldn't you? To be competitive, you'd have to know what was being given to the other ISPs.

MR SHAVIN QC:

Yes, you might know that. You mightn't know the volume, because you won't know the volume of customers, and you don't know that offering the same amount is going to cost you the same amount. It depends on the size of your customer base.

ANDERSON J:

But theoretically, you could reduce the effective cost of termination fees, by some amount.

MR SHAVIN QC:

The internal cost of Xtra on to you.

ANDERSON J:

Say one cent a minute. Say you assume that it's one cent a minute cheaper for Internet users to use Clear's ISPs, and you say, well, we'll make one and a half cents a minute cheaper. You then save half a cent per minute in relation to termination fees.

MR SHAVIN QC:

Your saving at cash outflow is not quite the same as generating an ink flow.

ANDERSON J:

Yes, it's just reducing loss.

MR SHAVIN QC:

Yes. If I decide to buy a Holden Commodore instead of a Rolls Royce, I might save myself many hundreds of thousands of dollars, but it doesn't –

ANDERSON J:

But it's just not worth it, is it?

MR SHAVIN QC:

No. My partner might think, well, if you save that money, you can go and spend it, but the bank manager seems to have a different view of it.

ANDERSON J:

Yes, I agree that you're not increasing revenue. You're just reducing loss.

MR SHAVIN QC:

Yes. And yes, it might be that that's an exception to the predatory pricing principles, legitimate business reasons, discussed by the High Court in *Boral*. But to say that that is the way you should go, rather than reduce your costs where you can, increase your prices where you can't, maintain the quality of service. There's a reason why the Courts below didn't say that this was a commercially viable option. Can I then go to their third proposition? One thing which I ought to do is this. It must be remembered that the ISPs were, for the large part, sustainable only for so long as Clear subsidised them. Without taking Your Honours to the transcript because of the shortage of time, could I give Your Honours these transcript

references? Mr Forsyth case on appeal, volume 2, page 213, lines 15 to 25, Mr Forsyth was a senior executive of Clear called by the Commission. Mr O'Brien, also a former executive of Clear called by the Commission, case on appeal, volume 3, page 894, lines 8 to 12 and Mr Dick, to whom our friend has already referred, he was the person if I recall correctly who talked about CallPlus obtaining 10,000 new customers a month, but if one goes a little bit further in the transcript to the passages to which our friends took the Court, a case on appeal volume 2, 528, line 17 to 18, there Mr Dick, in looking at terms said, "That the interconnect revenue was the termination fee sharing with Clear". And then the next page 529, lines 25 to 32, the total revenue was accounted for by that interconnect revenue. One can see from each of those extracts from the transcript that the bulk of the ISPs that were the free ISPs were dependent upon the arbitrage. Now friends might say, oh well this was necessarily only 18 months, but that with respect, is also not entirely accurate because although the contract to which my learned friend Mr Hodder took the Court was a five year contract, if either party requested a further agreement under clause 7.4 and the term of five years was in clause 7.3 which could be found in case on appeal volume 7, page 2379, such an agreement was to be negotiated and failing negotiation there was to be mediation or arbitration to determine matters not agreed, that's clauses 7.4 and 7.5. Until a new agreement was reached or determined, the ICA would continue on the terms and conditions which applied at the expiry date, clause 7.5, case on appeal volume 7, pages 2379 to 80. Now we're going to come very shortly to Clear's view about negotiation with Telecom. So until the process of negotiation, mediation or arbitration concluded, the 1996 ICA continued.

TIPPING J:

Well if parties bound to renew if you like, on terms externally fixed.

SHAVIN QC:

Yes.

TIPPING J:

What happens if the mediation, if the mediation failed there was a binding arbitration was there?

SHAVIN QC:

Yes. And so there was an end point, but to say that that was necessarily a speedy process, unless both parties had a bona fide desire to negotiate, and we'll come to that in a moment, then you can't say this had a definitive end point. Now let's move to renegotiation, because the third commercial option that was raised by our friends was well, what Telecom could've done to overcome this issue was to negotiate with Clear. In our respectful submission negotiations are like dancing the tango, require two willing parties. In addition to the repeated

and flawed assumption that 0867 gives rise to a breach, entitling Clear to any compensation, the evidence before the Court was that renegotiating the Clear ICA was not an option available to Telecom in 1999. Now there are the following extracts from the transcript if I can state the proposition and where I get it from again, unless it would assist the Court for me to take you to the transcript, I seek to do it in this abridged manner.

ELIAS CJ:

Yes that would be fine.

SHAVIN QC:

If I can indicate to the Court my learned friend Mr Farmer and I have had a discussion and that is that we will finish by lunch time so that my learned friend has the afternoon in which to complete his replies as originally agreed. And we are seeking to compress our submissions to make sure that we finish by one.

In case on appeal, volume 2, page 221, lines 8 to 24, Mr Forsyth, and all of this is cross-examination of Mr Forsyth, who was the manager I believe of regulation and strategy for Clear and a principal witness called by the Commission. Clear only wanted bill and keep for voice traffic. At page 221, line 14 and following, the relationships between Clear and Telecom were strained and there's unlikely to be meaningful negotiation in relation to the introduction of a service that was going to remove something which Clear saw as leverage.

TIPPING J:

They wanted to keep the good bits and get out of the bad bits.

SHAVIN QC:

Yes. At case on appeal volume 2, page 232, line 31 to 233, line 15, Mr Forsyth said that Clear had a desire not to have bill and keep on terminating access, because they saw the payments that it received from Telecom as significantly higher than the payments it would make to Telecom and significantly higher than the costs incurred by Clear in providing the service. At case on appeal volume 2, page 236, line 29 to page 239, line 25. The essence was that Clear refused to negotiate with Telecom after receiving a draft agreement on 7 September, notwithstanding two written requests from Telecom seeking a face to face meeting, and we draw the Court's attention particularly, perhaps I'll take the Court to this, case on appeal if the Court has it accessible, at page 239. At line 3, I'm referring to a document, we don't need to take the Court to the document at the moment, the letter is two pages, I'm assisted by my learned friend, the letter is two pages, and the page after that, and that is a press release or media statement that ran for a two and a bit pages that was released by Clear, prior to but embargoed until 6 am on the 17th of September yes, and that was initiating a public media campaign against 0867 yes. "Between the 7th of September

when Telecom sent you a revised draft agreement and the 17th of September, you undertook no negotiations of any type with Telecom in relation to 0867 did you?" "Not to my recollection, no." "And this was notwithstanding that Telecom on two occasions in that period had written seeking a face to face meeting?" "That is correct." "And had offered to fly to Auckland to facilitate such a meeting?" "That is correct." And if I could take the Court to page 240, line, my learned friend's asked, just read the next bit, "And I put it to you, you had no intention of entering into bona fide negotiations in relation to 0867?" Answer, "And I reject that, and think that's substantiated by the letter sent by Tim Cullinane in response to request by Theresa Gattung to negotiate where Tim makes it clear that the negotiations which Clear wishes to have with regards to 0867 must include the issue of termination payments and the removal of the threat and the charging of two cents per minute."

Now I'm not going to read the whole of the next page but I'm going to take Your Honour to those negotiations because there was a meeting on the 4th of November between Mr Cullinane and Ms Gattung, who was at that stage the chief executive of Telecom. Perhaps I'll read the rest of that part to the next question. "Those two factors had already – had clearly been rejected by Telecom as being able in their view to be included in the negotiations and so that was the position that Clear was facing where the matter was renegotiating or negotiating 0867, you think it's appropriate commercial conduct do you Mr Forsyth in response to receiving a draft agreement and entreaties for a face to face meeting to respond with a media statement of opposition, I think you're mischaracterising the sequence of events. If we go right back to the 10th of June which is when we had the first notice of this scheme and as you pointed out there were a number of facets of the scheme, many of which we found detrimental to our business, our ISP's business and our ISP's customers and we sought to one, understand firstly what all the aspects were. We then sought to include those things and all the time we got rejected by Telecom in our various tos and fros to the essential elements of the 0867 scheme. So we were fully of the view that Telecom had no intention of altering the key aspects of the scheme. They had, in fact, they were still threatening to launch the two cent a minute charge and we knew that there were, our ability should we have reached agreement, to actually put anything in place, would have been sorely tested and so notwithstanding two requests for a meeting your response was a media release?" "Correct." "And then after you've tried to create public pressure on Telecom you then say of course we're happy to sit down and talk?" "No. I don't think at any stage I said we were happy to sit down and talk." "No, you weren't happy to sit down and talk at all, were you Mr Forsyth?" "No." And there's a long further discussion.

So I commend the whole of this section of the transcript to the Court so that they can understand what Clear's position was. But at 245, line 2, to 251, line 31, there is cross-examination over a document which can now be found in case on appeal, volume 14, page 5670. I won't take the Court to it. It's a minute that was recorded, probably by Mr Cullinane,

of a meeting between him and Ms Gattung on the 4th of November. At page 246, lines 31 to 54, Mr Forsyth accepted that the minute was accurate. Accepted that Clear rejected a renegotiation offered by Ms Gattung, that's at line – page 247, lines 6 to 27, and said that Clear's idea of improving the overall relationship was to file the 60 page submission with the Commerce Commission, page 247, line 28 to page 250, line 32. And at no stage did Clear intend to have genuine bona fide commercial discussions with Telecom in the absence of seeking to apply external pressure. That's at page 251, lines 27 to 31 and we also draw attention to 252, lines 4 to 27.

Now the essence of it was that there was the meeting between the CEOs. There was refusal by Clear to renegotiate anything other than 0867. They weren't prepared to, I think this is correct, to renegotiate the whole of the ICA. There was, however, an agreement to try and tone down the hostility. Clear said it had changed its lawyers and for presence of the then lawyers, I don't probably need to tell this Court about the history of the then lawyers.

ELIAS CJ:

No.

MR SHAVIN QC:

Unfortunately a fellow Australian but we simply made clear in the Court that it wasn't Mr Farmer. We didn't want there to be any misapprehension about that. And there was an acceptance that what the chief executives were saying is, we will try and have a more normal, commercial relationship. And it was in that context that immediately after the meeting Clear filed a 60 page submission with the Commerce Commission attacking 0867. Mr Forsyth said, oh well, this was part of the continuing investigation by the Commission. Said, do you think it would have helped in the meeting on the 4th of November if it had been said to Ms Gattung we're about to file a 60 page submission and his frank answer was no.

Now, we would ask the Court to look and to be fair because as the Court can see there was a lot of detail in the cross-examination and in Mr Forsyth's answers but if one looks at the transcript from 221 to 252 in our respectful submission the only assessment one can take from that is that in fact Clear was not prepared, at the end of 1999 which was I think immediately before or immediately after the election, to engage in commercial negotiations without seeking to apply political pressure and what we do draw the Court's attention to, and this is at transcript 308, line 17 to 309, line 13, Clear only agreed – I'll take the Court to it, and it's quite critical. Page 308, line 17, "Throughout the period from the 4th of November 1999 when the chief executive officer of Clear assured Ms Gattung that Clear had a desire to normalise the commercial relationship between the two companies. Clear maintained a constant campaign to the Commission in the Courts and to the new government seeking to have regulatory intervention in that commercial relationship, is that true?" "Correct." "And in

fact the point at which Clear finally decided to negotiate was the point at which Clear was told unequivocally by the new Minister that the government was not going to intervene in 0867. That certainly had a bearing as to the initiation of the negotiations with Telecom?" "Yes." "And once Clear decided to negotiate in fact agreement was reached on an interim basis within two weeks was it not? Some agreement most certainly was reached within two weeks very speedily." "Yes." "And as part of that agreement Telecom agreed on an interim basis to pay Clear 6.75 million dollars?" "Yes." "And you refer to that, I've lost the paragraph number, I just want to be – sorry. In any event the agreement was reached in about May. You refer in paragraph 91 to the renegotiation?" "Yes." And then you identify that within five months a new ICA and settlement agreement was reached?" "Yes."

So that in terms of what were Telecom's options to renegotiate with Clear, it is plain that there was no practical alternative available for Telecom to negotiate in relation to 0867, prior to the election, prior to Clear exhausting what it saw as the possibilities for political intervention, but Telecom's bona fides can be seen in that within two weeks of Clear realising that there was to be no governmental intervention stopping 0867. That interim agreement was reached and five months later, and in advance of the expiry of the old ICA, a new ICA was negotiated.

Now there are two other passages of Mr Forsyth's evidence to which I'd simply refer the Court, invite the Court to read both the passages and the areas around it. A question was asked by the Court, I think yesterday, as to what was the effect of 0867 on Clear and one of the things that's notable is that at page 271, lines 18 to 31, Clear increased its customer base after the announcement of 0867. It said it reduced the rate of growth but its customer base increased. Only 25 percent of Clear's customer base attracted or would have attracted the two cent charge. That's 274, lines 3 to 20. And the drop in Clear's revenue was from 1.25 percent of its total revenues to 0.625 percent of its total revenues. That is the cost to Clear that said, that had this devastating effect on competition, was 0.625 percent of its revenues, page 287, lines 17 to 22.

TIPPING J:
But that, in effect, halved it.

MR SHAVIN QC:
Yes but we're talking, in terms –

TIPPING J:
Yes, yes, I appreciate it but that's not a coincidence. Those are the figures?

MR SHAVIN QC:
Yes. Now are they precise to the second decimal place, no.

TIPPING J:

No, no.

MR SHAVIN QC:

And it came because effectively the wholesale part of Clear was about 5 percent of Clear's then business and then you can work it down through the documents that we had available from discovery. And we refer in this context to our written outline at page – at paragraph 5.71 to 5.75. So that in our respectful submission when one looks at each of the three commercial options to which the Commission refers, we say that not one of them fits within the category of being even available to Telecom, let alone so clearly and obviously superior to the course of introducing 0867, that the fact that Telecom introduced 0867 should be the subject of an adverse inference.

Now can we then go to the network management issues? Network management problems were dealt with by a number of people. We would refer to paragraphs 44 to 59 of Mr Parkes' brief, which is case on appeal, volume 3, page 926 and following, and 7 I think it might be. Sorry, can I just check that, I think I have it written wrong because I can't read my handwriting. Yes I'm sorry, I've misread my handwriting. It should be 920 to 921 of the case on appeal, volume 3.

TIPPING J:

Have we finished with volume 2 for the moment?

MR SHAVIN QC:

I have, if the Court pleases. Now there was a lot of cross-examination of Mr Benson if I can – well I'll identify some areas of the transcript where this can be found but I don't want to over-emphasise this in terms of time. Can I paint you a scenario? Mr Benson was an engineer who was responsible for advising the Telecom Board on its strategy in terms of provisioning the network, the PSTN network, scaling it and identifying strategies for updating and making sure it grew at an appropriate level. And in, this was a continuing process, but in 1995-1996 and 1996-1997 he undertook very extensive process accessing switch requirements. Whether Telecom should acquire new switches, whether it should change switch suppliers, what were the alternatives available, and at that stage Mr Benson identified a number of issues. He identified that ordinarily voice traffic grew at 3 percent a year but that with internet traffic it was spiralling up at an incredibly rapid rate and each time one looked at it the growth rate of internet use had exceeded the forecast rate.

One can see this, I won't take the Court to it at the moment, but one can see this in a graph which is to be found in volume 10 of the case on appeal at pages 3640 to 1 and if the Court

looks at that you'll see how the graphs just zap up to 1998 before the event, was just going almost vertically at a very steep rate. He saw, this is at page, transcript 369, lines 30 to 33, he saw in 1996 that a lot of traffic might move off the PSTN but that at 370 the precise character of the technology that would be the new technology wasn't then fixed but he had the prescience to see we can't keep doing this the same way. We have to, in a technical sense, we have to take this data traffic off the PSTN. That by 1996 ordinary internet growth was already stressing some of the capacity in the network, 371, lines 17 to 18, and he had concerns about three things. Core capacity, the local part, the front end of the switch and international and they had to all be treated holistically. Now at 374, growth rates were so fast and the initial proposal to get off the PSTN was through the hybrid fibre cable network, which was at 388. 397 of the transcript, lines 6 to 13, having identified the stress that could be placed on the PSTN he developed a growth programme the subject of recommendations in fact accepted by the Board. And this was designed to help the PSTN cope with growth up to 1998 and he forecasted at 399, lines 15 to 24, that by the year 2000 internet use would equal local calling and there would be a tripling of volumes. And he warned the Board, and this is page 401, line 6 to – of the risk that the investment in the PSTN would be stranded by movement to a new platform so that when they were looking at their investment in switches, in 1996 and 1997, they were already conscious that there was a limited life of the PSTN and they agreed at that stage to invest, I think some 225 million, in just ordinary PSTN they were conscious that some of that would be – so they're taking it in little steps and stairs. Now this is significant in understanding what is being said by our friends as to the options available to Telecom in 1999 because the last thing you would be doing in 1999, which is two years after this massive nine month study by Mr Benson, is putting enormous new investment into the PSTN knowing that ADSL was around the corner.

So that in that context we look at internet, intelligent network functionality. Now it was suggested by our friends that what should have happened is that we simply put a list of all the ISPs in and then you wouldn't need to have 0867 because you'd simply know the list of ISPs and you'd have a table. And that's fine, as a matter of theory, but there are some problems. You do need to have a table because the way in which the system works is that it looks to a number, it goes and looks at a table, and you'll find this discussed by Mr Benson around page 442 of the transcript. You have to have a database to which the IN can refer, lines 2 to 15. So if there wasn't, to have a special number dialled by residential users to use the internet, it was necessary to establish a database of all local numbers used by ISPs but Dr Milner's evidence in his brief at case on appeal, volume 2, page 1172, paragraph 91, was that Telecom had no capacity to direct all ISPs to give it their numbers. Without it, it couldn't create the database and in fact it would involve an enormous amount of processing power because what you'd have to do is you'd have to interrogate every single number. So every call would have to be interrogated back to the database because you don't have an 0867 set of digits up the front which enables you to say, 8, all right that's intelligent network, 67, that's

internet call, you're going to have your normal seven digit number. So you're going to have to interrogate the database in relation to all these numbers. You can't tell the ISPs what numbers to do because a lot of them aren't your network, they're on Clear's network. You don't have a contractual relationship with them.

So Dr Milner's evidence was that Telecom just didn't have this processing power in 1999 and it was a very inefficient way of doing it and he also said in his evidence in chief that in fact Telecom at one stage had tried to get the ISPs to give Telecom all of their numbers that they were using –

BLANCHARD J:
How many ISPs were there?

MR SHAVIN QC:
100, 150 I think of that order but a lot of them had multiple numbers because some of them were very small enterprises and they weren't, they didn't actually see Telecom as a very warm and cuddly brother at that stage because their concern would have been, and Mr Mitford-Taylor gave evidence as to this, that if you give Telecom the number, it wants the number because it wants to be able to block traffic when the network gets congested, so giving Telecom your number and saying this is the dial-up number we're using, or that we've changed to, or we've opened up a new little sub-office and we're using it, enables Telecom to interrupt your business.

ANDERSON J:
But the people who were using those ISPs must have known the number?

MR SHAVIN QC:
Yes but you don't have a – to make this work you have to have an absolutely accurate database up to date.

ANDERSON J:
Just Google it.

MR SHAVIN QC:
But we're talking 1999. I think the only person – I didn't know about Google in 1999. This was when you asked technical questions about computers. We are 11 years ago and it's amazing when you think where technology has gone in 11 years and how we use – think about how you used the internet 11 years ago and how you use it now. So what we say is, to

just finish this point if I may, what we say is that on the evidence it was not practical for the intelligent network to be used simply by generating a database and in some way interrogating every single call without disrupting the whole system.

TIPPING J:
Interrogation would be to make sure it was a qualifying number?

MR SHAVIN QC:
Yes. Is that a convenient point?

ELIAS CJ:
Yes that is. We'll take the morning adjournment. Thank you.

COURT ADJOURNS: 11.29 AM

COURT RESUMES: 11.50 AM

ANDERSON J:
Mr Shavin, there is a point that I would like to clarify with you now so I don't interrupt the flow of the argument. It's something that cropped up a day or so ago.

MR SHAVIN QC:
Yes certainly.

ANDERSON J:
The ICA provided for termination calls in respect of communications between the 300 hertz and 3400 hertz range.

MR SHAVIN QC:
Yes.

ANDERSON J:
And did I understand you to say that's the range for voice but data frequency is above 3400?

MR SHAVIN QC:
Yes.

ANDERSON J:
At some stage perhaps one of your team –

MR SHAVIN QC:

I'll deal with that exactly now because it becomes immediately relevant. Where you have, or had in 1999, a modem you were sending an analogue signal, so it was in the voice range. And when that signal got to the first switch there was a network with IPNet, there was a network access server, and that took the signal and converted it into a digital signal and could then send it as a digital signal down a different backbone and so it took it off the PSTN.

ANDERSON J:

What because the digital signal was a higher frequency –

MR SHAVIN QC:

Yes.

ANDERSON J:

– or because it was digital?

MR SHAVIN QC:

Well it was a higher frequency because – it was digital and it was a higher frequency. When it's an analogue signal it's within that 64 kilobit range. And the short point as to why IPNet was not available as a ready alternative was this. Prior to the introduction of IPNet you would have these analogue signals coming down the line from the modem and they would get to the ISP. The ISP had a whole bank of what were called network access servers. They had 30 ports. They were in banks of 30 and they were used by the ISP to manage its traffic. Now if I can just take you so that I don't get this wrong, because the evidence of this was oral from Mr Benson. A network access server is a device used to terminate dial-up Internet calls over the PSTN that converts the call into digital form.

ANDERSON J:

Where is this reference?

MR SHAVIN QC:

There's a discussion in Mr Benson's cross-examination at volume 2, page 457, really for about 10 pages, and there is also, if you look in the document of Dr Milner that was referred to, in fact it's a PowerPoint, about 60 pages, and in that, in diagrammatic form he goes through each of the different forms of communication from the plain old telephone service, through the analogue service, through ADSL, explaining a synchronistic transfer mode, ATM, hybrid fibre, all of them explain technically how they work and what the network structure looks like.

ELIAS CJ:

If his oral evidence refers to that diagram, do you have the reference to the diagram in case it's necessary for us to – in the case on appeal?

MR SHAVIN QC:

Could I come back Your Honour on that?

ELIAS CJ:

Yes. It may not be necessary for us to go into it –

MR SHAVIN QC:

No but we will –

ELIAS CJ:

– but it may not be easy to understand his evidence if he was using a visual aid like that.

MR SHAVIN QC:

Yes. It starts in case on appeal 18, at 7584.

ELIAS CJ:

Thank you.

MR SHAVIN QC:

I won't take the Court through it –

ELIAS CJ:

No.

MR SHAVIN QC:

– if I might but if I could refer the Court to it. So a network access server is a device used to terminate dial-up Internet calls that converts the call into a digital form. It usually comprises banks of about 30 modems, each bank being connected to a two mega-bit per second trunk interface. That's Mr Benson, case on appeal volume 2, 457, line 23 to 458, line 2, if I just give the case on appeal page number and the line number, if that's sufficient for the Court's purpose. Each NAS port acts like a modem which terminates an incoming call from a customer modem, converts the tones from the customer into a digital stream of data. The multiple streams of data from each bank of NAS modems are statistically multiplexed together into a single higher stream, normally 10 megabits per second, and a standard Ethernet switch is then used to multiplex N times 10 megabit per second streams into higher speed streams which are delivered to the ISP for processing. That's Mr Benson, case on appeal page 458, lines 6 to 28.

The mass banks used to support the traffic originated within the free calling area of say Auckland, would usually be located at the ISP's premises in Auckland or close by and the ISP would lease 10 megabit per second trunks from the nearest Telecom exchange. Each NAS bank would be allocated one or a few standard seven digit local numbers so that customers can make calls into the NAS without extra charge. Mr Benson, case on appeal 2458, line 30 to 459 line 12.

Where an ISP is located in Auckland that wishes to service customers in other regions, it would lease premises within each of the free calling areas it wishes to service and appropriately to mention NAS banks (are) located in each premises. 459, lines 13 to 30.

So with IPNet the NAS is still the critical feature but now it's located in a Telecom exchange and it's done that way so that the call is converted into a digital form, not at the end point where the ISP is, but at the exchange closest to the customer and in that way Telecom is able to send it down as a digital stream through the ATM network rather than sending it as an analogue stream along the voice network.

BLANCHARD J:

But that wasn't available in 1999/2000?

MR SHAVIN QC:

It was, but they had this problem. The ISPs had all invested very substantial sums of money in their NAS banks. Telecom's investing its money inputting the NAS in the exchange so the first thing that happened is that Telecom needed to recover the costs of putting the NAS in the exchange but the ISP was left with this investment that was stranded and so they didn't like this because if they were going to a new area it was fine, if they hadn't already invested the money in the NAS bank, then they were quite happy to take IPNet where Telecom's investing the money and putting it in the exchange. But they didn't want to lose their own NAS and Mr Mitford-Taylor, if I can just find the paragraph, volume 4, case on appeal, page 1286, lines 1 to 18. Mr Mitford-Taylor said –

ANDERSON J:

Sorry, what page?

MR SHAVIN QC:

1286, lines 1 to 18. And Mr Mitford-Taylor said that a second reason the ISPs didn't like it is they lost some control over the process. So ISPs would seek to differentiate themselves to some extent by quality of service and they didn't like ceding all of that back to Telecom so that in fact IPNet wasn't very successful as a commercial product. It was fine for Xtra. Telecom

moved Xtra over onto IPNet and some of the newer ISPs or the smaller ISPs moved but the substantial ISPs weren't interested. So that IPNet wasn't an immediate thing that could be a substitute for the existing problem because it involved rendering the investment by the ISPs in their own NAS banks as stranded or obsolete. And so IPNet had been conceived by Telecom as an answer to its problems, in fact it was not terribly successful.

That leads us then – there's quite a bit of discussion about the NAS in the transcript, case on appeal volume 2, 460, up to page 465, which gives the technical background. So using the intelligent network alone wasn't an option. Too much processing power. Too much disruption because it required interrogation of every single seven digit call creating an up to date and absolute bank of ISP numbers, Dr Milner said had been tried by Telecom and failed, IPNet wasn't seen by the ISPs as a viable substitute. So then we come to ADSL. Now the important thing about ADSL is that in 1999 it was an immature technology. The standards weren't finalised until June. Most Internet sites weren't configured for high speed access and Mr Forsyth's evidence is very important. It runs from case on appeal, page 151, line 30, to 153, line 17 and if I could take the Court briefly to this –

BLANCHARD J:

Could you repeat those numbers please?

MR SHAVIN QC:

Certainly Your Honour. Case on appeal volume 2, page 151, line 30 to page 153, line 17.

BLANCHARD J:

Thank you.

MR SHAVIN QC:

At line 30 I asked Mr Forsyth, "In 1999 broadband was not regarded by consumers in New Zealand as a viable substitute for dial-up Internet access was it?" "I don't think in 1999 the term broadband existed and it most certainly wasn't offered, certainly not at the residential level so no." "It wouldn't have been considered as an option by residential users?" "No." " And even though Clear had intercity trunking in New Zealand it hadn't linked that with a broadband offering to its customers had it other than high speed data links for corporates?" "No. That would be correct." "And those high speed data links for corporates tended to be framed relay links, didn't they?" "In the large, yes." "So from a supply side perspective in 1999 you wouldn't have perceived broadband as a substitute for dial-up Internet access?" "No." "From a demand perspective in 1999, that is looking at the consumer's perspective, consumers would have perceived modems for ADSL and the associated hardware needed as immature technically and comparatively expensive would they not?" "Yes I think so." "And certainly a lot more expensive than the standard modem that was either contained in a

computer or appended to a computer for dial-up Internet use at that time?" "Yes." "And indeed a lot of laptops, then perhaps less so than now, contained standard modems built into them for Internet access by dialling up the Internet, didn't they?" "Yes." "And thus when one looks also from a consumer's perspective at what they could use their Internet access for, web based content was not structured for high speed Internet access, was it, by and large?" "By and large, no." "And by and large if you looked at a webpage in 1999 it was configured and structured primarily for dial-up Internet use?" "Yes." "Unlike today where most webpages in fact assume that the person seeking to view them has broadband access?" "That's a better statement, yes, I'll agree with that."

Now Mr O'Brien also confirmed this. Could I take the Court to volume 3, at page 817, lines 21 to 25. Perhaps I should start at line 13. "And so in 1999 to access the Internet via a DSL link involved the acquisition of modems and hardware by the household did it not?" "Correct. There was an upfront purchase requirement at the time; you needed obviously a computer, a modem associated with it, ISP software and a phone line; so, there was quite a large upfront establishment of access to the Internet in the first place." And that's what you meant, is it not, and was still expensive and not well known?" Answer, "The DSL required a modem which at that time was far more expensive than they are now, "yes, compared to say voice dial-up modems."

And if I could then take the Court over the page to 818 – I'm sorry, at the foot of that page, line 35 on page 817, and "relatively simple to configure. And so, for the majority of consumers in your experience in the middle of 1999 DSL was not seen as an immediate substitute, was it?" "Not an immediate one, no." Now when you look at all of that what one sees from both Mr Forsyth and Mr O'Brien, the two senior Clear executives called by the Commission, ADSL was not, from either demand or a supply perspective, in 1999 a substitute. It was not going to solve, in 1999, the traffic management problems. Now yes that had been two trials run by Telecom of the technology in 1997 and 1998. They - Mr Benson had formulated a plan to roll out Internet access over five years and it was but the bulk of the take up was in the new millennium and thus the evidence simply doesn't support the Commission's proposition that ADSL was a viable option to 0867 in 1999. It can't be when consumers, to use it, have to go and spend money on hardware that's immature.

The Court may recall, if the Court had laptops, but in 1999 of course as the evidence said, most laptops came with a modem built in. You didn't go and buy another modem, it was there. But with ADSL at that time you had to go and buy a modem. It was later that ADSL modems had standards and were supplied with laptops. And thus, in our respectful submission, when we look at the so-called options, the Commission has, in our respectful submission, failed to establish that they were alternatives. That that would be insufficient for them. What they clearly have failed, in our respectful submission, to establish is that there

were alternatives that were so obviously better than the 0867 scheme that an adverse inference ought to be drawn from Telecom's choice. Now whether as the High Court said there may have been some better traffic management options, maybe they could have been explored more, that's a management decision as we knew there were real difficulties about how you rolled out ADSL, how you configured the Internet network, how much money you put into the PSTNs, these were very delicate issues. There has to be some capacity for management to make decisions rather than a Court, even as senior a Court as this, 11 years after the event. Saying we can, with the benefit of hindsight, think that maybe you could have taken a different technical engineering choice. What is clear is that these other options weren't obviously better. Were not so much better that one can say that because Telecom made the decision that it made, you should draw an adverse inference. In our respectful submission the commercial options weren't available and the technical options were difficult.

TIPPING J:

The adverse inference would only be relevant, I would have thought, to purpose –

MR SHAVIN QC:

Yes.

TIPPING J:

– rather than to use.

MR SHAVIN QC:

Yes although I think our friends are trying to blur, we would think, with respect, the distinction because I think our friends are trying to say, well you can infer that they had a purpose and perhaps they were consciously going about and using their power. Now we don't think that's legitimate. We think that Your Honour's approach is the only approach open. But we say that in any event no inference can be drawn from these alternatives on the evidence.

Now can I, at this stage, then return to the wholesale market because in our respectful submission the treatment by the High Court, and I won't go to the dominance question that was dealt with by my learned friend Mr Hodder yesterday morning. Of wholesale network access was clearly right. It was done briefly. They simply said look, even if we were wrong, and even if Telecom was dominant in the wholesale market, the analysis for retail is the same. And one can see this from Telecom's own submissions and from Dr Bamberger's evidence.

Could I ask the Court to have open our learned friend's outline at page 36? Now, can I start by identifying that each of the High Court and the Court of Appeal held that the relevant market was for terminating access alone. We think that, with very great respect to our friend,

that he made an error on Tuesday. He criticised Professor Hausman for looking only at terminating access, rather than originating and terminating access. But, in fact, both the High Court and the Court of Appeal held that the relevant market was terminating access, because the conduct at issue related to terminating a call network-to-network wholesale from Telecom to Clear. And that is to be found in the High Court judgment at paragraphs 22 to 24, case on appeal volume 1 at pages 43 to 44. The finding is at paragraph 24. "The Commission's expert, Dr Gustavo Bamberger, preferred a combined market, as did Professor Lewis Evans, who also gave evidence for Telecom. Professor Hausman thought that the relevant market should be confined to terminating access. We agree with him that the narrower definition is better suited to a consideration of dominance. At the wholesale level, the 0867 service related only to the termination of local calls. This is the relevant field of rivalry. We note also Dr Bamberger's acknowledgement that nothing in his evaluation of dominance turned on this aspect of market definition".

This was upheld in the Court of Appeal at paragraph 62, case on appeal volume 1 page 95. The discussion extends from paragraph 59 at the foot of page 93, but the conclusion is clear. "This is a general appeal", paragraph 62. "To succeed, there is an obligation on a party to satisfy us that a judgment or a particular part of it is 'wrong'. We are not so satisfied on this point. The focus of this particular inquiry is on a particular kind of economic activity. The argument is not as to an extended field of telecommunications activity, but, in this instance, to the wholesale network terminating access market". So both the Courts below were in agreement on this, and the High Court, of course, had the assistance of the lay member. Now, in that context, it's terribly important to consider what our friends are saying, and there is corresponding evidence of Dr Bamberger which has the same problem. Indeed, these paragraphs seem very heavily based on paragraph 33 of Dr Bamberger's reply brief, though he was cross-examined on them.

Can I take the Court through the two paragraphs, because the flaws are self-evident? In the wholesale market counterfactual, our friends contend it should, again, be assumed that Company X has a traffic imbalance problem, and there's a net payment of termination fees for local calls. Because Company X is non-dominant, it can be assumed that in the wholesale market, any network could terminate or originate a call for a rival carrier. So the first thing is that our friends have not tailored their submission to the market as found by both the Courts below, because a terminating market does not incorporate call origination. Therefore, they say, Company X could not unilaterally assert that 0867 numbers were outside the ICA. It's a non-sequitur, in our respectful submission. The contract, whether or not calls are inside or outside the 1996 ICA, is a matter of construction of the contract. There is no causal connection between any market power and construction of the contract. Then there is this typically understated language, "And force Company Y to sign an ICA from foregoing terminating payments". That assumes the outcome without giving Company Y something in

return. Why would it have to give something in return unless there was a contractual entitlement to it? So the contractual entitlement is a matter of construction. If there's a breach, there'll be damage. If there's no breach, there's no damage, there's no entitlement to compensate.

Then, they say, nor could Company X unilaterally refuse to deliver or receive 0867 traffic on Company Y's network. Well, how does Company X receive traffic on Company Y's network? It can't. All it's doing is delivering a call. Company Y could decline to do business with Company X because it would be able to buy its wholesale network access from another carrier. Buy what? This is terminating access. The nature of terminating access is that Network X originates a call on its network, delivers it to network I to terminate it on Network Y. So Company X is buying the right to terminate on Network Y from Network Y. It pays a terminating access charge. Network Y sells access for a charge, two cents a minute. Network Y isn't buying anything. It's a seller. That's why it has bottleneck power. That's why it had the capacity to extract an above-cost return. So Company Y isn't buying anything from anybody else. It's selling it.

Then we go on. In the factual scenario, it was Telecom's dominant position in the wholesale market that prevented its wholesale customers from switching to another carrier. Company X could not profitably have adopted the same strategy in the counterfactual. Company X would risk losing its wholesale customers. But hold on. The market is a market for terminating access. What customers is it going to lose in a competitive market? Ah, we find out the answer here. Because they could switch to another carrier. What it's really talking about is not its wholesale customers but the retail ones, because, as we see, Company X would then likely lose a substantial number of its retail customers because they would not be able to call ISPs on Company Y's network. So what they're saying is, really, this isn't about wholesale at all. They're saying because the retail customers would move, X would suffer a loss. There's no other rational way of trying to understand these sentences. And, indeed, when one looks at Dr Bamberger's cross-examination, one finds that that's exactly what he meant, even though, linguistically, this is very confused, because our friends have, we would say, with the greatest of respect, failed to acknowledge that the market found is one for terminating access alone.

Now, the cross-examination of Dr Bamberger starts in volume 5 at 1667, line 14. But in the interests of time, could I take the Court to an answer that starts at page 1669, line 16. I would invite the Court to read these pages, really, starting at about 1664. But it's in this particular answer. It's a very long answer, but one can see where Dr Bamberger is going. And the endpoint of this that we seek to draw from this answer is that the High Court was absolutely right in saying that in assessing the Commission's argument, it's really the retail argument that was the subject of the detailed counterfactual analysis. I ask, at line 16 on 1669, "So I'm

trying to identify precisely what it is that you say the rivals were buying from Telecom. I put to you that they weren't buying anything from Telecom that would enable their ISPs to service customers on Telecom's network. You, if I understand you correctly –

ELIAS CJ:

Sorry, I haven't found the page.

MR SHAVIN QC:

1669, Your Honour.

ELIAS CJ:

Oh, 69. No, no, my fault. Thank you.

MR SHAVIN QC:

I'm at line 16. So there's a question at line 16 to 21, to which he answered yes. So at line 23 I ask, "So I'm trying to identify what it is that Company Y – let's keep it simple – was going to buy from Telecom that would enable Company Y's ISPs to deal with customers on Telecom's network. Let me try this, maybe this will answer the question, because I'm not 100 percent sure I understood your hypothetical. In the real world, Clear has a lot of ISPs. Those ISPs need to be able to receive calls, and they need to be able to receive calls almost completely from Telecom customers because, in the real world, that's where all the customers are. So for Clear to offer a viable service to its wholesale ISPs, it was to have an interconnection agreement with Telecom. No ISP is going to locate its network on Clear's network if Telecom residential customers cannot call Clear. So that's in the real world that they have to deal with, and by deal with, I'm talking about signing an interconnection agreement, they have to buy and sell in the sense of terminating access. They have to be able to receive calls from Telecom customers.

Now, in the counterfactual, the distinction as I see it is Company Y doesn't have to deal with Company X in the same way because Company Y in the counterfactual has a lot of ISPs or a disproportionate number of ISPs which are important to Company X's residential customers. Those residential customers that call the ISPs on Network Y which, again, is the reason we've got this problem, want to be able to do that. But " – and this is the important paragraph – "Because Company Y doesn't have to deal with Company X, because they can buy" – and I emphasise that word – "wholesale network access from somebody else, if they do that now, the leverage, I think, is on the other foot. That's never a good metaphor, but the leverage is on the other side, because those customers don't have to stay at Company X. The residential customers can say, well, you know, we like our ISP, and we can just now switch to another carrier, another dominant carrier, and that's different. Now, how credible a threat is that? Will all of them switch? Probably not. Maybe some of them will just switch ISPs. But the point is,

the amount of leverage is very different in the counterfactual than it is in the real world". Now, can I pause there. The Court will, no doubt, wish to take that more slowly than I've taken the Court through it now. But I'd ask the Court to compare this answer with the two paragraphs in our learned friends' outline, and then keep very clearly in mind that the market held in the High Court and upheld in the Court of Appeal was for terminating access alone. And what we see, really, is nothing more than a re-packaging of the retail market analysis. And thus it is that the High Court said, in dealing with this issue, and that's to be found in paragraph 90 at case on appeal volume 1 page 66. I'll just read it. It's only four lines. "Although our counterfactual analysis has been confined to the market for residential customers, we would have reached the same conclusion, albeit by a somewhat different route, had we been required (by a finding of dominance) to undertake an analysis of the wholesale network terminating access market." In our respectful submission, it's plain why that is right, because at the end of the day, even though there's enormous confusion, first by Dr Bamberger and secondly, we would say, with respect, by our friends, as to what the wholesale market is, it is clear it depends upon the threat that retail customers will move away from Network X to some other network in an attempt to avoid 0867 and the IDC. And for the reasons that we articulated yesterday and again this morning, in our respectful submission, on a proper analysis of the counterfactual, that isn't demonstrated.

And in the submissions that our friends have made in support of their appeal, which is to appeal against this counterfactual, for the reasons articulated earlier this morning, they have been unable to identify any error in the reasoning. So that even if the Court concludes that the Court of Appeal was right, that is, that one ignores regulatory effects in terms of constraint, and therefore says that Telecom was dominant in the wholesale network terminating access market, there is no reason why that would result on a counterfactual analysis, with use. So that just as the assessment of the counterfactual in the retail market demonstrates no use, so on the arguments articulated by our friends for the Commission in relation to the wholesale market, you would reach the same conclusion as the High Court found.

Now, the Court of Appeal didn't comment on this aspect. But in our respectful submission, the High Court has sufficiently, and when one understands that, in fact, the Commission's argument boils down to the movement of retail customers, one can find no error in the High Court's conclusion. Would the Court pardon me for just one moment. I might interpose at this point, just so the Court has it in mind. Dr Bamberger did concede that the KSO, which, as my learned friend Mr Hodder noted yesterday is a form of regulation, was some, although he wouldn't say complete, constraint on Telecom's pricing, and that's in volume 5 of the case on appeal, page 1637 at lines 2 to 32, and earlier, at page 1636 lines 32 to 34, he conceded that by reason of the conditions, the KSO had an effect but didn't stop the imposition of the IDC. So that we would say, in additional support to the proposition that regulation is a factor that

must be taken into account in assessing dominance, dominance being the ability to act substantially without constraint, the conclusion reached by the High Court for the reasons articulated by the High Court that Telecom was not dominant in the wholesale network access market by 1999 were correct. I don't want to deviate too far from that. I just want to draw the Court's attention to those two references.

McGRATH J:

Dr Bamberger's concession, presumably, only relates to voice calls?

MR SHAVIN QC:

The concession, I should perhaps, to be fair, perhaps if I take you to 1636, because it related to the IDC, Your Honour. This is volume 5, case on appeal, page 1636. The discussion on that page and the preceding page was the impact of the KSO on the imposition of the Internet dialling charge. At line 23, just to give some context, "Those conditions," – these are the conditions imposed in the KSO – "operated as a constraint on the way in which it was implemented, didn't they?" "On the way it was implemented, but not on the fact it was implemented. It could have been implemented maybe in a different way and maybe they wanted to implement it with no quality assurance, and that would have been constrained by the KSO. But the fact that they implemented it, so far as I know, is not in dispute. They implemented it." "Telecom did not have an unrestricted ability to impose a charge, did it?" "If you're referring to the conditions, no, but I don't recall saying that it was unrestricted, it was not precluded," and that of course is the Internet dialling charge.

There's one other matter, too, before I go to the next topic, and it's really in response, I think, Justice McGrath, to a comment that you made yesterday, where your impression from the documents that you had read was that the concern was more as to the cost of the terminating access charge, rather than to traffic management. Could I simply draw to Your Honours' attention again the Project Morecambe document –

McGRATH J:

Yes.

MR SHAVIN QC:

– to which my learned friend Mr Hodder took you, and that document was primarily concerned with the traffic management issues.

McGRATH J:

Thank you.

MR SHAVIN QC:

Now, could I then move to the Commission's alternative tests for establishing use? Can we make these propositions? The first is, as my learned friend Mr Hodder noted, these were not put at trial, they were not pleaded. It's not the way the case was opened, it's not the way the case was closed. If it is being said that there was some leg-up that Telecom obtained that was not available in a competitive market, that in some way, as I think my learned friend Ms Coumbe put it in her submissions on Tuesday, that it was made easier for us. Telecom's been given no opportunity to adduce evidence as to degree of difficulty, as it's been given no opportunity to adduce any expert evidence on this. As must be clear, in our respectful submission, from the analysis of the authorities, to which my learned friend Mr Hodder took the Court, there has to be a connection between the power and the use, it cannot be, as our friends contended yesterday, that you simply look at Telecom, say it's big and ugly, and therefore assume that helps. That's not found anywhere in the authorities, and my learned friend –

TIPPING J:

I don't want to appear pedantic, but is it a connection between power and use or between power and conduct?

MR SHAVIN QC:

Well, you're quite right to correct me, Your Honour. It's between power and conduct. I apologise.

TIPPING J:

No, no, I just – this is a slippery field and you're a true – thank you.

MR SHAVIN QC:

I'm not trying to be slippery.

TIPPING J:

No, no, it's me, it's just my lack of – I just want – it's important that one be absolutely clear.

MR SHAVIN QC:

Yes, no, no, Your Honour's absolutely correct.

TIPPING J:

If you'll forgive the pun.

MR SHAVIN QC:

It is there has to be a connection between the power and the conduct for the conduct to be a use of the power.

TIPPING J:

Exactly.

MR SHAVIN QC:

And what we're doing is looking at what that connection is. But it is absolutely wrong, in our respectful submission, to suggest that you don't have to look at connection, that you can simply say, oh they've got this market share, or, they own this network facility, or, they have this number of access lines, and then say, and what they've done's nasty. You can't – we don't accept any of those propositions – but you can't then jump and say "use". Every articulation of this by the Australian High Court to the extent that this is being founded either on *Melway* as explained, as my learned friend Mr Hodder articulated yesterday, or Deane's J statements as properly understood in the context in which he made them and as explained in the subsequent cases, points to connection. That means that if some other test other than *Telecom v Clear* and *Carter Holt Harvey*, which was the only test on which this case was run at trial, is to be assessed, as a matter of natural justice Telecom has to be entitled to adduce evidence on it and, in our respectful submission, a reason why this Court would not and ought not allow the Commission, at this level, for the first time, to seek to articulate these tests, and we note in their outline they don't even seek to have a definitive test, even now there is not the evidence available and Telecom has not been given an opportunity to consider and adduce evidence or cross-examine witnesses in relation to whatever test it is the Commission says we had to meet. This trial was run on one basis alone and it would be, we would say with respect, completely unfair for Telecom to be tried on some different basis on the second appeal. It was not necessary for our friends to run the case the way they did, they could have said, "We wish to reserve for consideration by the High Court this alternative test, we think it is open, and this is the evidence that would be run so that we would have had an opportunity to test that evidence and adduce our own evidence," and then this Court would have had the factual material upon which, if it was disposed to, say there was a different test, could apply that test. But where there was no reservation, where there was no notice given, where there was no opportunity for evidence to be adduced, in our respectful submission it is not open for this Court to apply the test in this case.

Now, in any event, the matters raised by the Commission, in our respectful submission, are flawed. We have dealt with this in our written outline at paragraphs 5.50 to 5.55, but the Commission first asserts that Telecom's dominance in the retail market, primarily its ownership of 99 percent of residential access, materially facilitated the introduction of the 0867 numbering scheme without losing market share. However, the Commission points simply to the limited options available to residential users. This, however, doesn't establish any relationship between Telecom's ability to introduce and its market power, or that the market power rendered it easier to introduce. We know, from the counterfactual, that a firm in

a competitive market can introduce it, what relevance is there otherwise in making it easier? They haven't shown it was hard in the counterfactual, this has to be relative. They're saying, easier. Easier than what? Easier than a firm in a workably competitive market that was non-dominant. We don't know what the nexus is, we don't know what the facts are, and there's no economic evidence that was available to assist the Court to understand the relationship. To say, as our friends do, "economic evidence is irrelevant" is clearly wrong, because the connection is a connection with which the economists can and must be able to attempt to assist the Court. Market power's not something observable, it's not a truck hurtling down the road. The only way you can articulate the impact of its presence is to see what would happen if it wasn't there. That takes you back to the counterfactual. On the evidence there's no relationship established between market share loss, network ownership, the introduction of 0867. Here, for example, the mere ownership of access lines would have no impact if the other network was able to obtain unbundled local loop access to essential customers. In having two networks you assume customers can move, so the very assumption in the counterfactual of a workably competitive market is people can move. In Australia they can move. I've got a telephone line, Telstra put it in but I am on another network provider, gets unbundled local loop. It's what happens in most countries of the world if you want rack access, so the fact you own the network lines doesn't undermine the counterfactual. The very premise of the counterfactual is that you'll have multiple networks, so why is it that there is some different test, made easier than in the counterfactual? It was clear, in our respectful submission, that whichever permutational combination one looked at no other network would accept a residential customer from Telecom and still themselves negotiate an ICA with Clear giving Clear above cost terminating access payments. What's changed? This is the difficulty that we have in trying to deal at this stage of the case with this new test, where there's no underlying facts laid out, where they've not been able to be tested, where there's been no cross-examination on them.

The second argument put by the Commission is that Telecom's dominance in the wholesale market materially facilitated Telecom's ability unilaterally to declare that 0867 numbers were outside the ICAs. There are at least three fundamental flaws in this argument. First, as we've noted, there's no relationship between power and asserting that something is or outside a contract. There was in fact an express finding in the High Court on this, where the High Court said, this is something that's simply done by anyone seeking to assert a contract. At paragraph 80 –

ELIAS CJ:

Of?

MR SHAVIN QC:

The High Court judgment?

ELIAS CJ:

Yes.

MR SHAVIN QC:

Case on appeal, volume 1, page 63. It deals with it in reverse, but it makes the same point. "Dr Bamberger made the preliminary point that in a competitive market Telecom would have been compelled to negotiate with Clear by the threat of legal action." We disagree. There's no evidence that Clear could have succeeded in legal action against Telecom, whether for breach of the ICA or otherwise. Grant Forsyth, the former Manager, Industry and Regulatory Affairs, at Clear, acknowledged that Clear settled its claims against Telecom when it became clear the Government would not intervene to prevent the 0867 package from being implemented. There is no reason to suppose that Company Y would be better placed than Clear to use the threat of legal action to deter the introduction of 0867 in the counterfactual. At the end of the day, if there's a breach there's a breach. Market power's not relevant to that.

Secondly, the Commission's argument was because of the absence of choice, carriers had no option but to interconnect with Telecom's network. Again, there's a misconception, we're talking about the wholesale terminating access market, it misconceives the nature of terminating access. Clear was not acquiring a service from Telecom, it was refusing to supply a service to Telecom at anything other than a monopoly price. That's why it didn't want to have bill and keep for terminating access. We refer to the cross-examination of Mr Forsyth. As we saw, this argument ultimately falls back to the question as to whether Clear would obtain sufficient leverage from persuading Telecom's retail customers to move to another network, taking us back to the residential retail counterfactual.

The third flaw is the Commission's assertion that the lack of choice to rival carriers about to interconnect gave Telecom network bargaining leverage to not pay compensation. But the fundamental flaw here, what compensation? What basis does Clear have for compensation in the absence of any contractual breach? The argument amounts to saying that Clear should be compensated for the loss of monopoly rents it was extracting from foreclosing access, it was terminating access service, unless a monopoly price was paid. Or, put another way, in terms of *Olympia,* that Telecom should have held an umbrella over Clear, notwithstanding the inefficiencies that flowed. And it's how the Commission's third argument simply builds on the flawed foundation of the first two, it is that Telecom's dominance in both markets materially facilitated Telecom's refusal to provide Clear with 0867 numbers because Clear wouldn't sign an ITA. The Commission is unable, however, to point to any example anywhere in the world, let alone in New Zealand, where a telecommunications carrier has been required to deliver a service in the absence of an interconnection agreement. Because,

of course, interconnect agreements have two parts. There's the price and the non-price terms and conditions. If you're sending something as a digital signal, there has to be a whole series of protocols as to how that signal's dealt with, how information management is dealt with, all sorts of technical issues, they are dealt with in the interconnect agreement. The interconnect agreements are in the case on appeal and you'll see the technical documents. They deal with the interface of the networks, price is but one theme. Clear was saying, "We won't sign an interconnect agreement with you, Telecom, because you're not going to agree to pay us our above cost terminating access charges." Telecom said, "Well, I'm not going to give it to you on that basis, I'm going to give it to you on the official bill and keep basis." The Commission then says, "Oh, well, it couldn't do that because all the residential customers would go somewhere else." We're back to where we started this morning, where, because no-one is going to agree to pay a terminating access charge to Clear for a service for which it cannot recover the cost of the charge from the customer. The easiest way to turn a big business into a small business is to pay more for the service than you receive from the customer. There are a number of very efficient examples of this in New Zealand and in Australia over the last few years, but it's not something which is mandated by the Commerce Act.

The Commission's final argument is that it asserts that Telecom had three other competitive and commercial options to solve the termination payment problem and the alternative options open to resolve its network management issue, these were the matters that we've dealt with already this morning and said, "Well, they weren't options."

Now, one then has the straightforward factual inquiry test. We refer the Court to Telecom's outline at paragraphs 5.60 and 5.61. The strength of the Commission's decision can be seen from its outline, which I think is a single line, it's in paragraph 4.6, "As an overall assessment of the facts, Telecom's conduct was self-evidently an exercise of market power." Well, in our respectful submission, that takes the Court nowhere. This is not some intuitive individualistic assessment, for all of the reasons articulated by my learned friend Mr Hodder. All of the authorities, the Privy Council, and the High Court of Australia, show that you must demonstrate a connection between the power and the conduct. One can't simply say, oh, look at it, draw an answer, without establishing that connection. It's either established by the counterfactual or on some other basis that wasn't put at trial.

We then finally come to the issue of purpose. This has been dealt with quite fully in our submissions at paragraphs 5.63 and following. Could I simply add a couple of comments to that? I was aiming to finish just before one. I understand that the Crown wishes to just substitute one piece of material for the others, and we thought we might be able to do that just before the luncheon adjournment, so we don't eat into Mr Farmer's time.

ELIAS CJ:

Thank you. I'm sorry, that's it?

MR SHAVIN QC:

No, no, I'm just going to add two things to –

ELIAS CJ:

No, no, yes.

TIPPING J:

Not quite.

MR SHAVIN QC:

Not quite. I was just foreshadowing, I'm going to try and finish just before.

ELIAS CJ:

Yes, that's fine, yes, thank you.

MR SHAVIN QC:

Mr Palmer raised the matter with me at the adjournment.

ELIAS CJ:

Yes, thank you.

MR SHAVIN QC:

If I could ask the Court to turn to our outline at paragraph 5.66 on page 59? We'd wish to supplement what we've said in paragraph 5.66 by noting that there's no provision in the Commerce Act which says that a dominant firm must stop competing or that when a firm has a substantial degree of power in a market it must stop competing. Indeed, for all the reasons articulated by my learned friend Mr Hodder, such a provision would be contrary to the policy objectives of the Act, to advance the long-term interests of consumers. It's competition which give consumers benefit, it assists the derivation of efficiencies and helps to lower price. Therefore it must be that dominant firms can compete and be competed with, so that they continue to seek to derive efficiencies. We've seen, in the network management issues, that 0867 was directed to efficiencies in the network. We have seen, in the way in which the conduct of Clear impacted on ISPs, that in fact it undermined the legitimate ISPs – and the references are contained in our outline – where the legitimate ISPs, those that had an infrastructure-based business independent of subsidies, said that they were being devastated, because when the free ISPs came in they undermined the business plan of the long-term ISPs, and yet the free ISPs knew that they had a business plan that was in fact

limited to the life of the subsidies – I'll pick up the references to that in just a moment. This is dealt with at 5.72 of our outline on page 61. Now, it follows that by competitive activity competitors will be deprived of revenue. It cannot be, however, that in seeking to compete any firm that is dominant is held to have an unlawful purpose. And we say that the High Court was right to carefully distinguish the nature of Telecom's conduct and purpose on the evidence, and it had the advantage in doing so of watching Telecom's witnesses, and particularly Mr Parkes, being closely cross-examined by our learned friends for in excess of a day, and forming a judgment.

Then, in relation to our submissions at paragraph 5.69, we simply add the comment that the operation of the perverse incentives and the subsidies given by Clear were not going to sustain or enhance long-term competition – and I'm sorry, here I've found my notes – was the evidence of Mr Wood at case on appeal volume 3 page 696 line 16 to 697 line 16, that free ISPs were an aberration that practically almost destroyed the Internet industry in New Zealand at the time. Mr Wood was a witness called from Ihug by the Commission, so a Commission witness. Mr Hussona at Compass, my learned friend referred to part of his evidence at case on appeal volume 3 page 619 to 20, said at 629, lines 70 to 28, "At some point, Compass decided to stop taking on new customers because of the risk that when the revenue turned off," – that was the share of the terminating charges – "they'd be running at quite a large overhead." So it shows that it was a limited distortion.

Mr Dick at CallPlus said that, if interconnect revenue was ignored, the risk of building up a free ISP business was, "A hell of a risk that he wouldn't have taken and the banks wouldn't have funded," case on appeal volume 2 page 562 line 31 to 563 line 17.

And finally Mr O'Brien at Clear noted that, "In truth, ISPs were flawed in terms of their timing, there was too long a gap between when the terminating revenue would stop to the point where volumes would support advertising revenue that would enable the business to be profitable," that's Mr O'Brien at Clear, called by the Commission, case on appeal volume 3 page 895 lines 4 to 19. He also expressed the view that the advent of free ISPs dependent upon a subsidy of terminating access revenue would have impacted the viability adversely of the business plans of existing pay ISPs, volume 3 page 894 line 30, page 895 line 3, "Thus, any springboard effect was outweighed by both the damage inflicted on ISPs with long-term business plans and the adverse effects on the PSTN –

BLANCHARD J:

Can you repeat that sentence a little more slowly, because it seemed to me this is what you were culminating with?

MR SHAVIN QC:

Yes, I'm sorry, Your Honour. Any springboard effect –

BLANCHARD J:

Yes.

MR SHAVIN QC:

– was outweighed by both the damage inflicted on ISPs with long-term business plans and the adverse effects on the PSTN. By introducing –

BLANCHARD J:

Hang on.

MR SHAVIN QC:

I'm sorry.

BLANCHARD J:

And adverse effects…

MR SHAVIN QC:

On the PSTN. Secondly, by introducing 0867 and bringing to an end the perverse incentives, Telecom's conduct was introducing a more sustainable competitive environment promoting the long-term interests of consumers –

BLANCHARD J:

You're getting ahead of me again.

MR SHAVIN QC:

I'm sorry. Telecom's conduct was introducing a more sustainable competitive environment promoting the long-term interests of consumers. This can be seen from the fact the 0867, as Mr Hodder showed, has been retained in the current regulatory environment under the 2001 Act. The Commission can't deny the benefits of 0867 and its incorporation, mandated in the current environment. So when one looks at purpose, one looks at the damage to ISPs with long-term businesses, the benefits to the long-term interests of consumers of 0867 and the material to which we have referred, in our respectful submission, no basis has been demonstrated as to any error by the High Court in concluding that there was no unlawful purpose. So, in our respectful submission, the counterfactual analysis demonstrates that there was indeed no use of any dominance even if, contrary to our submissions, the Court finds Telecom relevantly was dominant, and the Court ought to conclude that Telecom's conduct was, in any event, not infected with any improper purpose.

Unless there is any further way in which we can assist the Court, those are our submissions.

ELIAS CJ:

Thank you, Mr Shavin.

MR SHAVIN QC:

I do understand, if the Court has a very slight indulgence, Mr Palmer will literally only be seconds.

ELIAS CJ:

Yes, thank you.

MR PALMER:

If it pleases the Court. Just very briefly, the Crown had submitted in its submissions it had made something of the objective of harmonisation of business law between Australia and New Zealand. In its bundle of authorities it had included three copies of different memoranda of understanding between those Governments. Yesterday there was a new one signed, and just to ensure that the Court had a complete version of these memoranda I thought it was appropriate to table, for the Court's attention, the current version of the memorandum of understanding.

ELIAS CJ:

Thank you. I'm struggling now to remember how it fits in, but we'd better have a complete set if we have some.

MR PALMER:

Yes, Your Honour. It simply goes to the Crown's point that the international agreement between Australia and New Zealand has an objective of harmonising business law and this went to support that point, and this current memorandum of understanding that was signed yesterday between the two Governments replaces the 2006 memoranda, which is in the bundle. It is, in fact, stronger in its emphasis on the need for harmonisation of substantive law, and I just wanted to leave it with the Court.

ELIAS CJ:

Thank you, Mr Palmer. Thank you, counsel, we'll take the lunch adjournment now.

COURT ADJOURNS: 1.00 PM

COURT RESUMES: 2.14 PM

ELIAS CJ:

Yes Mr Farmer.

MR FARMER QC:

Thank you Your Honours. I wonder if I can just start with three or four just very short miscellaneous points which are really in the nature of correcting things that have been said by my learned friends. The first one which arose this morning and also yesterday from my learned friend Mr Shavin was that people were being paid to stay online. He referred to Mr Parkes' brief, paragraph 133, volume 3, case on appeal, 938. That, I won't take you to it but that was his speculation of what, where logically this might ultimately lead. There was a reference at volume 15 at 6234 to a Computer World report of a California company that was extending its services around the world, paying people to be online. What my learned friend didn't read to you in the same report was a statement by one New Zealander who'd actually joined this scheme but hadn't actually been paid. So it was a bit of a fly by night, somewhat dubious outfit it would seem.

Second point, please stop me if I go too fast but as my learned friend said we're all a bit pressured for time so I may speak more quickly than perhaps I normally would.

ELIAS CJ:

Well if we can't take it in Mr Farmer you will have to slow down so I'm warning you that the Bench may require you to slow down.

MR FARMER QC:

Okay. The second point is the statement that somehow the Telecommunications Act 2001 which was passed some two years after 0867 was introduced, provides some kind of endorsement to 0867. Now we've dealt with that and I won't take you to it in our submissions at paragraphs 3.36 to 3.38. The only reference to 0867, and it's a very odd form of legislative drafting, is to be found in the definition of KSO which is in the Telecommunications Act section 4 which defines the KSO as meaning the obligations that were set out in clause 5 of Telecom's constitution and includes, and then there's a reference specifically to correspondence between the Minister of Finance and Telecom in relation, first of all, to directory assistance and secondly to the two letters of 15 September 1999 relating to 0867. How anyone reading the statute is supposed to know what any of that means if they don't have the correspondence, goodness only knows, but that's as far as it goes and in our submission, quite apart from the fact that the Act was some two years or so later, the inclusion of that reference in a statutory definition of KSO can't be said to be some kind of legislative approval of everything that Telecom has done in relation to 0867.

The third point is more just a reference point. I wanted to complete the references that you were given to the interconnection charges that are payable under the 1996 ICA and perhaps if

you do take volume 7, first of all at page 2480 you'll find the charges that Clear pays Telecom in respect –

ELIAS CJ:

I'm sorry, page?

MR FARMER QC:

2480?

ELIAS CJ:

Thank you.

MR FARMER QC:

Clear pays Telecom in respect of local calls and as you heard a local call is defined in effect as being a seven digit number and the 0867 of course, as Your Honour Justice Tipping put it, the beauty of the 0867 scheme was that by providing a number that was not a seven digit number because it had some extra digits added on the front, Telecom's argument was that local calls that were carrying Internet, going to the Internet, to an ISP, were no longer within this agreement even although they had been previously so that the point of 0867 was two-fold. It was, first of all, to of course achieve what Telecom wanted to achieve in terms of removal of termination payments and secondly the way it did that was by increasing the number of digits, taking therefore an Internet local call outside the definition of a local call within this agreement, and on Telecom's view therefore demanding a new form of agreement for something that is no longer regulated by agreement, in other words, a new ITA which would have bill and keep rather than termination payments.

So anyway, going back to 2480, you'll find the Clear payments for local calls, two cents per minute or part of a minute for peak calls and then I want to draw your attention to C8.1.2 which was an additional charge of one cent per minute or part of a minute. So the call, the charge in fact was three cents and the additional one cent you'll see was given various descriptions, first of all described by Clear, recorded here in the agreement as costs incurred, the payment as costs incurred because of the Kiwi Share requirements. In other words a contribution to Telecom's Kiwi Share Obligations. Telecom, however, described the payment as a contribution to fixed and common costs of the Telecom local network. There was an agreement to disagree on how the payment should be described. That one cent charge did not change throughout the whole five year life of the agreement. The two cent charge did change as, in terms of the life of the agreement, that one didn't. So there you have, it's a charge that started out as three cents. There was no comparable one cent charge of course being paid the other way by Telecom to Clear.

If you're still looking at that agreement, if you turn to 2508 you'll see the comparable charge that Telecom paid to Clear, starting at one cent repeat call and gradually moving up over the life of the agreement to two cents but, as I say, still with that one cent, further one cent differential which I've just described. So that at no time did the asymmetry of charging, at no time was it removed. It always remained, albeit, with a differential to change from – over the life of the agreement.

BLANCHARD J:

You said a moment ago that the two cent charge did change. Is that correct?

MR FARMER QC:

No I'm sorry, I take that back. What happened was that the, as we've just seen –

BLANCHARD J:

Changed the other way?

MR FARMER QC:

The other way –

BLANCHARD J:

Right.

MR FARMER QC:

It gradually came up to that two cent level but, as I say, the one cent on top remained at all times. The other point to note about these charges is, and I'll give you the reference, in the Fletcher report, volume 17, case on appeal at 7045, that committee report found that the costs of termination were, "A low fraction of a cent." And I think there's evidence to similar effect both by Professor Hausman and Dr Bamberger that that's what they would expect in relation to variable costs, termination costs of terminating calls. So you'll see immediately that leads into the issue which I'll come back to of the very considerable margin that existed between a cost and charge or cost and price and therefore the very considerable contribution both to fixed and common costs and indeed also to the earning of monopoly profits that these charges represented.

The third point, the next point I just simply make very briefly is that the, is the reference to *Trinko*, from my learned friend Mr Hodder. We simply say that *Trinko* has no relevance to the present case. *Trinko* was a case concerning the US telecommunications legislation. It was a heavily regulated industry and the finding in *Trinko* was to the effect that in a heavily regulated industry there really isn't room for application of anti-trust law. In *PAWA*, *NT Power v PAWA*, the High Court of Australia refused to apply *Trinko* because, as they said, because of that

difference and also because section 2 of the Sherman Act was said not to be in precisely similar terms to section 46 of the Australian Act.

Then finally just again on these preliminary points to give you full reference, because I think you may not have got them the other day when I tried to give them to you, the impact on Clear of 0867, my learned friend Mr Shavin addressed that briefly this morning. Mr Forsyth's brief, volume 2 at, I don't think you need to turn to it, I can just give it to you, at page 135, at paragraph 74 and following, "Implementation of 0867" is the heading. You have a subheading, "Loss of ISPs" and he gives the numbers. "Clear had 17 ISPs on its network at the time of the announcement of 0867. Three weeks after the launch of 0867 Ihug left and took its ISP traffic to Telecom," and we would say that the evidence is that 0867, it's certainly true that Ihug had been impacted, its business had been impacted by the perhaps more aggressive and vigorous competition from some of the other ISPs but it was 0867 which was the straw that broke the camel's back as it were. Ihug then agreed with Telecom that it would move its business onto Telecom's network. Telecom paid it $16 million for the privilege of so doing and Mr Forsyth, having recorded that, goes on to say at paragraph 76 and following, in 77 he says –

ELIAS CJ:

What do those payments represent?

MR FARMER QC:

Just Telecom buying the business which is a form of competition in a sense but Ihug –

ELIAS CJ:

I just meant in economic terms, just thinking about some of the submissions we heard this morning.

MR FARMER QC:

Well –

ELIAS CJ:

How we could characterise. Is it against future revenue?

MR FARMER QC:

Indeed and in fact Ihug had indeed been softened up by 0867, it saw the writing on the wall, and so it moved the business in return for that payment. The, in paragraph 77 Mr Forsyth records that the volume of local calls terminating on Clear's network between July and

October 1999, after 0867 had been announced, and clearly was about to be implemented, fell by 22 percent due to the migration of ISPs to Telecom and ISP revenues dropped from 25 percent to 13 percent of Clear's wholesale revenue in that time period. Then he has a section of the effect on ClearNet, ClearNet being the Clear ISP, and he said in particular that ClearNet's growth rate fell significantly following the announcement of 0867 from 5 to 10 percent, which is what it had been, down to zero or close to zero. Then he said churn rates for October 1999, that's people leaving ClearNet, had more than tripled as a result of 0867. He said at that stage ClearNet was facing possible exit from the residential Internet customer segment. So there's absolutely no doubt, in our submission, as to the impact that 0867 had.

Now if I can move now to perhaps more substantive topics. I want to deal first of all with the three options and then go on to look at the network management issues and then what I'll come to deal with after that is to look at the counterfactual analysis in the present case, and what we say was absolutely wrong with it, and then we'll look from there at some of the conceptual problems with the counterfactual in interpreting and applying section 36 and then I'll just be able after that to finish off fairly quickly.

So the three options, just to remind you briefly, they were to compete more aggressively for ISP business. That's the first. The second was to compete more aggressively for Internet residential users, in other words get them through Xtra, and the third was to renegotiate the ICAs. So taking what we call, I think, the competitive alternatives to 0867 and what we heard from my learned friends is that those three options were not realistic options and were not achievable. Now option 1, competing more aggressively to attract more ISPs to the network. A point to make immediately about that, and really this is a point that I think arose in the exchange between Your Honour Justice Anderson and my learned friend, that it's important to note, first of all, that Telecom, if it did succeed in attracting an ISP to its network, from Clear's network for example, would actually reduce its costs. That was an immediate benefit to it, it would make a saving and the saving, of course, was the two cent termination payment that it was making to Clear. Now that two cents being received by Clear was being divided, or shared as we know, with the ISP, each of its ISPs and I think there's evidence to the effect that there may have been an average figure that ISPs were getting about nought point six cents, they were getting point six of a cent rather, of that two cents and Clear was retaining the balance.

So it's immediately obvious that Telecom could pay that same .6 of a cent or perhaps .7 of a cent to the ISP and make a saving of 1.3 or 1.4 cents. That would have the effect of increasing Telecom's profits, which is what it wanted to do, and that is the equivalent of the $16 million payment that it made to Ihug to attract Ihug's business to it. This has nothing to do with predatory pricing as my learned friend was suggesting to you. This is actually perfectly rational competitive and commercial conduct that increases profits to the, to

Telecom, and that particular point is in I think Dr Bamberger's evidence, sorry I can't give you an immediate reference to it, and we say that that, as I say, was perfectly rational conduct.

Now that's exactly true also in terms of the second option which is compete more aggressively for Internet residential users and indeed we saw, and I gave you the reference, I'll give it to you again, Mr Parkes recommended that Xtra should compete more aggressively in order to deal with the situation that had arisen with the low cost ISPs that were eroding Xtra's business and that's volume 4 of the case on appeal at page 1523. And so the same point really arises that Telecom, rather Xtra, in fact needed to reduce its prices. In fact it had already begun the process of reducing its prices under the competitive pressures that had come from the other ISPs. That was a process that it could follow through more aggressively and in time particularly if ultimately it was able to attract, as well as those customers directly, if it could also, if Telecom could attract the ISP business well then those two options would run together and in our submission would have been very effective in dealing with the situation with which they're concerned.

Now option 3, the renegotiation of the ICAs, now of course the ICAs, I made this point earlier, the ICAs didn't just deal with Internet termination payments. They dealt with a whole range of things. Locals calls, as we've just seen, covered Internet calls and voice calls and then what I haven't, I haven't taken you to it but of course the ICAs also covered and dealt with toll calls so that Telecom was earning very substantial interconnection revenues, and I'll call all of those payments together interconnection revenues, substantial interconnection revenues off the ICAs. We know that Clear was unhappy about that situation. We know that certainly in the early stages of the ICA, the life of the ICA, Clear wished to renegotiate the ICA. They, in fact, took a position that the ICA was anti-competitive and the problem, the problem for Telecom though – sorry, and I gave you the reference from the report that was made in March 1999 from the separate internal Telecom team which said, "The way to deal with this Internet termination payment problem is to renegotiate the ICA." That report was put up at precisely the same time as Mr Parkes' report suggesting, or proposing 0867 as the solution and both of those reports went to Dr Deane at the time so that clearly within Telecom itself renegotiation of the ICA was seen as a potential solution to this particular problem. That was not the route that Telecom chose to go down. My learned friend this morning made much of evidence from Mr Forsyth and Clear to the effect, he says, that Mr Forsyth's, that Clear was not interested in negotiating.

Can I make these points? First, there was no attempt made by Telecom to negotiate or renegotiate the ICA prior to the announcement of an 0867. In other words 0867 was Telecom's unilateral act, it was the solution it imposed and then having imposed it, it said then, let's talk. So that's the first point. The second point to note about it is that Mr Forsyth's evidence is in fact that Telecom refused thereafter to talk about 0867 as such, refused to

negotiate on 0867 and I want to show that, volume 2. My learned friend read to you at some length from Mr Forsyth but I did have to ask him, and he of course very properly complied with my request that he read all the relevant evidence because what he took you to page 239 of volume –

ELIAS CJ:
Sorry, what volume?

MR FARMER QC:
Sorry?

ELIAS CJ:
Volume?

MR FARMER QC:
2.

ELIAS CJ:
Thank you.

MR FARMER QC:
And he started reading to you, I think I'm right in saying, from the top of the page, then he got about three quarters of the way down the page where there'd been an offer to fly to Auckland to facilitate meetings and so on and he's talking here about September 1999 and what I asked him to read, and he did read, rather rapidly but I want to read it a little bit more slowly, was towards the bottom of the page, line 26, the question was, "I put to you, you had no intention of entering into bona fide negotiations in relation to 0867?" Mr Forsyth said, "I reject that. I think that's substantiated by the letter sent by Tim Cullinane, who was the CEO of Clear, in response to a request by Theresa Gattung to negotiate where Tim makes quite clear that the negotiations which Clear wishes to have with regards to 0867 must include the issue of termination payments and the removal of the threat and the charging of two cents per minute. That's the IDC charge. Those two factors, he says, had clearly been rejected by Telecom as being able, in their view, to be included in the negotiations and so that was the position that Clear was facing when the matter was renegotiated or negotiating 0867. So there had been a clear position taken by Telecom at the beginning they would not negotiate the two cent IDC and that's really where the whole thing got off on the wrong foot and then there was obviously the usual kind of inter-company sort of positioning that took place after that including, much to Telecom's dismay, ultimately in effect a complaint being made by Clear to the Commerce Commission. I mentioned a minute ago, I have got a reference to

Dr Bamberger dealing with the subject of Telecom being able to compete for ISP business and that's in his brief, paragraph 110, volume 4, case on appeal, 1388.

Now just a few other points about these competitive options and one of the, the first one I think I've really made, my learned friend said well Telecom had no revenue stream. If it had a customer on its network or an ISP on its network it had no revenue stream in the form of termination payments and I've made the point, but if it had, that it had a cost saving which fed into a profit increase if they were able to attract a customer or ISP and through that the ISPs customers onto the Telecom network. And I think the other point that is worth making too is that, and I'll come back to this, that we do keep emphasising, it's important that we do, that the revenue stream, so-called, is not just the single revenue stream of a termination payment for an Internet call. There are revenue streams that attach to a customer and they are all that customer's telecommunications business. Not just Internet, voice, local calls, toll calls, value add on services and in the future, and I'll come back to give you a reference to this, all of those new E-commerce type broadband based, all of those sort of future opportunities that telecommunications companies were gearing up for.

ELIAS CJ:

Is there not a problem for you, though, in the way the High Court and Court of Appeal have dealt with this on the basis of the only market that we're concerned with being the termination?

MR FARMER QC:

I'll come back to that.

ELIAS CJ:

Thank you.

MR FARMER QC:

There is – I'll come back to that and perhaps I'll just say this about that terminating market. I mean it's been said in lots of cases of course as you would know, particularly more recent cases, that market definition is one of those things that is an aid only to analysing the competition issues that arise in the case. It's not an end in itself. It is something that you don't get too hung up on. It's just something that should illuminate the competition issues and not in fact –

TIPPING J:

You don't redefine the market on second appeal do you Mr Farmer?

MR FARMER QC:

No I'm not, I don't need to.

TIPPING J:

You don't need to?

MR FARMER QC:

I don't need to but what I am going to say is why there was debate around that market, whether it was just terminating market or originating and terminating market is because what the Commission was certainly emphasising at trial was the fact that under the interconnection agreements there were more – and the point I've already made – there was more than one revenue stream that was arising. There were revenue streams going both ways but in relation to interconnection, interconnection is an access arrangement and it's access between both networks. It's not – the problem with defining it simply as a terminating market, you can define it that way if you like, but if you do so you shouldn't lose sight of the fact that there are actually, under that one agreement, the same agreement that is actually providing for those payments into that market, there are also other payments being made between the same parties, that deal with other kinds of telecommunications services. Voice calls, toll calls et cetera and you have payments going the other way and that's the originating and terminating point. Now so long as we don't lose sight and so long as we don't lose sight of the importance of taking account of the big picture, and I don't care if it's just a terminating market, if that's how we want to call it, but I do care about making sure that the whole picture that emerges out of the ICA and of the revenues that are earnt out of the ICA, the interconnection revenues for all the traffic that's going, both ways, that we don't lose sight of the importance of that in considering what is happening here.

So that, and that's where, when we come to look at the risks to Telecom of losing customers in a counterfactual in an 0867 scheme, that's where that whole big picture is so important and if, in fact, all you do is say, well we've got this little terminating access market and so we'll restrict our consideration of the competition issues in this case to those payments, those Internet payments that are made for terminating, for Clear to terminate Internet calls into its network, well then we will, in fact, have a very distorted view of what is actually going on here. And what the competition effects are of what is happening and in fact it leads you, particularly when you, if we're considering well what could Telecom have done by way of being more competitive for ISP business and for Internet usage business. The fact that it was earning substantial revenues from telephone users over and above, quite separate from, the Internet usage, is highly relevant to how Telecom is able to compete because Telecom is a multi-product firm. It provides voice calls, local voice calls. It provides toll calls. It provides mobile calls. It provides all the value added services we've talked about. It provides Internet services. And so the point about a multi-product firm is that multi-product firms in respect of

their different products, will face different levels of competition in each of those segments and some segments where some services where perhaps they face less competition, for example voice calls, and I'm not forgetting the KSO but I made a submission the other day that within the cap of the KSO the evidence does suggest there are considerable margins available to Telecom so that, the point being that with different levels of profit, in some cases very considerable profit, able to be made on different products in a firm like Telecom provides, it will naturally, there will naturally be a process of cross-subsidy, it will go on as between those different products. It will use the monopoly profits or the very large profits, if you don't like that word, that it's able to make from some products, to be more competitive in relation to products where it faces greater competition. Be more competitive in the sense of lowering prices and that's what's called random pricing. It's something that we had a lot of debate about during the *Telecom v Clear* case in the early 1990s and it's a perfectly common, legitimate, understood form of pricing by which multi-product firms are better able to compete. There's nothing at all anti-competitive about it. It is a competitive advantage that a multi-product firm has. It's different in character but it's no different in effect from the sort of thing we've been looking at in this case of a firm like Clear receiving very substantial, or payments with a very substantial margin over cost in the form of the termination payments, and then using that advantage to become more competitive in relation to another product that it provides, a product to ISP customers.

So that's, we would submit, in terms of – and that's, perhaps to make this point, that's why the wholesale access market is actually quite important. It's quite important that it's considered alongside the residential market because the two inter-relate. They feed one on the other and the revenues that are earnt in the wholesale access market, in this case by Telecom, are very significant to it in terms of what it's able to do in relation to the residential – the products that it provides to residential, and for that matter business, users. And it shows, very clearly, why Telecom is not likely to risk or put at risk all of that, all of that advantage in that big picture by introducing in a counterfactual situation, an 0867 scheme where the risk of losing customers – I emphasise the word "risk". It's the risk of losing customers. We don't actually have to show as a matter of proof that Telecom or a non-dominant Telecom will definitely lose customers. How can we anyway, it's a counterfactual hypothetical example. All we have to show, as a matter of theoretical construct, having regard though to the facts of this case as I've just outlined them, and to the industry facts, all we have to show is that they are at risk and the questioning is, will they take that risk? Will they be likely to take that risk and we would submit the answer is no, they wouldn't. And the problem with the High Court and the Court of Appeal's approach to this whole big issue is that they got the assumptions in the counterfactual wrong and in particular the assumption they got wrong was the assumption that there were no monopoly profits being earnt in the counterfactual and that had to be there and the reason it had to be there was because the ICA had to be there and the critical feature of the ICA was that it did have these high, this high margin of price or charge over cost which

served two purposes. One, it was a contribution to Telecom's fixed and common costs. We went through the other day that this is an industry characterized by very high fixed costs, the network costs, more than, well over 50 percent, it doesn't matter what the percentage is, of total costs. So it had to perform that function but secondly it also had to perform the function of providing a further margin on top of that which would enable that margin to be used for competitive purposes. In the case of Clear it would be used to provide the subsidy, the ISP. In the case of Telecom, where the margin was much greater, it would be used for all its many purposes of running a very large network and for developing that network for the future. So the risk was not a fanciful risk, it was a very real substantial risk and it's one that we say Telecom would not have, a non-dominant Telecom would simply not have faced.

Now if I can move on – perhaps if I could do this –

TIPPING J:

What do you say Mr Farmer to the proposition that you didn't prove supra-competitive profits or whatever the correct terminology was for your add-ons if you like? I think I know what you're –

MR FARMER QC:

For the add-ons?

TIPPING J:

For the add-ons. That was one of the significant arguments, I thought, against you, as an argument.

MR FARMER QC:

And it's clearly proven in respect – I'm going to give you some references to where the supra-normal profit is acknowledged on both sides in respect of the termination payments. For the add-ons, just excuse me for a moment. Could I – I wonder if I may be able –

TIPPING J:

Come back to it if it's easier.

MR FARMER QC:

Well it's –

TIPPING J:

Because if your thesis is that they wouldn't have risked this, there has to be a "this" that they were risking.

MR FARMER QC:

No and the add-ons, the add-ons are call plus, the call readdress and the call waiting and the maintenance contracts and those sorts of things. I've just asserted to you that add-ons are always profitable because I read a book once that told me they were and so I will say that there's no specific evidence in this case that's directed to these specific add-ons. I'll say that. I wonder if what I could do is just at this point where I'm wanting now to indicate to you the problems with the counterfactual analysis in this case and the reasons for those problems, which I've already identified, which is that the assumptions were wrong because although they assumed an ICA, they didn't assume this critical feature of it, that there were supra-normal profits being earned under it and in fact to the contrary they said there will be no supra-normal profits being earned to the counterfactual and of course we know that the Court of Appeal at paragraph 100 came back to that and said, well it doesn't look right somehow to us and we're just wondering how good this counterfactual really is, even though they'd, in fact, dealt with the case under it.

But I wonder if I could actually hand you up, I mean I, before I came down here I read the exchange between Your Honour the Chief Justice and Your Honour Justice Blanchard with Mr Julian Miles about handing up bits of paper and I was so terrified by what you said that I –

TIPPING J:

Good.

MR FARMER QC:

– came along without any bits of paper but then my learned friend seemed to get away with it his morning.

ELIAS CJ:

I think it was a substantial bit of paper and Mr Miles himself, who I don't think had had a huge hand in it, was quite happy to let it drop. We're very happy to receive small bits of paper but –

MR FARMER QC:

Well this is why I'm handing you in the same spirit that this is just over two pages and it has –

TIPPING J:

Not supra-normal anyway.

MR FARMER QC:

Pardon?

TIPPING J:

Not a supra-normal amount of paper.

MR FARMER QC:

No. So if I could hand you that and it's got some references in it and I hope this is, matches what my learned friend gave you this morning. I mean his was one page, he did rather better, but if I could just quickly go through this. So the question, paragraph 1, the question is whether a non-dominant Telecom, Company X, would in the sense of could rationally have introduced 0867 in a workably competitive market. Now as to the characteristics of the counterfactual the Commission has said in our submissions we give the reference that it cannot be assumed that in the counterfactual no firm would be earning supra-normal profits. That's the problem with it. That's the key problem to it. That would, we submit, be inconsistent with the other assumption that, of an interconnection agreement on the same terms as the 1996 ICA.

Now just to take you to two exchanges. First of all the evidence of Professor Hausman in volume 5 and at page 1772 of the case, I think I read you previously lines 9 to about 14 where he said there was nothing perverse about Clear's contractual arrangement to the ISPs, in fact that's perfectly consistent with competition. At line 18 he said, "Sure, Clear was exercising, you could either call it market power or monopoly power, in the wholesale access market that Dr Bamberger talked about," and he's referring there to a terminating market, "so it was earning supra-normal profits –"

ELIAS CJ:

What's the difference between supra and super, is there a different one or it's just –

MR FARMER QC:

Economists love the word supra and –

ELIAS CJ:

Oh I see. They like supremacy talk.

MR FARMER QC:

That's the word they use and I think my learned friend would agree with that.

TIPPING J:

Super is physical, supra is metaphysical.

ELIAS CJ:

Ah.

MR FARMER QC:

In any event, there it is, so I'll say supra, "supra-normal profits and in competing for ISPs they were sharing some of these. I consider that to be an outcome of both the supra-normal profits and the monopoly or market power price it was charging in competition for ISP." So he there saw the termination payments that Clear was receiving as being monopoly pricing and as I said before that must of course mean that Telecom, any payments that Telecom might receive, certainly in a counterfactual, would be even more supra-normal. And then, on the opposite page, at 1773, line 27, he said, "I don't think it really mattered –

ELIAS CJ:

I'm sorry, can you –

MR FARMER:

Sorry?

ELIAS CJ:

Why do you say – where's this reciprocity?

MR FARMER:

Well, in fact, there was none, because Clear didn't have any residential customers, so it didn't have any Internet users going into Telecom. But in the counterfactual –

ELIAS CJ:

Yes.

MR FARMER:

– it would have. So, 1773 at line 27, "I don't think it really matters here, they're both charging above cost, I'm certainly going to agree with that."

Now, I've got next, the end of paragraph 2, a reference to what's called the "Copeland/Farmer exchange", and I have to hand you a piece of paper which is – because it's not in the bundle but it's the transcript from the High Court.

ELIAS CJ:

Who is Copeland again?

MR FARMER:

He's the lay member, in the High Court.

ELIAS CJ:

Oh, sorry, yes, of course.

MR FARMER:

Mr Michael Copeland. So, this is the exchange that we had. So about halfway down the page we had a little bit of a discussion about whether you need to have an ISP, a proprietary ISP, a subsidiary ISP, and I said, "Well, I don't really care, one way or the other," and then he said, line 28, "Second, I am struggling to interpret the legal test. As I understand it from the *Carter Holt* passage, it's a competitive market, so not only is Telecom not dominant, that also precludes any other player in the market being dominant," and I said, "Yes, it does." This is a sort of a little bit of a side issue here, I wonder if I can find the reference? Professor Hausman, during his cross-examination, said, 'It's a feature of workable and competitive markets that firms don't have market power and it's a feature of such markets that firms don't price above cost,' but of course you've got to be careful how you apply that here, because we do have in our counterfactual Clear pricing above cost, because otherwise you don't have, if you say, 'No, well, Clear's not to have any market power at all,' you take Professor Hausman's view that market power, he's happy to define it as price above costs, and what you've done is you've actually defined out the problem," and he, Mr Copeland, said, "I'm certainly happy to leave, I think we can leave it, leave that in." So he was, in that exchange, he was leaving in the fact that price was above cost, and that had to be left in because of the ICA. And so, to the extent that it said in High Court judgment there was agreement about the counterfactual, and my learned friends have leapt on that and said, "Oh, yes, it's because the Commission's trying to change it's position a little," but the reality is that this was always a very tricky issue as to how you had a supposedly competitive market, albeit workably competitive, but at the same time you were somehow trying to strip out the monopoly profits when the ICA, which you're also keeping in the market, had as an essential feature of it that there were monopoly profits. And so that was the matter that, at that stage I might be forgiven for thinking Mr Copeland was with me on – it turned out not to be so.

Now, going back to this written summary therefore, paragraph 3, "There must also be an implicit assumption in the counterfactual that residential customers can easily switch from Company X's network to a rival network and vice versa. It is assumed that several local loops connect each customer's premises to an exchange," para 4, if "Company X were to introduce 0867 in workably competitive retail and wholesale markets," these were the things that we say would follow. We would say "there is a risk that retail customers could switch carriers to stay with their preferred ISP." Now, I've given a reference to Dr Bamberger, if you've still got volume 5 there. Now this is the beginning of the very lengthy – my learned friend accused me of being very lengthy in cross-examination, and people like Mr Parkes, well, Mr Forsyth got a fair old working over too, as we saw, and so too did Dr Bamberger. And at 1681, the beginning of which my learned friend read to you, and I just want to show you that in fact

Dr Bamberger's primary initial, his first position, was that the IDC, the two cent IDC charge, just wouldn't stick, and the reason it wouldn't stick is because of the risk that Telecom would foresee of losing business. And you'll see that, 1681, line 10, my learned friend – let's look, first of all, just above that, in the previous answer he said, "What I had in mind was that Company X would be faced with the threat of losing retail customers, that would be important to it." Question, "Let's look at that proposition: if Company X is to lose customers, to which network will they go?" and then his answer to that was, "Well, they won't necessarily lose them. The point in my mind is, the threat of loss is what prevents Company X from implementing an 0867 solution. They could go to Company Y, they could go to Company Z, they could go to a variety of places, but Company X isn't going to run that risk," and that was his position and my learned friend, who is very persistent and I admire him for it, then said, "Oh, well, let's get past that, let's pretend that they do go. Where do they go to? Go to Company Y, Company Z, Company W? And then let's look at the horrible problems that then emerge." That was the whole thrust of my learned friend's cross-examination, and Dr Bamberger did his best to deal with what became an extremely speculative and theoretical debate. And our submission is it's important not to lose sight of where Dr Bamberger started out and where he really wanted to stay, but for my learned friend's persistence in insisting that he go beyond his initial primary position.

So, going back to paragraph 4, the risk of customers switching would be enough disincentive to not proceed with 0867, not to put it in in the first place. Knowledge of that risk, we say, would eliminate the incentives on ISPs to change to 0867 numbers, so that Company Y and other carriers would not therefore face pressure on them to obtain 0867 numbers or to sign new ITAs and, in addition, Company Y could decline to do business with Company X – this is getting into the access, the wholesale access, it could easily switch to another wholesale access or Internet supplier and you can get indirect access to customers in that way, and I dealt with that point the other day and, indeed, it's in Dr Bamberger's reply brief.

So, paragraph 5, we say Company X would not be indifferent to the risk of losing retail customers for these reasons. First, it must be assumed that Company X did earn substantial, other substantial revenues, both current and future, from those customers, as listed in our submissions. Now, that's 5.7(a) to (e), which is on page – I think we went through these the other day – it begins on page 31, but I might quickly just ask you to look at them. So, what we say there is that there are these other substantial revenues, charges for additional services. Now, this is going back perhaps to Your Honour Justice Tipping's question to me, when I've said, "Well, there's no evidence of just how profitable they are," but if you look at footnote 161 you'll find listed there a considerable number of internal Telecom materials for the most part, where the importance of those services is actually discussed at some length, and in particular in relation to Telecom's overall marketing strategic and financial planning. You'll see actually a report there, which I won't take you to, Telecom marketing strategic financial plan overview

for 1996 to 2001, the second line revenues, which were very, very, seemed to be very significant, 22 million predicted within five years –

TIPPING J:

But this assumption must be that these other services produce revenues significantly above the costs of providing the services, mustn't it?

MR FARMER:

That's the assumption I'm asking the Court –

TIPPING J:

Yes.

MR FARMER:

– to draw as a matter of just, to use my learned friend's phrase, "commercial common sense", it's a phrase we all refer to when we don't have any evidence.

TIPPING J:

Yes, understand.

MR FARMER:

But my point here is that it's in fact what you can see. I mean, Telecom has clearly given very, very substantial internal consideration to expanding its business through all of these other revenue-earning sources, and therefore it must be a proper conclusion that they seemed to be very significant. But over and above that, we have got, going back to the submission, page 31, the second bullet point is revenue from national tolls and international tolls. We do know that that's certainly the revenues area above cost, you can work that out very quickly just from looking at the interconnection charges and so on and the ICA and so forth. The opportunity to sell innovative packages of services such as integrated Internet and voice offerings, interconnection revenues, which we've listed, it's the fourth bullet point. And then, over the page, potential revenues from new products, for example, broadband, and from future products based on new technology, and the statement that's there made is, "Company X would rationally want to maximise the number of customers on its network to whom it could in the longer term sell these new technologies," and the very important document that I want to draw your attention to, which is in footnote 167, and you'll find it in volume 6, if you go to volume 6 at page 2208 – sorry, it begins at page 2206 – this paper is called "Telecom white paper, strategy white paper, competing for the future," the date of it is I think August, yes, August 1995 and, interestingly, it foresaw very accurately, at least in substance if not in detail, the Internet, the importance, the growth of the Internet, and the opportunities that the growth of the Internet would give rise to and the reasons for it, which

you'll see on page 2208 at the first paragraph, a few lines down you'll see the reference to; "The convergence of computer, telephones and television is expected to occur at an accelerating rate," and it was that technological convergence which was going to give rise, as I say, to terrific opportunities, particularly through the Internet, for telecommunications companies. And a key feature of that, if you're to be able to exploit that opportunity, you'll see in the section below on that page, under the heading "Strategic model" with the recommendation that Telecom enter the New Zealand market with a non-proprietry Internet-based online service, and if you go down to the very foot of the page there is a reference to, the second sentence, "We believe the provision of Internet access alone, that is no content offerings such as localised news, information, email or organisation of other Internet content, et cetera, is quickly becoming a commodity product and has minimal margin-earning potential," so this is where they getting into the add-on, value add-on services that go with Internet. And then there's this sentence, "Maintaining ownership of the customer is a critical long-term objective for Telecom. A content-based offering, as opposed to access only, will give Telecom an opportunity to maintain the ownership of a customer and compete more effectively for value-added services."

Now, I won't take you through the rest of it but you'll see, if you do read through it, and it's a very interesting read, that this was, as I say, seen as an enormously profitable opportunity – on the next page, it's the heading "Business economics" and looking at the end of that first paragraph, "The ability to leverage the existing ubiquitous network in New Zealand, the specific knowledge of the local environment to develop localised content and Telecom's strong brand recognition, are the primary sources of competitive advantage that will drive its market share in New Zealand," and, at the foot of the page under "Entry strategy," two paragraphs down, "The competitor with the largest market share will ultimately be in the best position to participate in advertising and transaction revenue. Accordingly, it's recommended Telecom enter the market quickly and aggressively," and so it goes on. So there's the value of the customer to Telecom and, in particular, in relation to the Internet.

ELIAS CJ:

What was this directed at though, this recommendation?

MR FARMER:

It's directed at the risk – sorry, in the document?

ELIAS CJ:

Well, yes, "It's recommended that Telecom enter the New Zealand market quickly and aggressively." "Market" in what, what was this directed at?

MR FARMER:

Market for Internet services, but with considerable content to them, such as the add-on services such as news services, advertising, transactions, various kinds of transaction-type services, et cetera. So, in other words, a package, an Internet package, not just mere access alone. And the key to that was maintaining a large market share, the ubiquity of the network and ownership of the customer. And that's what would be put at risk, we would say, that's the sort of risk that we would say –

ELIAS CJ:

So, you'd characterise the risk as not about stranded technology but lost customers?

MR FARMER:

Yes. My learned friend's putting Xtra in the market, Xtra is a wholly-owned subsidiary of Telecom.

ELIAS CJ:

Yes. That's what this was directed at, putting Xtra into the market?

MR FARMER:

Well, I don't know whether Xtra operated at that time, I suspect it did, but…

ELIAS CJ:

That's fine, I just wanted to know how it fitted within the introduction of the 0867 number.

MR FARMER:

Right. Now, that's taking now, I think – going back to these typed notes – back to, in the paragraph numbered 5, and on this question of why Company X would not be indifferent to losing retail customers, and I'm focusing on the other substantial revenues current and future and I've gone through those, they're the ones listed in our submissions at paragraph 5.7. And the second bullet point is really saying that it's only in a perfectly competitive market that Company X would be indifferent to the risk of losing customers, because in a perfectly competitive market you don't have, for example, fixed and common costs, you don't have high fixed costs, you just have marginal costs and therefore marginal revenues, and what we're looking at, what everyone agrees, Telecom, the Court of Appeal and ourselves, is that we are looking here at a workably competitive market, and for some reason the Court of Appeal thought that we were advocating a perfectly competitive market, but I don't know where they got that from because, as I think I said the other day, it's just simply fundamental that in telecommunications you are always looking at a workably competitive market, and that was the whole platform upon which the *Telecom v Clear* case and the Baumol-Willig rule was based in the early 1990s.

I think the next reference we've given here, and you've seen it already, at paragraph 58 of *Melway* and I don't think you need turn to it, in that reference it's plain that when they talk about, when they make an assumption of a competitive market, they are very much talking about a workably competitive market, and references are made to, the phraseology that's used is "The reality of the market," and in that paragraph also they talk about, "Loss of sales, et cetera, in such a market."

Now, the next bullet point, under 5, and again on the same subject really, that Telecom has actually conceded, and rightly so, in its submissions at paragraph 5.22, that in a workably competitive market contract prices and payment terms "may well be", that's the phrase they use, above marginal costs, in order to capture the contribution to fixed and common costs, and I think you'll find the same thing – I won't take you back to it – in their footnote 5. And we would submit, and this is the best perhaps I can do, going back to Your Honour Justice Tipping's question, this is perhaps the best I can do, that this would necessarily apply to all the services that Company X provided to its retail customers.

TIPPING J:

Well, at the very least you can say that they wouldn't want to lose that contribution to fixed and common costs.

MR FARMER:

No. In respect of any of its products.

TIPPING J:

Yes.

MR FARMER:

Yes, that's right, and that's as far as I can probably take that, except that I do maintain that –

TIPPING J:

But that's quite an important point.

MR FARMER:

Yes, yes, indeed, because the contribution to fixed and common costs is an absolutely fundamental –

TIPPING J:

Quite.

MR FARMER:

– plank upon which a company survives, or doesn't survive, as the case may be and, again, is a reason why you wouldn't lose customers, because if you lose customers the saving, you make a saving from not serving that customer, but those cost savings are marginal costs only, but the revenue you lose from the customer is revenue that contains within it the contribution to fixed and common costs and, we would say, probably contains more than that. And, indeed, the contribution to fixed and common costs, as we say at the top of page 2, will include a reasonable rate of return on capital, because the return on capital is regarded as a cost for this purpose. It's a cost that's got to be covered if you're actually going to meet, if your revenues are going to cover your costs, otherwise you don't make, if you don't make a return on capital you're actually losing money.

So that takes us to what we call the fundamental error in the counterfactual analysis presented by Telecom as adopted, and adopted by the High Court and the Court of Appeal, and that is that it required proof, that Court that is, required proof that supra-normal profits were being earned on all services provided to retail customers before Company X would have any concern about losing them. Now, pending of course what you mean by "supra-normal profits", at the very least those profits had to cover that contribution to fixed and common costs and if it didn't, then yes, Telecom would, or Company X would have a concern.

TIPPING J:

Well, at the very least it had to cover fixed costs, common costs and costs of capital.

MR FARMER:

Yes, well –

TIPPING J:

Maybe the ones that are included in the –

MR FARMER:

The costs of capital are part of that, included in that, that's right. And then, as I say, if you're actually correct the assumptions that were stated, namely that nobody's earning supra-normal profits, if you correct it, you can correct it in two ways. You can correct it to make sure that there are supra-normal profits in the sense of profits that will cover fixed and common costs, or you can go the next step and correct it, so that there is actually an element of monopoly profit in there, which is what the Court of Appeal in paragraph 100 is addressing, and we would say you have to have that there really, because otherwise you don't have an essential feature of this case, which is the ability to provide a subsidy to your ISP customers.

So, the last bullet point in paragraph 5, we say, "In any event, it must be assumed that in relation to the interconnection revenues" – it's, there's a typo here – "In any event, it must be assumed that in relation to the interconnection revenues identified," – that should be the fourth bullet point of our paragraph 5.7(a) of the Commission's submissions – "Company X would also be earning supra-normal profits on local and toll voice calls terminated at the premises of residential customers of its network, because of the terms of the 1996 ICA," and that was in effect recognised, we say, by Professor Hausman in the passages I've referred to.

Now, paragraph 6, similar considerations apply to the risk of losing wholesale customers. Wholesale customers also contribute to Company X's fixed and common costs, the interconnection revenues themselves. Company X would not want to risk losing them as well. So that the overall outcomes in the counterfactual should Company X introduce 0867, in our submission, are as follows. Firstly, Company X risks losing both retail and wholesale customers, would not be indifferent to that for the reasons I've already given. Second bullet point, 0867 as a scheme cannot be implemented in a counterfactual other than the IDC, because ISPs and wholesale carriers, knowing that retail customers can simply change networks to stay with their preferred ISP, are not incentivised to take up the 0867 numbers, and then, thirdly, the cost to Telecom therefore is the loss of retail and wholesale customers and the revenue associated with that and – and this is the timing point that I dealt with the other day – for an indefinite period. We don't know how long each customer will be lost for, Telecom might win it back the next day or next year or the year after, but whatever the time period is, it's an indefinite period, and it has to be weighed up against the 18 months that were still to run under the ICA, the termination payment problem, which would come to an end at the end of that period.

So, in our submission, that should be a sufficient analysis. To take it beyond that, as my learned friend did with Dr Bamberger, and to talk about what Company W does and so on, if it gets one of these customers, is very much entering into the area of speculation and cannot be a reliable determinant in this case, which, again, we rely again on paragraph 58 of *Melway*, and the last two sentences in that paragraph says, "It is one thing to compare what it has done," that's the firm, "with what it might be thought it would do if it lacked market 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." That's the warning that if you get too far away from market reality and from the facts of the case and you get too far into the academic theoretical hypothesis of a complicated counterfactual, then really the whole exercise loses its utility, and it was that concern that has obviously driven the High Court of Australia into looking for more simple, straightforward, factual-based type approaches. Certainly, in a *Queensland Wire* case, one can readily provide a simple counterfactual analysis and come up with perhaps a fairly clear and obvious answer, but this unfortunately is not one of those cases.

So, at paragraph 8, we say in the end it comes down to this, in the factual, in our submission, "Telecom can introduce 0867 and achieve its objectives of implementing 0867, eliminating short-term termination payments, and saving Company X 205 million, all at virtually no cost," this is in the factual, this is what it actually did, did all of these things, saved –

TIPPING J:
Would cost better be rendered by risk?

MR FARMER:
Sorry?

TIPPING J:
Would cost better be rendered by risk?

MR FARMER:
Or it virtually – it's both really, yes, no cost and no risk. No risk, because it had the market power –

TIPPING J:
Yes.

MR FARMER:
– and no cost because there was no real cost in 0867 to it and there was, of course it was therefore able to deal with the –

TIPPING J:
It's just that you've been emphasising this aspect of risk and –

MR FARMER:
I have, and I've been doing that in the context of the counterfactual, but here I'm addressing the factual.

TIPPING J:
Yes, I know.

MR FARMER:
And it's been able to do that because it's had no particular –

TIPPING J:

But there's no risk in the factual, you say –

MR FARMER:

No.

TIPPING J:

– there is significant risk in the counterfactual.

MR FARMER:

Thank you, Your Honour, yes, indeed, with respect. So that's what we, in the last bullet point we say, "In the counterfactual, if Company X tries to introduce 0867, we say it will not be able to implement 0867 but will simply risk losing retail and wholesale customers and their contribution to the fixed and common costs for an indeterminate period." Company X, acting rationally, would not risk introducing 0867 but would have to adopt one of the three competitive commercial options identified by the Commission in its submissions. And any one of those competitive options would in fact deal with the 205 million issue which was on the table at that time, although I did say the other day that figure was never accepted and was heavily challenged throughout the trial, and that's the effect of the footnote at the bottom of that page.

So, if I can perhaps then from there just say something about the network management issues – and it's wonderful having very good juniors who keep you up to the mark – and I just want to stress then, at this point, that if Telecom had first exercised one of those three competitive options it would not have needed a network solution, network management solution, because the termination payments would have been eliminated and the so-called perverse incentive of causing traffic growth would also have been eliminated. But if we, independently of that, look at the network management issues, one thing I do want to correct immediately is a suggestion – I may have misunderstood what my learned friend Mr Hodder said the other day, but I understood him to be suggesting that 0867 calls are somehow not carried on the PSTN, and I may be doing him a disservice, but they are in fact carried on the PSTN. The critical point though about the intelligent network system which, it's not a network, it's in effect a software that identifies calls and then manages them, and the whole point of the exercise with IN and with 0867, and I'll come back and suggest there are other ways of doing it too, was to identify Internet calls so that if there was a congestion problem it could, in effect, give them less priority, you could give voice calls priority over them so there would be no reduction in quality on the voice calls and the Internet calls would simply be deferred in priority, where there was a problem. If there wasn't a problem then that was fine. So, that was the whole point of the IN, and we suggested to you first of all, I think, three alternatives, three alternative solutions to the management problems. One was, the first one was that identification didn't need 0867, the IN was sufficiently sophisticated with some programming

to be able to in fact identify numbers. In other words, you could have said to every ISP, "Your numbers will be allocated in a bank of seven-digit numbers, but the first three numbers will be 867," or just 86 or whatever you wanted, and through that you could have identified just as well that these were Internet ISP-directed calls. You didn't need to add to the number of digits –

BLANCHARD J:

Have you got any evidence on that?

MR FARMER:

That was –

BLANCHARD J:

Because that's asking us to essentially make a factual finding.

MR FARMER:

Yes, there is, Your Honour, and I'm going to take you to it. Because in fact this was, there was cross-examination on this, and I'm going to give you the references in fact, almost immediately. And we dealt with this in our submissions first of all, perhaps rather shortly, in paragraph 2.8 I think it was, and in particular footnote 19, and we've given references to cross-examination of Mr Benson and Dr Milner. My learned friend this morning referred you to Dr Milner's brief of evidence, where he did suggest problems with what I'm suggesting, but that evidence was tested on cross-examination, not only of Dr Milner but also of Mr Benson, and in particular Mr Benson even in his brief of evidence, which my learned friend didn't refer to, volume 2, at page 351 –

ELIAS CJ:

Sorry, 3 –

MR FARMER:

351.

ELIAS CJ:

– 51.

MR FARMER:

Paragraph 13. It says, in paragraph 82, "Mr Parkes proposes to say" – he's referring to another Telecom brief – "that only numbers commencing with special numbers such as 08 would activate the IN. This is true, but only because that is the way Telecom chose to set up its IN. The IN is capable of looking at every number that is sent to it and taking routing or

traffic management action as required. There is no reason why the IN cannot examine all nine six-digit, six X numbers, that's seven digits, and route and manage them as INs frequently do in, for instance, number portability solutions," and then –

ELIAS CJ:

But this is the point that was raised about the data processing capacity.

MR FARMER:

Yes, that's right. And then he was cross-examined – what's the reference there? – at volume 2, 423, Mr Benson was, I should say, make plain, if I've been giving the wrong impression, was called by, a Commission witness, and he said at 423 when he was cross-examined, beginning at line 25, I think he was cross-examined from line 25 through to 424, line 28 and then from 454 – these I'm reading from footnote 19 – lines 5 to 14, and just to pick out one perhaps pertinent part, if you look at 424 line 21, he said, "You can make the IN work any way you want, but that rough description of how it works you can make it look at one digit, two digits, nine digits or 10 digits, and you can then tell it exactly what you want it to do in terms of what you want it to deliver with what you want it, to take the call, et cetera, et cetera, so there's a whole flexibility built around tables and what numbers you take into it." Now, Dr Milner was a little less confident, but he did say this, at volume 4 page 1210, beginning at line 17, he was then cross-examined by me on whether the degree to which Telecom would need co-operation from the ISPs in learning what their numbers were, and whether or not Google existed then I don't know, but in any event at line 17 he said, "So there certainly is a way of making sure the ISPs are allocated numbers which can be uniquely mapped to ISPs, assuming you have co-operation between Telecom and the ISPs." He said, "Remember that some of the ISPs are not customers of Telecom," and I said to him, "Well, I understand that, we'll deal with those separately perhaps in a minute. But even if the ISPs didn't co-operate, by revealing themselves with their numbers at least you knew 90 percent of them, didn't you, or at least you knew 90 percent of the Internet calls, because the 90 percent, as you told us earlier, were carried up to, I think 10 might have been the figure you mentioned, ISPs?" He said, "Yes, you could identify those, you could segregate them in some way." The question, "It was those large ISPs, you created the commercial problem for Telecom in terms of the revenue-sharing arrangements," and he said, "Traffic is always determined by the largest users, that's for sure." So, the point being the 10 percent were these tiny, wee, fly-by-night people, who came in and out of the market, and there might be a bit of a time lag before it was known that these were ISPs, but the big fish, who had 90 percent of the traffic, Dr Milner agreed, they knew who they were, there'd be no problem about programming the IN to deal with them.

TIPPING J:

And that is programming the IN to deal with them without increasing the number of digits?

MR FARMER:

Yes, yes, that was the very issue that was being addressed.

TIPPING J:

Yes.

MR FARMER:

Yes. Now, IPNet, which was the second alternative, which is in fact a different network, it does take, as my friend described to you, it does in effect take the call off the PSTN in a relatively early stage and puts it onto a different digitalised platform and transports it to the ISP, it just bypasses the rest of the PSTN. It goes onto the PSTN initially, from your home, but goes to the nearest local exchange that's got the necessary technology, digitalises it, carries it off the PSTN and takes it through a data platform and then takes it to the ISP in that way. And what we say about that is that there was no problem with the technology, the problem was, and both Mr Benson and Dr Milner agreed with this, the problem with IPNet was not the technical design, it was a commercial one, and the commercial one was – in fact Dr Milner, I think we give this reference, described it as I think, "An ideal solution," that's paragraph 2.8 of our submissions, and we give the reference there, "The ideal solution," and he as a technical man, very highly qualified technical man, was frustrated in fact at the slowness with which Telecom were, the lack of pace in terms of Telecom's ability to roll out IPNet as the ideal solution to dealing with Internet traffic. And the problem was partly one of price, he deals with that, the references are in our submissions so I won't take you to that, and the point we make about that is there was no attempt made by Telecom to accelerate IPNet in order to deal with the termination payment problem, there was no urgency about it, instead they went down the 0867 route. And the same is true of ADSL, the broadband, it's Mr Benson's evidence and he was tested in cross-examination on this, he was adamant that Telecom could have rolled out sufficient ADSL by mid-1999 to its main exchanges to alleviate the congestion, there was a five-year plan, but he had been at Telecom before he went to Clear, he had actually formulated a plan, a five-year plan, it had been adopted by the Telecom Board, but not implemented in the way, certainly, that he envisaged. He would have wanted to have seen an aggressive roll-out and, again, a sense of urgency brought to bear to deal with the termination payment problem, if it really was such a problem. And the references I'll give you there are his cross-examination – I won't take you to it – volume 2 page 436, lines 13 to 15, 466 at lines 29 to 35, 467, 1 to 34, 439 at line 19 and then 468 at lines 19 to 35.

BLANCHARD J:

Did he explain why it wasn't being rolled out, did he give an opinion on that?

MR FARMER:

I haven't, to be quite honest with you, I haven't reviewed the detail of that cross-examination to be able to answer that question, but, and there was an issue, which my learned friend referred to, as to whether the standards, the specifications, had been given the necessary international approval. There was quite a bit of cross-examination, which I do remember, around that, and the effect of the answers was, "Well, actually, that was all in the pipeline, we don't actually wait before we buy the equipment for the standards to be finally settled and we hadn't waited, we were already underway, we'd trialled it and we were beginning to roll it out," and they were in fact beginning to roll it out, but the question is whether they rolled it out sufficiently quickly or aggressively in the way that he wanted, and that –

TIPPING J:

This amounts almost to a submission that they were deliberately slowing it down in order to go down the 086 –

MR FARMER:

I don't think we –

TIPPING J:

That's quite a serious inference.

MR FARMER:

I don't think we ever made the submission quite that bluntly.

TIPPING J:

Well, you're getting intolerably close.

MR FARMER:

Well, no, we're saying, I'm saying they had these alternatives. If termination payments were the problem, the major problem, and they said they were, these were alternatives they could have pursued which would not involve the exercise of market power. They would have had a cost to them, they would have had a cost to them, but they chose to exercise market power, at no cost, to impose a different solution, that's the submission that we make.

TIPPING J:

Understood.

MR FARMER:

Now, I'm conscious of time, and I'm getting there. I don't want to go past four and you wouldn't want me to either. So, the next topic, as it were, the last major topic, is really the question of the conceptual problems around the counterfactual, and you've heard an awful lot about this, and what I do want to do, if I may, is just take you back to our submissions which, we would submit, a rereading of them will provide all the answers to the submissions you've heard from my learned friends, in particular Mr Hodder, and this is page 16 of our submissions, the heading just before paragraph 3.25, and this really is, that heading is identifying the vice, we would say, of a counterfactual test, a mandatory counterfactual test, particularly in cases of any complexity, such as this one. And so what the heading says is, "The counterfactual test does not adequately distinguish between good competitive conduct and bad misuse of market power, which is, as we've seen in the cases, including *Magic Millions*, is the very issue that it needs section 36, the application of section 36 needs to address. And we've set out in paragraph 3.25 just a statement of the counterfactual test, and we pointed out halfway through that paragraph that that statement entirely ignores the impact and purpose of the conduct, both the impact of it and the purpose of it, and so that, and as we say, and this is the point that's made both by Professor Ahdar and by Scalia J in the *Eastman Kodak* case which I referred you to the other day, "The same conduct engaged in by both dominant and non-dominant firms may have dramatically different effects upon competition and may be undertaken for quite different purposes. The failure of the counterfactual test to recognise this is a serious flaw and underlines that there can be no one universal test of the use of market power." And we then give, in 3.26 we go through a number of examples of common kinds of commercial conduct, some which are perfectly benign and, indeed, pro-competitive, others which may not be, and we give these as examples of where we say the counterfactual test isn't likely, certainly isn't certain to give you the right answer, you just don't know what kind of answer you're going to get, so that if you take for example exclusive dealing, which is our first example, the requirement of exclusive dealing imposed by a dominant firm may foreclose, competition both upstream and downstream, and that such conduct by a non-dominant firm in a competitive market would not have that effect and nor would it have a proscribed purpose, it just couldn't be done. But if the defendant's conduct is judged by a counterfactual test, then use of dominance may be very hard to establish it, and that is because exclusive dealing typically offers some economic benefits, even for non-dominant firms, and the case to think about in this, it's *Re Application by Fisher & Paykel Limited* (1989) 2 NZBLC (Com) 104,377 (CCOMM) back in the late 1980s, where exclusive dealing was ultimately upheld by the Court as being pro-competitive, but there were strong arguments both ways, and in that case – it was not a section 36 case, I hasten to say, it was a section 27 case, and I don't think from my recollection that section 36, if it was pleaded, I'm not, certainly it wasn't advanced – but there was a case where, as I say, on the one hand you did have restraints on competition, on the other hand it was held ultimately by the High Court that those restraints were, as it were, necessary in order to achieve pro-competitive benefits. And if you in fact had looked at that case and regarded Fisher & Paykel as a dominant firm

and then tried to apply a counterfactual analysis to that, the submission I would make is that you wouldn't actually be better off in finding what was the right sort of answer.

And that's true in our second example over the page, loyalty rebates and discounts, obviously if it's a non-dominant firm offering those features to its products, that can't be said to have an anti-competitive purpose because others can match it in the market. But the same conduct by a dominant firm could well have an anti-competitive effect and/or purposes, particularly of course if it's allied with bundling of products if it's a multi-product firm, as many firms with market power are. And then we go through these other examples, which includes –

ELIAS CJ:

Can you just – I'm just trying to work out where you're going, Mr Farmer, what's this in reply to? Because we have read these submissions.

MR FARMER:

Yes, what I'm going to, it's really in 3.27, is that the counterfactual test is, it's not a one size fits all kind of test that can apply to this whole range of different kinds of competitive behaviour in a market by firms that, say, do have market power. And that's where a materially facilitated or a factual inquiry or a factual observation type approach, in many of these instances, is more likely in fact to give you a better answer, and certainly we would submit the Court should not be precluded from having the advantage of looking at the evidence as a whole and taking more of a factually-based approach, and particularly with materially facilitated, being able to ask that question, has the market power that this firm has made it easier, materially facilitated what it sought to do, the competitive advantage that it obtained, and if it has then there would be use of that market power in terms of the Act. So that's where it goes, Your Honour, and I don't need to go through the detail, I don't have time to do that anyway.

Now, the next submission that we make, and this is again looking at the concept of the counterfactual and just saying it's not something that is always going to work. The problems, the next heading halfway down page 18, is "Determining and applying the assumptions to be made in a counterfactual can be difficult, speculative and unworkable," and really we've dealt with all of that, but I do, with respect, urge you to read again, if you wouldn't mind, pages 18 through to 20, where we actually elaborate on that point. And, in particular, paragraphs 3.27(a) and (b), which are dealing with the determination, first of all the characteristics of a counterfactual market, what you state those to be, and the structure of a hypothetical market, and we note some submissions about that in relation to this particular case and the question of whether we are divorced from reality in what we're trying to do in the counterfactual in this case. And then finally paragraph 3.31 is really the culmination of that, and the fact that, as has been said by Professor Ahdar, that the counterfactual approach has

in many instances inhibited the proper findings of liability where, on the face of it, you would think there should be liability.

So that really takes me to saying, well, if you do look at the facts of this case, my learned friend Ms Coumbe the other day at the end of her submissions summarised the facts of this case, emphasised the leverage at the different stages that Telecom was able to impose on its own customers, on ISPs, on rival carriers, et cetera, and the focus there is, what actually happened here, and when you look at what actually happened here it would seem, in our submission, fairly obvious that what we're viewing is an exercise in market power.

Now, finally, my learned friend Mr Shavin, also in a very spirited final speech to you, said this, "Telecom, through 0867, introduced a more sustainable competitive market and brought to an end the damage done to ISPs with long-term business plans." Now, I'm not sure who he's referring to, but it can only be, I assume, Ihug. The fact of the matter is that it was 0867 which was, as I say, which forced Ihug to accept not long thereafter Telecom's offer of the 16 million to move its business away from Clear onto the Telecom network. That is not, with respect, introducing a sustainable competitive market, that is a blatant exercise of market power. And so we submit that his rhetoric should be, with respect, simply disregarded. The point is, it's not in any event for Telecom to determine what is the ideal competitive environment. That's what PAWA, the Power and Water Authority, tried to do in the *NT Power* case when it said, "We won't give you access because there's actually a much better competitive market which will come about if we have devised some form of regulation that allows you in, but only on certain terms," and the High Court of Australia said, "It's not for you to decide that, your duty is not to breach the competition law," and we would submit that's equally true here.

So, I see it's one minute past four, according to this clock, and those are our submissions in reply, if Your Honours please.

ELIAS CJ:

Thank you, Mr Farmer. Well, thank you, counsel, for your very helpful submissions. We'll take time to consider our decision in this matter.

COURT ADJOURNS: 4.00 PM