PRICE SQUEEZES IN NEW ZEALAND COMPETITION LAW: GOODBYE TO THE EFFICIENT COMPONENT PRICING RULE AND THE EQUALLY EFFICIENT COMPETITOR

Paul G Scott*

One of Professor Prebble's many achievements is that he is a fellow of the Law and Economics Association of New Zealand. This achievement recognises his contribution to the economic analysis of law. The first field to which scholars applied economic analysis of law was competition law. This article examines a particularly contentious area of New Zealand's competition law; viz the Efficient Component Pricing Rule and s 36 of the Commerce Act 1986. This rule first arose in Clear Communications Ltd's dispute with Telecom Corp of New Zealand Ltd. The Privy Council endorsed charging on the basis of the rule – saying its use did not breach s 36. Many years later New Zealand's Court of Appeal held Telecom's use of it amounted to a breach of s 36 in the context of price squeeze litigation. This article examines how the Court of Appeal concluded this. It looks at the economics of price squeezes and the rationale behind the Efficient Component Pricing Rule. It discusses United States law on price squeezes and shows how that law is hostile to finding competition law liability for price squeezes. It outlines the New Zealand cases and analyses the reasoning of the cases – particularly the Court of Appeal price squeeze case. It concludes that in holding use of the rule was a breach of s 36 the Court has eliminated the equally efficient competitor standard test for monopolisation and interred the Efficient Component Pricing Rule. It also argues that proscribing price squeezes is worthwhile.

I INTRODUCTION

The Government intends to amend New Zealand's monopolisation, provision s 36 of the Commerce Act 1986.[1] A reason is that s 36 fails to capture sufficient anticompetitive behaviour

* Senior Lecturer, Faculty of Law, Victoria University of Wellington | Te Herenga Waka. I thank Professor Harry First of New York University for his helpful comments on previous drafts of this article.

resulting in monopolists escaping liability.[2] Ironically the Court of Appeal's last s 36 case resulted in a $25 million penalty.[3] The case involved price squeezing and the Efficient Component Pricing Rule (ECPR) which has been a controversial part of New Zealand's competition law. The ECPR is a pricing rule that determines the access price that a vertically integrated monopolist (VIM) should charge for access to its facility. It emphasises the VIM's opportunity cost of providing access. If the VIM receives the same profits from access as it does from the sales of its retail service, the access seeker can only enter if it is as equally efficient in providing retail services as the VIM. It allows the VIM to capture any monopoly profits it may be making. The Privy Council had blessed the ECPR in earlier litigation.[4] Despite this, the Court of Appeal held that use of the ECPR did not prevent a VIM's access pricing from being a proscribed price squeeze under s 36. In so doing, it effectively rejected the equally efficient competitor standard which says behaviour should only be a proscribed act of monopolisation if it harms an equally efficient competitor. As a result, New Zealand now has the world's strictest law against price squeezes.

Price squeezing is controversial, as some doubt whether it deserves condemning. The overseas jurisprudence reflects this because the United States has de facto eliminated liability for it, whereas Europe strongly emphasises efficiency. Europe only condemns price squeezes if the practice damages an equally efficient competitor. New Zealand law lacks this efficiency focus. This article examines whether New Zealand's law is how it should be. To that end Part II outlines price squeezes and how they can be anticompetitive. Part III shows why some argue that price squeezes do not merit concern and how outlawing it can be dangerous. As the United States is the source of price squeezing law, Part IV discusses United States law and how it is now de facto legal. Part V discusses the Australian and New Zealand case law. It shows that Australian law in effect proscribes price squeezes if the access seeker is unable to make a profit after paying the access price – irrespective of whether the access seeker is as efficient as the VIM. The ECPR which requires the access seeker be as equally efficient as the VIM is crucial to the New Zealand cases. Accordingly, Part V outlines the ECPR and how it works. It discusses the litigation which led to the Privy Council endorsing it. Part V then discusses the case which led to the Court of Appeal eliminating the ECPR. As the Court of Appeal overturned the High Court, it outlines the High Court's reasoning. It analyses the Court of Appeal's

---

1 Ministry of Business, Innovation and Employment *Discussion Paper: Review of Section 36 of the Commerce Act and other matters* (January 2019) [MBIE Discussion Paper]. Clause 14 of the Commerce Amendment Bill 2021 (9-2) amends s 36 to read:

> A person that has a substantial degree of power in a market must not engage in conduct that has the purpose, or has or is likely to have the effect, of substantially lessening competition in –
>
> (a) that market …

2 Ministry of Business, Innovation and Employment, above n 1, at 6 and 17–18.

3 *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278 [*Data Tails* (CA)].

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

reasoning and argues that despite some wobbles along the way, the Court was correct in killing off the ECPR. It argues its decision was consistent with Australian authority, and ultimately, with the Privy Council. In so doing, Part V shows how New Zealand law differs from overseas law and discusses whether New Zealand should be so strict. Part VI offers some conclusions, including that it is worthwhile to proscribe price squeezes.

II ECONOMICS OF PRICE SQUEEZES

A Definition

A price squeeze occurs when a vertically integrated firm sells an input at one level (upstream market) and also sells an output using the input at another (downstream market). That firm can price squeeze by:

(1) setting the price for the input so high that its rivals/customers cannot compete with it in the output market; or
(2) cutting the price for the output so low that rivals cannot compete in the output market; or
(3) doing both at the same time, such as increasing the input price and decreasing the output price.

The high input price and the low output price in combination squeezes the rivals because the difference between the two means rivals cannot compete. The profit margin for rivals may be too small or negative.[5] This raises the question of: Why all the fuss over price squeezes? This involves examining how price squeezes can be anticompetitive.

B How Prices Squeezes can be Anticompetitive

Intuitively price squeezes seem an effective anticompetitive strategy. By using a high upstream price, a low downstream price or a combination of both, a vertically integrated monopolist can make downstream rivals' activities unprofitable. This either eliminates them or weakens their competitive ability, leading to price increases for consumers.

The quintessential anticompetitive uses of price squeezes are for a firm with market power to protect its upstream monopoly and extend it into the downstream market.[6] It does so by increasing entry barriers into the upstream market, thus deterring downstream firms entering. It leads to downstream or potential rivals deciding that they must enter both levels. As this is more difficult than

---

5 Erik Hovenkamp and Herbert Hovenkamp "The Viability of Antitrust Price Squeeze Claims" (2009) 51 Arizona L Rev 273; Dennis W Carlton "Should 'Price Squeeze' be a Recognized Form of Anticompetitive Conduct?" (2008) 4 J Comp L & Econ 271 at 274; Robert O'Donoghue and A Jorge Padilla *The Law and Economics of Article 82 EC* (Hart, Oxford, 2006) at 303; and George Hay and Kathryn McMahon "The Diverging Approach to Price Squeezes in the United States and Europe" (2012) 8 J Comp L & Econ 259.

6 *Town of Concord v Boston Edison Co* 915 F 2d (1st Cir 1990) at 23–24.

entering one, the monopolist deters entry.[7] This protects its upstream monopoly. With increased security over its upstream position, the monopolist can increase prices leading to consumer harm. Downstream firms may be potential entrants into the upstream market.[8] They may develop better services or be more efficient and obtain the strength to challenge the monopolist. Price squeezes can prevent such firms expanding upstream. This is defensive leveraging; the monopolist prevents its monopoly from eroding.[9]

A price squeeze can be anticompetitive when the vertically integrated monopolist charges high input prices. When this price is as high as the output price, downstream rivals cannot compete effectively with the vertically integrated monopolist, no matter how efficient. This is a means of Raising Rivals' Costs (RRC).[10] A firm does this to decrease rivals' profits or to induce them to increase price, decrease output or exit the market. An effective RRC strategy does not require a rival to exit. If it does, then the price squeeze has caused foreclosure which is another way that price squeezes can be anticompetitive. Foreclosure is excluding actual or potential rivals from a retail market or supply source. Competition is thus foreclosed in that market. Here it means an input supplier using vertical restraints to achieve market power in the output market. By price squeezing the vertically integrated monopolist causes the input price to increase to downstream rivals foreclosing such rivals from the market.[11] Price squeezes can not only decrease price competition but they can also hinder or eliminate non-price downstream competition.[12]

Price squeezes are only anticompetitive in certain circumstances. The vertically integrated firm must have significant upstream market power. It must have no or few competitors who can supply downstream rivals at competitive prices.[13] It must also have some downstream market power as it

---

7 Phillip Areeda and Donald F Turner *Antitrust Law* (Aspen, New York, 1978) at [725h].

8 *Town of Concord v Boston Edison Co*, above n 6, at 24; and Joseph Farrell and Philip J Weiser "Modularity, Vertical Integration and Open Access Policies: Towards a Convergence of Antitrust Regulation in the Internet Age" (2003) 17 Harv J Law and Tech 85 at 111–112.

9 O'Donoghue and Padilla, above n 5, at 308; and Gunnar Niels, Helen Jenkins and James Kavanaugh *Economics for Competition Lawyers* (Oxford University Press, Oxford, 2011) at 243–244.

10 Steven C Salop "Exclusionary Conduct, Effect on Consumers and the Flawed Profit-Sacrifice Standard" (2006) 73 Ant LJ 311 at 315–318; Steven C Salop "Refusal to Deal and Price Squeezes by an Unregulated Vertically Integrated Monopolist" (2010) 76 Ant LJ 709; and Thomas G Krattenmaker and Steven C Salop "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price" (1986) 96 Yale LJ 209.

11 Krattenmaker and Salop, above n 10, at 236; Michael A Salinger "Vertical Mergers and Market Foreclosure" (1988) 103 QJ Econ 345 at 353; Janusz A Ordover "Equilibrium Vertical Foreclosure" (1990) 80 Am Econ Rev 127; and Bruno Jullien, Patrick Rey and Claudia Saavedra "The Economics of Margin Squeeze" (2013) IDEI Reports at 13–15.

12 *Town of Concord v Boston Edison Co*, above n 6, at 24; and Areeda and Turner, above n 7, at 204–208.

13 O'Donoghue and Padilla, above n 5, at 306.

must be able to capture most of the downstream rivals' former sales. If downstream rivals can pass on the increased upstream prices to customers, then the price squeeze will be ineffective. Preventing this requires some downstream market power.[14] Barriers to entry must also exist in both the upstream and downstream markets. Without them the squeeze will fail, as increased prices at either level attracts new entry.[15]

III RISKS OF OUTLAWING

While price squeezes can be anticompetitive, some commentators argue that outlawing them harms consumers.[16] They argue a claim alleges that the defendant has removed a margin which enables its downstream rival to compete. This does not necessarily harm consumers, as the rival may be less efficient. The defendant may be profitable if it had to pay the same input price. Liability punishes a firm for failing to ensure its rivals' profitability.[17] Focusing on how well rivals do is inconsistent with competition law protecting consumers, not rivals. Judge Breyer noted price squeezes can be procompetitive as "the primary-level monopolist might carry out its second-level activities more efficiently than its independent competitors."[18] Eliminating less efficient downstream rivals leads to lower prices and saves economic resources.[19]

Sidak notes:[20]

> Any rule of price-squeeze liability that threatens liability based on the claim that the difference between a firm's upstream and downstream prices leaves downstream rivals an insufficient profit margin substitutes a rule of competitor welfare for consumer welfare.

Another criticism is that liability leads to firms either abandoning or avoiding efficient vertical integration.[21] Vertical integration can achieve efficiencies and benefit consumers by: significantly reducing the costs of producing or distributing products; and also reducing transaction costs by avoiding having to deal with other firms.[22]

---

14 At 306.

15 At 306–307.

16 Carlton, above n 5; and J Gregory Sidak "Abolishing the Price Squeeze as a Theory of Antitrust Liability" (2008) 4 J Comp L and Econ 279.

17 Sidak, above n 16; and Carlton, above n 5, at 277.

18 *Town of Concord v Boston Edison Co*, above n 6, at 24.

19 At 24.

20 Sidak, above n 16, at 294.

21 Carlton, above n 5, at 277–278.

22 Phillip E Areeda and Herbert Hovenkamp Antitrust Law (2nd ed, Aspen Publishers, New York, 2002) at [757a] at 23–24; and Roger Blair and others "Analyzing Vertical Mergers and Accounting for the Unilateral

Vertical integration can also reduce inventory costs, result in a firm better coordinating investment decisions, allocating risks better, and diffusing new technology and techniques.[23] It can also eliminate double marginalisation, which is discussed below.[24] Liability deters entry by a vertically integrated monopolist who then has a duty to protect its rivals by ensuring their profitability.[25] Liability also harms consumers by encouraging vertically integrated monopolists to keep downstream prices high to ensure that rivals survive. It incentivises downstream price increases and discourages downstream price cuts. This protects inefficient downstream rivals to consumers' detriment.[26]

Sometimes a vertically integrated monopolist eliminating a downstream rival and taking its place is procompetitive.[27] This occurs when the upstream and downstream firms are both monopolists. If so, a pricing distortion called double marginalisation arises.[28] The upstream firm sets its production (or input) price above its marginal cost of production. The downstream firm sets its retail (or output) price above its input cost (ie, what the upstream firm charged for the input). Consequently, the final retail price is marked up above the marginal cost of production twice. The result is a higher total price for the output than a single vertically integrated firm would set. For consumers, two successive monopolists are worse than one.[29] This is uncontroversial.[30] Thus, a squeeze that eliminates or harms a downstream monopolist can benefit consumers. Liability prevents this.

Liability arguably reduces incentives to innovate and invest.[31] A complaint may be that the input price is too high. Liability means this price decreases. This lower price reduces a firm's incentives to invest and innovate. Creating an input may be risky and costly – particularly a network. Firms will

---

Effects Tradeoff and Thinking Holistically about Efficiencies" (2020) 27 George Mason L Rev 761 at 765 and 774–775.

23 Blair, above n 22, at 765 and 773–782.

24 See below n 27 and n 30.

25 Carlton, above n 5, at 277; and Sidak, above n 16, at 297.

26 Carlton, above n 5, at 277; and Sidak, above n 16, at 297.

27 *Town of Concord v Boston Edison Co*, above n 6, at 24–25; Carlton, above n 5, at 276; E and H Hovenkamp, above n 5 at 278; and Areeda and Hovenkamp, above n 22, at [765b], 11.

28 Simon Bishop and Mike Walker *The Economics of EC Competition Law* (2nd ed, Sweet and Maxwell, London, 2002) at 159.

29 Bishop and Walker, above n 28, at 159; E and H Hovenkamp, above n 5, at 278, n 20; and Areeda and Hovenkamp, above n 22, at [758].

30 *Town of Concord v Boston Edison Co*, above n 6, at 24: and *Fishman v Estate of Wirtz* 807 F 2d 520 (7th Cir 1986) at 563: "That successive monopolies injure customers is a proposition on which there is unanimous agreement."

31 Areeda and Hovenkamp, above n 22, [7672d], at 133.

not create an input if the law forces them to share the benefits of that innovation. Liability does that and is at the expense of dynamic efficiency.

This is a property rights argument that firms need *ex ante* incentives to invest and create property. Property rights can enable firms to enjoy the benefits of their investments and innovations. Excluding rivals is one of the greatest incentives to create and improve property and is a fundamental right in the bundle of rights that constitutes property. Allowing access decreases these incentives and enables entrants to free ride on the creator's investments.

To enjoy innovation's benefits, firms must be free to charge entrants what they want for their input.[32] The price must fully compensate for their assets' use and the risk they incurred in investing. To avoid this, free riding entrants should only get access at a price which equals its value in the monopolist's hands: ie, the opportunity cost of the incumbent losing its assets' exclusive use.[33] Such a price fully compensates the firm for the risk it incurred in its initial and ongoing investments. This can be a monopoly price representing the capture of monopoly profits, but it preserves the firm's investment incentive.

Liability also removes the downstream firm's incentive to innovate as it can rely on the law for a lower input price.[34] The Hovenkamps note that price squeeze law which forces an upstream monopolist to maintain a downstream rival's profitability "has the perverse effect of removing that rival's incentive to innovate, as it receives the same returns regardless of any improvements."[35] Liability imposes significant administrative problems on courts. They must supervise prices at two levels – input and output. A regulator is better suited to this.[36]

Liability may be unnecessary. The complaint is that the defendant is either charging too high an input price or too low an output price. "Refusal to deal law" covers the first while "predatory pricing"

---

32 Glen O Robinson "On Refusing to Deal with Rivals" (2002) Corn L Rev 1177 at 1193–1194; and Lawrence Sullivan, Warren Grimes and Christopher Sagers *The Law of Antitrust: An Integrated Handbook* (2nd ed, West Academic Publishing, St Paul, 2000) at 126.

33 William Baumol and Gregory Sidak "The Pricing of Inputs Sold to Competitors" (1994) 11 Yale J on Reg 171 at 199–201; and Gregory Sidak and Daniel Spulber "The Tragedy of the Telecoms: Government Pricing of Unbundled Network Elements Under the Telecommunications Act of 1996" (1997) 97 Colum L Rev 1081 at 1095–1098.

34 Salop (2006), above n 10, at 369; Salop (2010), above n 10, at 715–716.

35 E and H Hovenkamp, above n 5, at 277.

36 Sidak, above n 16, at 294; E and H Hovenkamp, above n 5, at 281; and Areeda and Hovenkamp, above n 22, at [767d2] at 132.

covers the second, meaning price squeeze law is otiose.[37] Courts, however, must deal with price squeezes as plaintiffs bring cases. The United States has the fullest consideration of them.

IV UNITED STATES LAW

The first relevant case, although not a price squeeze case, is *United States v Colgate*.[38] Colgate was a manufacturer. It announced a suggested resale price and refused to supply distributors who sold below it. The plaintiffs alleged this was monopolisation contrary to s 2 of the Sherman Antitrust Act 1890 (Sherman Act).[39] The trial judge dismissed the complaint. The Supreme Court upheld his decision holding firms have a general freedom to deal or not as they choose. This freedom is qualified. It said:[40]

> In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long-recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.

One of the qualifications, viz; refusal where the firm has "the purpose to create or maintain a monopoly" covers price squeezes. Charging a high price for the input may be a constructive refusal to supply. This could be having "the purpose to create or maintain a monopoly" over the output. The issue was not live and further elucidation was not possible until *United States v Aluminium Co of America (Alcoa)*.[41] The Justice Department alleged (inter alia) that Alcoa had price squeezed contrary to s 2. Alcoa had a monopoly over aluminium ingot (the input). It converted some of its ingot into finished products, such as rolled aluminium sheets (the output). It sold these to industrial buyers. It also sold some of its ingot to other firms (fabricators) which converted it into rolled aluminium sheets. Alcoa and the fabricators competed in the sheet market. The fabricators were not vertically integrated. The Justice Department alleged Alcoa set the price of ingot so high and the price of its finished

---

37 Sidak, above n 16, at 281; *Town of Concord v Boston Edison Co*, above n 6, at 25; and Bradley Auburn "Margin Squeezing: The Superfluous 'Fancy Phrase' of New Zealand Competition Law" (2012) 18 Auck UL Rev 216.

38 *United States v Colgate & Co* 250 US 300 (1919).

39 Section 2 provides:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony …

40 *United States v Colgate & Co*, above n 38, at 307.

41 *United States v Aluminium Co of America* 148 F 2d 416 (2d Cir 1945).

products so low that the fabricators could not compete in sheet. Judge Learned Hand agreed. He set out the elements for an illegal price squeeze. A firm breaches where:[42]

(1) it has monopoly power over one product;
(2) its price for that product is higher than a "fair price";
(3) that product is necessary to compete in a second market where the firm itself competes;
(4) its price in the second market is so low that rivals cannot match it and still earn a "living profit".

Judge Hand wrote:[43]

> That it was unlawful to set the price of 'sheet' so low and hold the price of ingot so high, seems to us unquestionable, provided, as we have held, that on this record the price of ingot must be regarded as higher than a 'fair price'.

While "fair price" and "living profit" suggest looking at the effect on fabricators, Judge Hand took the price of Alcoa's ingot and its rolling (conversion) costs as a fair measure of costs and compared those costs to Alcoa's price it charged for rolled sheets. His Honour found the margin was negative in many cases (ie costs exceeded price) and barely positive in others. This meant fabricators (and Alcoa) could not survive under Alcoa's pricing. This is a cost test based on Alcoa's own costs. If Alcoa could earn a profit if it had to pay the same input price as it charged fabricators, then there is no price squeeze. Conversely, if Alcoa could not make a profit if it charged itself that same price then there is a price squeeze. This was called the "transfer price test."[44] The Court asks whether the vertically integrated company could make a profit by selling at its own retail rates if it had purchased at its own wholesale rates. If it could, there is no price squeeze. Judge Hand did not set out his measure of costs and whether it is marginal, average variable or average total costs[45].

A Town of Concord

Town of Concord v Boston Edison Co[46] is significant. Edison was an integrated power company that generated, transmitted and distributed power. It also sold some of its power to rivals and used its lines to transmit electricity that its rivals purchased from other generators. The Federal Energy Regulation Commission (FERC) regulated the rates Edison charged for selling wholesale power. Another body regulated the rates it charged for distributing power to consumers. Concord ran a distribution system that bought wholesale from Edison. Edison, over three years, persuaded the FERC

---

42 At 436.

43 At 437–438.

44 Salop (2010), above n 10, at 719.

45 E and H Hovenkamp, above n 5, at 275.

46 *Town of Concord v Boston Edison Co*, above n 6.

to authorise increases in its wholesale rates it charged customers, like Concord. It did not seek an increase in its own retail rates. Concord claimed Edison was price squeezing. The wholesale price was going up while Edison kept a low retail price. Concord's retail price was becoming non-competitive with Edison and it was losing customers to Edison and not gaining any.

Judge Breyer held the regulation of Edison's rates in both the wholesale and retail markets barred antitrust liability.[47] Concord had a remedy over Edison's pricing of complaining to the regulators. He set out a number of cases condemning price squeezes.[48] He also discussed the economics of price squeezes. First, he pointed out that a price squeeze may be procompetitive saying that "the primary-level monopolist might carry out its second-level activities more efficiently than its independent competitors."[49] This eliminates less efficient second level rivals resulting in lower prices and saving resources. He pointed out a price squeeze can cure the double marginalisation problem as if the second level firm is a monopolist it is desirable to allow the upstream monopolist to squeeze it out.[50] He showed how price squeezing can harm by entrenching the upstream monopolist and eliminating non-price competition downstream. It also could allow a monopolist to extend its power into a second market by raising new entry barriers, by forcing new firms to compete in two markets rather than one and depriving the market of non-price competition and pressures for innovation.[51]

Judge Breyer essentially approved Alcoa's transfer price test concept and noted:[52]

> … a practise is 'anticompetitive' only if it harms the competitive process. It harms that process when it obstructs the achievement of competition's basic goals – lower prices, better products and more efficient production methods.

His Honour questioned the Courts' ability to determine when the gap between upstream and downstream prices is too narrow to allow a rival to survive. This involved the lack of certainty over Alcoa's "fair price" for the upstream product and a "living profit" for downstream rivals. His Honour observed:[53]

> But how is a judge or jury to determine a 'fair price.' Is it the price charged by other suppliers of the primary product? None exist. Is it the price that competition 'would have set' were the primary level not monopolized?

---

47 At 19.

48 At 18 and 21–22.

49 At 24.

50 At 24–25.

51 At 23–24.

52 At 21–22.

53 At 25.

Stating that such questions were not unanswerable, his Honour said a price squeeze could be anticompetitive if the anticompetitive risks associated with one outweighed the positive possible benefits and adverse administrative considerations.[54] Describing the harms and benefits as closely balanced,[55] his Honour accepted *Alcoa's* conclusion that price squeezes could be anticompetitive. This was obiter given that the defendant's upstream and downstream prices were fully regulated. His Honour observed:[56]

> [W]e have limited our holding by stating that 'normally' a price squeeze will not constitute an exclusionary practice in the context of a fully regulated monopoly, thereby leaving cases involving exceptional circumstances for another day.

B Trinko

Verizon Communications Inc v Law Offices of Curtis V Trinko LLP (Trinko)[57] is important even though it involved a refusal to deal. Verizon was an incumbent local exchange carrier (ILEC) which owned a local telephone network. The 1996 Telecommunications Act required ILECs to share their networks with firms seeking to compete with them – in this case, competitive local exchange carriers (CLECs). Verizon had to enter into an interconnection agreement for sharing its network elements with any CLEC who requested interconnection. The plaintiff was the customer of a CLEC who wanted to interconnect with Verizon. Verizon failed to provide access expeditiously, so the plaintiff alleged this failure was part of an anticompetitive scheme to discourage customers from becoming or remaining CLEC customers and breached s 2.

The majority, in rejecting the claim, held the mere charging of high prices did not breach s 2. It noted:[58]

> The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth.

It believed forced sharing under s 2 could cause harm, noting that developing infrastructure could give firms a competitive advantage. Forcing firms to share could be in tension with competition law's underlying purposes, as it may lessen the incentive to develop such infrastructure.[59] Furthermore,

---

54 At 25.

55 At 25.

56 At 29.

57 *Verizon Communications Inc v Law Office of Curtis Trinko, LLP* 540 US 398 (2004).

58 At 407.

59 At 407–408.

forced sharing would require courts to become central planners setting terms of dealing for which they are ill-suited, and forced sharing could facilitate collusion.

The Court reaffirmed that firms are generally free to decide with whom they will deal but that right is qualified, saying it had been cautious in recognising liability for refusals to supply. Here, it was relevant that the defendant had never voluntarily dealt with and supplied the relevant services to rivals and nor, without the 1996 Act, would it have. This differed from previous cases where the Court had found liability.[60] This meant that the plaintiff's case was not a recognised claim under s 2. Furthermore, the 1996 Act governed access to the network. Regulators supervised the network. The Court did not need to extend refusal to supply law to cover Verizon because the plaintiff could complain to a regulator.[61]

C LinkLine

The Supreme Court dealt with price squeezes in *Pacific Bell Telephone v LinkLine Communications*.[62] The defendant, AT&T, was a vertically integrated owner of a fixed telephone network. It wholesaled digital subscriber line (DSL) services to rival internet service providers (ISPs). The rivals needed access to these DSL services to provide their DSL internet service. AT&T also provided its own DSL internet service in competition with rivals.

The rivals alleged AT&T charged such a high price for its wholesale DSL service and such a low price on its retail service that they could not make a reasonable profit on the difference between what they had to pay and what they charged their customers. Regulation required AT&T to supply its wholesale DSL service at a reasonable and non-discriminatory rate. This regulation ceased when the Regulator found sufficient competition had built up at retail. AT&T had no duty to deal under *Trinko*. The District Court and the Ninth Circuit allowed the claim to proceed as a price squeeze, holding that *Trinko* did not apply to price squeezes.[63]

The Supreme Court did not look at the price squeeze as a single concept. It broke it into its component parts – a high wholesale price and a low retail price.[64] The too high wholesale price claim failed as the defendant had no duty to supply under *Trinko*.[65] Accordingly, it had no duty to sell at

60 At 408–409.

61 At 411.

62 *Pacific Bell Telephone Co v LinkLine Communications Inc* 129 SCt 1109 (2009).

63 *LinkLine Communications Inc v SBS California Inc* 503 F3d 876 (9th Cir 2007).

64 *Pacific Bell Telephone Co v LinkLine Communications Inc*, above n 62, at 1118–1120.

65 At 1119.

reasonable prices. As in *Trinko* the defendant had never voluntarily sold at wholesale. The Court noted:[66]

> The nub of the complaint in both *Trinko* and this case is identical – the plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rivals from competing effectively in the retail market. *Trinko* holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal.

As for retail prices being too low, this failed as the plaintiffs did not show that the prices were predatory under the standards of *Brooke Group Ltd v Brown & Williamson Tobacco Corp*[67] which requires prices to be below some measure of cost. (The plaintiffs did not allege below cost pricing).

The Supreme Court noted:[68]

> Recognizing a price-squeeze claim where the defendant's retail price remains above cost would invite the precise harm we sought to avoid in *Brooke Group*: Firms might raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability.

Thus,[69]

> The plaintiff's price-squeeze claim, looking to the relation between retail and wholesale prices is nothing more than an amalgamation of a meritless claim at the whole-sale level. If there is no duty to deal at the whole-sale level and no predatory pricing at the retail level, then a firm is certainly not required to price both of these services in a manner that preserves its rivals' profit margins.

The Court discussed *Alcoa's* transfer price test and did not explicitly overrule it. It stated: "given developments in economic theory and antitrust jurisprudence since *Alcoa*, we find our recent decisions in *Trinko* and *Brooke Group* more pertinent to the question before us."[70] The Court effectively overruled it, as where there is no duty to deal upstream, the Court has eliminated any argument that the downstream division of a vertically integrated monopolist is selling at a loss, ie the difference between the upstream price and retail price does not cover the downstream division's relevant costs. The Court also noted the institutional concerns of courts having to monitor both upstream and downstream prices.[71]

---

66 At 1119.

67 *Brooke Group Ltd v Brown & Williamson Tobacco Corp* 509 US (1993).

68 *Pacific Bell Telephone Co v LinkLine Communications Inc*, above n 62, at 1119.

69 At 1119.

70 At 1120, n 3.

71 At 1121.

V AUSTRALIAN AND NEW ZEALAND LAW

A Queensland Wire

The leading authority is *Queensland Wire Industries Pty Ltd v Broken Hill Pty Ltd*.[72] While it does not refer to a price squeeze, one can characterise it as such.[73] The defendant, BHP, produced 97 per cent of Australia's steel and supplied 85 per cent of its steel and steel products. It was the only Australian manufacturer of Y-Bar, an input in making star picket fences. These were Australia's most popular rural fences. Imports were only one percent of sales. Y-Bar was the only product BHP manufactured that it did not sell to the public. It only sold it to its wholly owned subsidiary, AWI, who manufactured the fences. The Courts treated BHP and AWI as BHP.

The plaintiff, Queensland Wire (QWI), sold rural fencing products. It manufactured wire from rods it bought from BHP. It also bought star picket posts from BHP and competed with it in the rural fencing market in Queensland. It had 28 per cent of that market while BHP had the rest. QWI wanted to make its own star picket posts, so it asked BHP to supply it with Y-Bar. BHP refused and then offered to supply at an "uncompetitive price" or an "excessively high price" which would prevent QWI from competing with BHP. QWI sued under s 46 of the Trade Practices Act 1974 alleging that BHP had first engaged in an actual refusal to supply and then a constructive one.

BHP prevailed at trial and in the Full Federal Court. The High Court held BHP had breached. It held the object of s 46 was to protect the interests of consumers.[74] The issue was whether BHP had taken advantage of its substantial market power. Four judges held that for conduct to be a taking advantage of substantial market power, there must be a nexus between substantial market power and the conduct. In other words, a firm would only engage in that conduct by virtue of its substantial market power. This requires considering whether the firm with substantial market power would have

---

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

73 Easterbrook suggested a price squeeze was possible in *Queensland Wire*, Frank Easterbrook "The Inevitability of Law and Economics" (1989) 1 Legal Education Rev 3 at 17: McMahon does also, see "Refusals to Supply by Corporations with Substantial Market Power" (1994) 22 ABLR 7 at 21; and Paul McLachlan "Margin Squeezes as a Misuse of Market Power" (2016) 24 AJCCL 279 at 293.

74 At 191. Section 46 then provided:

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

acted in the same way in a competitive market.[75] If a firm acts differently than it would in a competitive market, then it has taken advantage of its market power. They held that BHP would have supplied QWI in a competitive market.

The fifth Judge, Deane J used a different test. His Honour inferred a taking advantage from BHP's substantial market power and its anticompetitive purpose. He reasoned that BHP's purpose in refusing to supply was to prevent QWI from selling star picket posts. It could only achieve that purpose due to its substantial market power. By refusing to supply, BHP had taken advantage of its market power.[76]

The majority's reasoning became known as the counterfactual test. The Court did not explain what it meant by a competitive market nor did it hear evidence on what BHP would have done in a competitive market. It said BHP would have supplied in a competitive market as Y Bar was the only product that it did not offer to sell. It had excess capacity in its rolling mills and in a competitive market, it would have supplied rather than lose sales.[77] Also relevant was that BHP did not offer a legitimate reason for refusing to sell.[78] BHP knew that major distributors insisted on a full range of rural fencing products consisting of posts and wires. By refusing to supply Y Bar, BHP could keep major distributors to itself.

The High Court did not discuss what price BHP should have supplied Y-Bar for. Mason CJ and Wilson J commented BHP breached s 46 because it would only supply Y-Bar at "an excessively high price relative to other BHP products."[79] They also commented on BHP being able to supply at a "reasonable price."[80] Deane J talked of BHP supplying at an "unrealistically high price."[81] Toohey J held that BHP breached s 46 because it would not supply at "competitive prices."[82] Pincus J at trial linked the definition of a constructive refusal to supply with the ability of QWI to compete in producing star picket fences:[83]

> [T]he offer made by BHP was pitched at a level which BHP knew would make it impossible of acceptance, because [QWI] could not manufacture star picket from Y-Bar purchased at that price and sell it competitively.

---

75 At 192, 202 and 216.

76 At 197–198.

77 At 185, 193, 197, 202 and 216.

78 At 193.

79 At 185.

80 At 184.

81 At 195.

82 At 216.

83 At 204.

Although the Court spoke of a constructive refusal to supply, the case is a classic price squeeze. The defendant, a vertically integrated monopolist sold an input at such a high price that the plaintiff could not profitably sell the output.

B New Zealand Cases

1 Clear v Telecom

This concerned New Zealand's telecommunications sector. Telecom was the former telecommunications service provider. The Government privatised it and deregulated the telecommunications industry. It did not impose industry specific regulation, but rather relied on general competition law – the Commerce Act – to police the industry. Clear was an entrant. It sought interconnection into Telecom's network to enable it to compete in the market for local calls. Telecom had given undertakings to the Government that it would facilitate the emergence of competition by providing interconnection on fair and reasonable terms and conditions.

Interconnection is important under competition law as without it, customers on one network could not communicate with customers on another. This would cause customers to use only the larger network even though it was more expensive. Interconnection enables customers on one network to communicate with customers on other networks. This allows competition on price and service, rather than just network size. The interconnection pricing issue remains. If the incumbent network can charge for interconnection however it wants, it can set interconnection prices so high as to competitively disadvantage access seekers. This causes competition concern.[84]

One of the issues was the price Clear should pay for interconnection. Telecom, after changing its stance, offered supply on the basis of what the Courts called the Baumol-Willig rule but is now called the Efficient Component Pricing Rule (ECPR).

2 ECPR

As the ECPR is crucial in the New Zealand cases this part explains it. While the ECPR starts with the works of Willig and Baumol[85] a number of writers have contributed to it.[86] The rule derives from

---

84 ABA Section of Antitrust Law *Telecom Antitrust Handbook* (2nd ed, ABA Publishing, 2013) at 17.

85 Robert D Willig "The Theory of Network Access Pricing" in Harry M Trebing (ed) *Issues in Public Regulation* (Michigan State University Public Utilities Papers, Michigan, 1979) 109; and William J Baumol "Some Subtle Pricing Issues in Railroad Regulation" (1983) 10 International Journal of Transport Economics 355.

86 Janusz A Ordover and Robert D Willig "Access and Bundling in High-Technology Markets" in Jeffrey A Eisenach and Thomas M Lenard (eds) *Competition, Innovation and the Microsoft Monopoly: Antitrust in the Digital Marketplace* (Kluwer Academic Publishers, Massachusetts, 1999) 103; William J Baumol and J Gregory Sidak "The Pricing of Inputs Sold to Competitors" (1994) 11 Yale Journal on Regulation 171; and Janusz A Ordover and Robert D Willig "An Economic Definition of Predation: Pricing and Product Innovation" (1981) 91 Yale LJ 8.

the contestable markets model[87] and departs from traditional models. The traditional model for analysing competition is perfect competition which has five central assumptions. A perfectly competitive market consists of many small firms – each having no impact on the others. All firms produce the same product, have perfect information and equal access to all production technologies. Finally, all firms can enter and exit the markets freely. This produces the most efficiency.[88]

Under the model, the fewer the firms, the less competitive the market becomes. While economies of scale lead to lower production costs they turn markets into oligopolies. In extreme cases, a natural monopoly results. In a natural monopoly, economies of scale are so great that one firm has the market to itself and competition is impossible. It is inconsistent with efficiency and the only way to achieve efficiency is to regulate.

The contestability model shows some natural monopoly markets can be competitive and efficient. This is so if the markets have easy entry and exit; it means the market is subject to hit and run entry. Thus, competition for a market can be just as effective as competition in a market.[89] The model works as follows: the incumbent firm increases price and high prices attract a new firm who enters quickly. The firms compete over price. One prevails and the other exits. The threat of easy potential entry forces the incumbent to price competitively making the market efficient. For this to work not only must entry and exit be easy, but there also cannot be large sunk costs in entering.[90] A sunk cost is a cost that a firm cannot recover if it exits. If a firm must incur large sunk costs to enter, then the market will not be susceptible to hit and run entry. As the entrant cannot recover sunk costs, the risk of entry is too high. Conversely, if the risk of suffering losses is low, the entry will be worthwhile even though it may cost a lot.

From this contestability model, Baumol, Willig and others developed the ECPR. The ECPR is a rule for determining the access price to a firm's network or essential facility that an entrant must pay. It involves the scenario where the incumbent is vertically integrated ie, it operates and competes in two markets – the input and output markets. Access to the input market is essential for a firm to compete in the output market. The incumbent may be a natural monopolist of the input or have substantial market power. An entrant wanting to compete in the output market needs access to the input. The ECPR determines the price the entrant must pay.

---

87 William J Baumol, John C Panzar and Robert D Willig *Contestable Markets and the Theory of Industry Structure* (Harcourt Brace Jovanovich, San Diego, 1982); Joseph F Brodley "Antitrust Policy under Deregulation: Airline Mergers and the Theory of Contestable Markets" (1981) 61 Boston UL Rev 823; and Harold Demsetz "Why Regulate Utilities?" (1968) 11 JL & Econ 55.

88 Luis M B Cabral *Introduction to Industrial Organization* (MIT Press, Cambridge, 2000) at 85–86.

89 Herbert Hovenkamp *The Antitrust Enterprise Principle and Execution* (Harvard University Press, Cambridge, 2005) at 242–244.

90 At 244.

It establishes that price as follows: the incumbent has a retail price for the output that it charges consumers. It has costs, first in producing the input, and second, in turning the input into the output. Under the ECPR, the appropriate price the incumbent can charge for the input is the difference between the retail price for the output and the avoided costs of producing the input and turning the input into the output. In other words, the final retail price minus downstream costs equals the efficient component price.[91] One can express the concept in other ways. An incumbent should only provide access if it is profitable for it to do so. Thus, it should give access according to its opportunity costs – ie, the revenue it loses by allowing access to the entrant minus the costs it saves by giving access. Another way of putting this is saying that the ECPR covers the revenue the incumbent lost by not having exclusive use of its assets. This means one can derive the ECPR access price in two ways. First, it equals the retail price minus avoided cost. Secondly, it is the cost of providing the access service plus foregone profit. A numerical example shows how.[92] A vertically integrated monopolist sells a retail product. The output price of this is $100. It also manufactures a vital input to the retail product at a price of $10 per unit. It has other incremental costs of $30 per unit of output sold. Thus, the costs per unit are $40. The monopolist earns a price-cost margin of $60 per unit. Under the ECPR, a monopolist will charge $70 to an equally efficient competitor who seeks access to the input. The entrant, as it is equally as efficient, will have incremental costs of $30. Thus, when charged $70, it will have a price-cost margin of zero if the monopolist continues to charge the pre-entry price of $100 for the retail product (costs include a competitive rate of return). The retail product price will stay at $100 and the monopolist retains its profit of $60 per unit. This is so whether the retailer or entrant sells the final product. Thus, the $70 input price represents the opportunity cost for the monopolist; that is, $10 cost of manufacturing the input and the foregone price-cost margin of $60.

The second way of calculating is that the retail price is $100. By allowing an entrant, the monopolist avoids the incremental cost of a unit of output: This is $30. The ECPR is retail output price minus the avoided cost, which is also $70.

The ECPR has implications and benefits. It sends the right signals to entrants as a firm can only profitably enter if its costs are lower or equal to the incumbent.[93] It maximises productive efficiency which benefits consumer welfare. Productive efficiency occurs when firms are using the least amount of resources to produce the greatest output. If firms are not productively efficient they waste resources that other firms could be employing elsewhere in the economy. A decrease in productive efficiency lowers consumer welfare as a decrease means that both costs and prices of goods are higher. So, productive efficiency ensures that low cost producers can charge prices that reflect the cost of supply

91 Baumol and Sidak, above n 86.

92 I take this from Salop (2010), above n 10, at 722–723; and see also George Hay "Reflections on Clear" (1996) 3 CCLJ 231.

93 Paul L Joskow "Regulation of Natural Monopoly" in A Mitchell Polinsky and Steven Shavell (eds) *Handbook of Law and Economics* (Elsevier Science, Burlington, 2007) 1227 at 1333.

of goods. If less efficient firms can enter, the incumbent who gives access is in effect subsidising them. Wasteful duplication of resources will result and any competition will be synthetic.[94] The ECPR also does not interfere with existing cross-subsidies and may be fairer to the incumbent.[95]

Clear, in *Clear Communications Ltd v Telecom Corp NZ Ltd*[96] did not challenge the rule on traditional price squeeze grounds; ie the price for access (input) was so high that it could not compete in the output market. Rather, it alleged that Telecom breached s 36 as it knew that the Baumol-Willig rule would be unacceptable to Clear and thus, was denying interconnection, ie it was a constructive refusal to supply. Clear argued that the rule "offends common sense; it requires Clear to underwrite Telecom's current profits and level of operating efficiency."[97] It said that the rule would lock in existing monopoly profits as it enabled Telecom to recover them as part of its access fee. This meant a firm in a competitive market would not be able to charge according to the rule. Furthermore, Telecom might not decrease its retail price to match a lower Clear price which would enable Telecom to keep its monopoly profits and exclude Clear. The High Court accepted that the rule might enable Telecom's access fee to maintain any monopoly profits that might exist.[98] It found that Clear had not satisfied the rule and that Telecom was earning monopoly profits, saying that it must remain agnostic on the issue.[99] The High Court noted its limitations with this as it was not a regulatory agency.[100]

The Court considered whether the rule had an exclusionary effect. The issue was whether:[101]

> ... the resulting price to Clear for entry could be so high as to frustrate its competition in local business, even if Clear were just as efficient or more efficient than Telecom.

The Court did not make a finding on this. While the Court did not determine the rule's exclusionary effects, it considered whether the rule's price might restrict effective competition. It noted that competition for local business customers would be likely no matter whether Telecom priced using the rule. Furthermore, while the rule may not eliminate any monopoly profit, any other pricing rule would

---

94 At 1334.

95 At 1334; and William J Baumol, Janusz Ordover and Robert Willig "Parity Pricing and its Critics: A Necessary Condition for Efficiency in the Provision of Bottleneck Service to Competition" (1997) 14 Yale Journal on Regulation 145.

96 *Clear Communications Ltd v Telecom Corp NZ Ltd* (1992) 5 TCLR 166 (HC).

97 At 207.

98 At 212.

99 At 213.

100 At 217.

101 At 217.

give Clear "a free ride on Telecom's network."[102] It would allow Clear to outcompete Telecom in areas where Clear is more efficient. In determining whether the rule risked excluding Clear, the Court had to balance this risk against the certainty that a pricing model, which did not charge for access or for interconnection's incremental cost, would foster inefficiency by Clear and allow uneconomic operators to proliferate.[103] It concluded that the rule was more likely than any alternative to improve competition.[104] Accordingly, Telecom was not using its dominant position for the proscribed purposes. As the rule enhanced competition, it improved the competitive process meaning no anticompetitive purpose and no breach of s 36.

Clear appealed and the Court of Appeal unanimously overturned the High Court.[105] Gault J, in delivering the main judgment, focused on s 36 and said that the issue involved applying it to the facts.[106] He held that the purpose of s 36 was to promote competition[107] and the test for use of a dominant position for a proscribed purpose required considering whether the conduct would have been open if the defendant had not been dominant in a competitive market.[108] His Honour accepted that monopolists can compete and that courts should not interpret s 36 so as to constrain such competition.[109] He warned against substituting economic models for the section's words.[110]

Then his Honour suggested that where a firm seeks access to an essential facility, such as a telecommunications network, it was helpful to ask whether the defendant had acted reasonably or with justification.[111] Gault J held that use of the rule breached s 36. His Honour accepted that a firm in a dominant position in telecommunications could charge in line with the price obtainable in a perfectly contestable market. However, such a market would not allow recovery of monopoly profits.[112]

While the High Court held Clear had not shown Telecom's prices included monopoly profits, Gault J said that it was unrealistic to ignore them. Monopoly profits might be reflected not only in

---

102 At 214.

103 At 217.

104 At 217.

105 *Clear Communications Ltd v Telecom Corp NZ Ltd* (1993) 5 TCLR 413 (CA).

106 At 418.

107 At 429.

108 At 429.

109 At 429.

110 At 430.

111 At 430.

112 At 433.

excessive prices, but also inefficiencies.[113] Telecom had argued: "Clear is not prevented from competing according to its relative efficiency so long as Telecom's charge to itself is no less than its charge to Clear."[114] Gault J rejected this while noting that it did not deal with the risk that the price Telecom was asking was so high that it could prevent or deter Clear from entering and competing.[115]

Telecom had submitted that if monopoly profits were a problem, then the Government could regulate under pt IV of the Act. Gault J disagreed, saying in view of Government policy, it would be unrealistic to leave the matter for regulatory intervention.[116] Thus, he held:[117]

> [I] cannot accept that the objects of the Commerce Act are served by a method of pricing that secures the profits of a firm in a dominant position.

As for "purpose", Gault J observed that where a rival seeks access to a dominant firm's facilities and the consequences of a refusal to deal lead to competitive disadvantage, then he could infer the requisite purpose.[118]

Clear was not entitled to damages as it had always refused to pay an access levy.[119] Gault J held Telecom could charge a levy – albeit not a Baumol-Willig levy. It could require Clear to contribute to the fixed and common costs of operating and maintaining Telecom's network. Telecom could only require the "true cost" which was the incremental costs involved in providing interconnection and a "reasonable return on capital so employed."[120] Clear had to contribute to such costs in proportion to the benefits it received.

Cooke P also concluded that the rule breached s 36. His Honour said that the rule's pricing involved opportunity cost pricing and referred to Baumol's evidence that Government intervention should not force the supplier of an input component to receive for it "less than the price that makes the supplier indifferent as to whether the other components … are supplied by others."[121] He said this meant the rule was obviously anticompetitive.[122]

---

113 At 435.

114 At 434.

115 At 434.

116 At 436.

117 At 436.

118 At 437.

119 At 442.

120 At 442.

121 At 416.

122 At 416.

Cooke P said that the notion that Clear would out compete Telecom's monopoly profits by forcing Telecom to reduce its final price was hypothetical; rather than decrease price, Telecom might prefer to continue to receive the high price and may decide to leave the downstream market.[123] As an aside, this is doubtful as it ignores double marginalisation and the vertical integration's benefits.

Neither judgment set a price for interconnection and commented all Clear could do was continue to negotiate.[124] The parties did not agree, rather, Telecom appealed to the Privy Council.[125] The main issue was whether Telecom had used its dominant position for an anticompetitive purpose.

On purpose, the Privy Council said that if a person used their dominant position, it would be hard to imagine that they did so other than for the purpose of producing an anticompetitive effect. Thus, a court can frequently infer from a defendant's use that their purpose was to produce the effect produced. Conversely, it was dangerous to argue that a defendant had used their dominant position because a defendant had a proscribed purpose.[126] A monopolist is entitled to compete. The Privy Council cited *Olympia Equipment Leasing Co v Western Union Telegraph*[127] stating that if the law prevents a monopolist from competing, it would be holding an umbrella over inefficient competitors.[128]

The Court reasserted the importance of economic models and agreed that the question depends on the statutory words. The words did not help as they do not distinguish between conduct which is a use and which is not.[129] It agreed that if the terms Telecom were seeking to extract were no higher than those a hypothetical firm would seek in a perfectly contestable market, then Telecom was not using its dominant position. It was legitimate and necessary to consider how a hypothetical seller would act in a competitive market and this required using an economic model.[130] The rule showed how the hypothetical firm would act.[131]

The Court disagreed that it helped to ask whether the defendant had acted reasonably or with justification, as this would place the monopolist in an impossible position. It would have little idea of what a court would regard as reasonable or justifiable as different minds can differ on this. The Court noted that courts must construe s 36 so a monopolist, before he enters upon a line of conduct,

---

123 At 417.

124 At 417 and 422.

125 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (PC), above n 4.

126 At 402.

127 *Olympia Equipment Leasing Co v Western Union Telegraph* 797 F 2d 370 (7th Cir 1986).

128 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (PC), above n 4, at 402.

129 At 403.

130 At 403.

131 At 403.

knows with some certainty whether the conduct is lawful or not.[132] It established the following test for s 36:[133]

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

The Court noted that Clear had the burden of showing that Telecom's monopoly profits would produce such a high price that it would prevent Clear from entering.[134] It also emphasised that courts had to look at other Commerce Act provisions when considering whether it proscribed monopoly overcharging. Part IV's price control provisions were relevant, as the Government can impose price control if competition is limited or likely to be lessened in a market.[135] Turning to the case, the Court observed:[136]

> It will be clear that the main, and most important, issue is whether the potential for a charge fixed on the basis of the Baumol-Willig Rule including monopoly rents currently charged by Telecom prevents that rule being an adequate model.

It upheld the Baumol-Willig rule; saying that opportunity cost pricing was theoretically valid, and a firm in a fully competitive market would charge its opportunity costs. Doing so meant it was not acting anticompetitively.[137]

The Court considered whether monopoly rents made the rule unsuitable. It discussed whether Clear had proved that Telecom's charges included monopoly rents, noting that the High Court held Clear had not proved this. It said that the High Court had ample evidence to justify this, meaning the Court of Appeal was wrong to the extent it purported to reverse this.[138]

As for whether the risk of monopoly profits meant the Baumol-Willig rule was inappropriate, the Court said no, stating Clear would eventually compete them out.[139] It noted that Clear had not established that Telecom's charges were so high that Clear could not enter the market as it did not

---

132 At 404.

133 At 404. The Court used "unless" rather than "if". This substitution is necessary, otherwise the test is the opposite of what the Privy Council intended. See *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111, [2011] 1 NZLR 577 [*0867*] at [30].

134 At 404.

135 At 404.

136 At 405.

137 At 405–406.

138 At 406.

139 At 407.

present any evidence.[140] It continued that s 36's purpose was not to eliminate monopoly rents.[141] In any event, pt IV could remove any monopoly profits. It rejected Gault J's statement that one could not rely on pt IV as it was contrary to the Government's light-handed regulation policy, noting "what policy the government adopts is no concern of the Courts".[142] Accordingly Telecom had not breached s 36.

C Afterwards

The Privy Council was heavily criticised. Some commentators criticised the Court's counterfactual "use" test as being too lenient.[143] Eventually the Government amended s 36 and substituted "take advantage" from s 46 of Australia's Act for "use."

The second criticism concerned the Baumol-Willig rule, or the ECPR as it was now known. Commentators regarded it outrageous that a rule that preserved monopoly profits could not breach s 36.[144] Successive Governments reviewed telecommunications. On the rule, the Government said it "had the potential to lessen competition" and that it "would be concerned to see the Baumol-Willig Rule being applied in the future."[145] It introduced industry specific regulation via the Telecommunications Act 2001. Regulations prohibited use of the rule.[146]

Before this, Telecom and Clear signed an interconnection agreement containing no ECPR pricing. The Commerce Commission subsequently alleged a price squeeze involving the ECPR.

1 Data Tails

In 2004, the Commission alleged Telecom had breached s 36 by overcharging competitors for access to its wholesale network. During the 1990s, rival telecommunications service providers (TSPs)

---

140 At 407.

141 At 407.

142 At 408.

143 Yvonne van Roy "Taking Advantage of Market Power: Should New Zealand Adopt the Approach of the High Court of Australia?" (2005) 11 NZBLQ 319; Rex Ahdar "Escaping New Zealand's monopolisation Quagmire" (2006) 34 ABLR 260; and Rex Tauati Ahdar "The Unfulfilled Promise of New Zealand's Monopolisation Law: Sources, Symptoms and Solutions" (2009) 16 CCLJ 291.

144 Van Roy, above n 143; Ahdar, above n 143; Valentine Korah "Changes for Inter-Connection to a Telecommunications Network" (1995) 2 CCLJ 213; Brenda Marshall and Rachel Mulheron "Access to Essential Facilities under Section 36 of the Commerce Act 1986: Lessons from Australian Competition Law" (2003) 9 Cant LR 248; and Brenda Marshall "Pricing Third Party Access to Essential Infrastructure: Principles and Practice" (2005) 24 ARELJ 172.

145 New Zealand Government "Government signals future directions for regulation of Telecommunications, Electricity and Gas" (press release, 26 June 2001).

146 Telecommunications Regulations 2001.

sought access to Telecom's network to offer a competing high speed data transmission service. Rival TSPs needed to purchase data tails from Telecom – "data tails" are the connections between an end customer's premises and the point where a TSP can take delivery of data signals from Telecom. They are the last mile connections between a customer's premises and a switch where a TSP can take over the transmission and send it along its network to another customer. Data tails can be at the start and/or finish of a transmission circuit.

In *Commerce Commission v Telecom Corp of New Zealand Ltd*,[147] the Commission alleged that from December 1998 until 2004, Telecom's wholesale price to other TSPs for access to data tails was so high relative to Telecom's retail prices that it caused a "price squeeze". Telecom sold data tails to TSPs at wholesale. It also provided its own high speed data transmission service at retail in competition with TSPs. Telecom decreased its retail price but did not commensurately decrease its wholesale price for data tails. In some cases, Telecom's wholesale price of data tails exceeded the retail price of its high speed data transmission service. This was the price squeeze. The Commission did not allege Telecom's retail price was predatory pricing.[148]

Two scenarios were at issue. One where Telecom provided all the tails in a TSP's customer network, whether two or more, and the TSP did not self-provide any (the "two-tail" scenario). The other where a TSP self-provided one or more tails and Telecom supplied the rest (the "one-tail" scenario).[149] The Commission brought its case on the basis that in neither scenario did Telecom's pricing comply with the ECPR. There was no evidence that Telecom ever had regard to ECPR when it set its wholesale prices.[150] However, the parties fought the case on the ECPR.

2 The High Court

Without citing authority, the Court said a price squeeze occurs when a dominant vertically integrated supplier sets prices in the upstream wholesale market in a manner that prevents equally or more efficient competitors from profitably operating in the downstream retail market.[151]

147 *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland CIV-2004-404-1333, 9 October 2009 [*Data Tails* (HC)]. I partly base the account of the cases on my co-written text: Lindsay Hampton and Paul G Scott *Guide to Competition Law* (LexisNexis NZ Ltd, Wellington, 2013) at 239–243.

148 *Data Tails* (CA), above n 3, at [123].

149 At [4].

150 At [89].

151 *Data Tails* (HC), above n 147, at [3].

It found that over the relevant period, Telecom had both dominance and a substantial degree of market power in the wholesale market for data tails outside central business districts, as well as the national wholesale market for backbone or network services.[152]

It looked at whether Telecom had used/taken advantage of its dominant position/substantial market power in two steps. First, whether Telecom was obliged to supply data tails and secondly, whether the prices Telecom charged its competitors were greater than the prices it would have charged in the hypothetical competitive market.[153]

It held that Telecom had no express statutory obligation to supply; nor did the "essential facilities" doctrine or any New Zealand equivalent require supply. It accepted a vertically integrated incumbent had a duty to supply an essential wholesale input to a competitor in a downstream market based on *Queensland Wire*, and also the obligation apparently assumed to exist in *Telecom v Clear*.[154] The Court viewed data tails as an essential input into providing a high speed transmission service. As Telecom could supply the data tails, the Court inferred Telecom had a duty to supply.[155]

As to the prices Telecom charged, applying *Telecom v Clear*, the Court endorsed ECPR as the appropriate model to address how to price network access in markets which a single vertically integrated provider of network infrastructure and services dominated.[156] The Court identified the ECPR's objective as to price access that compensates the incumbent for properly incurred costs, including profits foregone, while also ensuring that the access price is sufficiently low, so as not to deter entry.[157] An ECPR price permits efficient entry by ensuring that an entrant's costs will not exceed the incumbent's. A price which exceeds the incumbent's is harmful because it impedes efficient entry.

Two issues arose from applying ECPR. First, what is the price for access under ECPR when the rival TSP provides one or more of the tails and Telecom the remainder – the "one-tail" scenario? Telecom said if so, it can recover the profit foregone on the entire network, as this was consistent with the ECPR principle that Telecom should be indifferent between supplying itself and supplying a new entrant.[158] The Commission contended that the appropriate profit share that the incumbent should

---

152 At [9] and [41]–[42]; the Government had changed the threshold of s 36 from "dominance" to "substantial degree of market power" during Telecom's behaviour. Thus, the Court had to consider both thresholds.

153 At [126]. This is Judge Breyer's question from *Town of Concord v Boston Edison Co*, above n 6 which his Honour said was unanswerable.

154 At [127].

155 At [128].

156 At [129].

157 Baumol and Sidak, above n 86, at 178.

158 *Data Tails* (HC), above n 147, at [54].

recover for each tail it leases is the proportion that the leased tail bears to the total number of tails in the network.[159] The Court agreed with Telecom finding that pricing data tails this way would not preclude a more efficient rival entering.[160] As Telecom's one-tail pricing complied with the ECPR, it did not breach s 36.

Secondly, where Telecom supplied data services to a customer as part of a bundle of services which, for example, may include voice or internet services. Telecom claimed the profits lost on all services should be taken into account in calculating the ECPR price.[161] The Court disagreed stating:[162]

> [i]f the incumbent is to be compensated in an ECPR price for losing a data service customer, it is only to the extent of the additional profit derived from supplying the services as a bundle.

It doubted whether this profit would be significant as making data sales was not essential to voice or internet sales.[163] Furthermore, were Telecom to be compensated from the loss of profits on other lines of business when it loses data service to a customer because it would be discouraged from competing for the remaining services?[164]

The Court held in favour of the agreed counterfactual comprising two vertically integrated firms (T1 and T2), each with a 50 per cent share of the high speed data transmission business, a non-dominant Telecom would not set data tails prices above ECPR to an entrant TSP (T3) who had a core network but who needed to lease data tails.[165]

The Court accepted there were repeated "violations" of ECPR pricing when Telecom supplied both data tails in a two-tail circuit – the "two-tail" scenario.[166] The absence of information about the magnitude and distribution of ECPR violations was not fatal to the Commission's case. As long as non-compliance was more than *de minimis* it may breach s 36. In pricing above ECPR, Telecom breached s 36.[167]

---

159 At [54].

160 At [60].

161 At [64].

162 At [71].

163 At [71].

164 At [70].

165 At [129].

166 At [132].

167 At [131].

D The Court of Appeal

Telecom unsuccessfully appealed. The Court allowed the Commission's cross-appeal on the "one-tail" scenario. While the Court accepted in this scenario that Telecom's recovery of profit foregone on its entire network accords with ECPR, it still breached s 36 as this outcome would not survive the hypothetical competitive market.[168] Furthermore, it said it would be misreading *Telecom v Clear* to suggest that their Lordships were endorsing the use of ECPR to arrive at a price that would preclude competition.[169] The Court viewed it was implicit in the Privy Council's decision that an incumbent cannot charge a price above which a rival cannot compete.

It also found it unlikely that Telecom's pricing would allow monopoly profits or inefficiencies to be driven out of the market, as it permits Telecom to raise the wholesale price of its data tails as the TPS's network grows.[170] It also held that allowing Telecom to recover the profit foregone on its entire network in the one-tail scenario effectively rewards Telecom for imposing the two-tail price squeeze and forces TSPs to build their own tails when it may otherwise have been more efficient for TSPs to lease tails from Telecom.[171] It concluded that it should adopt a pragmatic approach and accept the Commission's suggested pricing methodology whereby Telecom should only be able to recover a proportionate profit share on its leased tails.[172]

E Discussion of Court's Decision

1 One-tail scenario

Telecom's pricing here complied with the ECPR and the High Court held no breach of s 36. Conversely, the Court of Appeal found a breach. This has profound consequences and it is worthwhile examining why the Courts differed. The Court of Appeal said such pricing conflicted with the decision of the Privy Council in *Telecom v Clear*, would exclude competition[173] and would not survive the counterfactual test.[174]

---

168 *Data Tails* (CA), above n 3, at [246].

169 At [235].

170 At [238].

171 At [241].

172 At [249].

173 At [233]–[242].

174 At [242]–[246].

2 Exclude competition

The High Court used examples to show the ECPR does not preclude competition by an equally efficient rival,[175] and why Telecom was entitled to recover the profit foregone on the entire network from a rival, even if the rival provided a tail. It used a five-tail network and assumed a retail network price of $14 – with direct network costs for each tail of $1; a direct network incremental cost of $2 and direct incremental retail cost of serving the customer at $3. This leads to a $4 profit to Telecom on the customer's business. If a TSP needed access to all five tails, the ECPR price would be $14 consisting of $1.80 per tail – the $1 cost per tail plus a $4 opportunity cost spread over the five tails. The TSP would pay $9 for the tails and $5 for the backbone and retail costs. Its profit is zero.[176]

If a TSP wanted to self-provide one tail and lease from Telecom, the ECPR allows it to charge the TSP $2 per tail (being the cost of $1 per tail plus $4 opportunity cost spread over four tails). This means a price of $13, being the $8 cost of tails plus the $5 for the backbone and retail costs. Assuming the same retail price, this leaves a surplus of $1. It would only be profitable for a TSP to self-provide if it provides the tail as or more cheaply than Telecom (ie, for less than $1). Thus, the ECPR permits self-provision of tails if the entrant is equally or more efficient.[177]

The Commission submitted this ignores entrants' fixed and common costs in self-providing a tail.[178] The High Court disagreed. It noted only incumbents' costs are relevant in calculating ECPR. It cited Kahn and Taylor to find that if an incumbent could profitably retain business at prices covering only its marginal costs, but the entrant required some larger markup to recover its fixed and common costs, then it is inefficient for society to make it possible for the latter to do so. It would involve wasteful duplication and incurring of new, extra common costs of facilities and activities that the incumbent already provided.[179]

The Court of Appeal accepted the Commission's submission that Telecom would have a $4 margin to help cover its fixed and common costs. The entrant would have only $1 (equal to Telecom's marginal cost) to cover such costs. An equally efficient TSP would be unable to enter unless such costs were less than the incumbent's marginal costs, which would never occur in the telecommunications industry.[180] As a result, such ECPR pricing precluded competition. Interestingly Clear did not challenge ECPR on this basis.

---

175 At [48] and [234]; *Data Tails* (HC), above n 147, at [55]–[59].

176 *Data Tails* (HC), above n 147, at [56]. This zero includes a competitive rate of return.

177 At [57].

178 At [61].

179 At [62].

180 *Data Tails* (CA), above n 3, at [234].

This is unconvincing. Fixed costs (including sunk and common costs) are important in telecommunications as they are a significant proportion of total costs. Consequently, price levels in such industries may exceed marginal costs.[181] This is relevant to the Commission's argument that in the High Court's examples, Telecom has a $4 margin to cover its fixed and common costs. This assumes only the final retail price is available to do so. This is not so, as in the examples, Telecom has already recovered them. The costs the High Court gave were the direct incremental network costs of each tail; the backbone and retail costs of serving the consumer.[182] Whether Telecom recovers all costs depends on whether these incremental costs cover fixed and common costs. Sadly, incremental cost is ambiguous. Sometimes it means the change in total costs resulting from an increment. If so, incremental cost equals total cost, assuming the increment is produced, minus total cost, assuming the increment is not produced. Because one can specify a wide variety of increments "incremental cost" can conceptually range from total cost per unit (entire output as the increment) to marginal cost (one unit as the increment). Usually one uses the entire service or element as the increment.[183] This means including fixed and common costs.

The High Court used incremental costs as incorporating fixed and common costs in its examples. It refers to Telecom incurring "total costs."[184] The Court refers to Kahn and Taylor who talk about efficient competition allowing entrants only to the extent that total costs to society are equal or lower than those of the incumbent.[185] Total costs to society involve fixed costs. Given this, when the High Court talks of a $1 cost of each tail, it means Telecom's total cost. This is not the same as Telecom's marginal cost. The High Court's cost covers Telecom's fixed and common costs. The result is a competitor will only be able to enter if its total costs are equal or less than the incumbent's. This is what the High Court held. Using total costs makes sense, as to be profitable over the long term, a firm must cover its average total costs. It will continue to produce if it covers its average variable costs. It will shut down if it cannot cover its marginal costs.[186] For the Commission to suggest that the High Court was referring to Telecom's marginal costs is misleading. If Telecom priced on that basis in the long term, it would have to exit.

---

181 ABA Section of *Antitrust Law Telecom Antitrust Handbook*, above n 84, at 3; and Baumol, Panzar and Willig, above n 87, 199–217.

182 *Data Tails* (HC), above n 147, at [55].

183 Colin Blackman and Lara Srivastava (eds) *Telecommunications Regulation Handbook* (10th ed, InfoDev, 2011) at C-7.

184 *Data Tails* (HC), above n 147, at [59].

185 At [62].

186 E and H Hovenkamp, above n 5, at 275–276; Dennis Carlton and Jeffrey Perloff *Modern Industrial Organization* (4th ed, Pearson, Boston, 2004) at 284–288; and N Gregory Mankiw *Principles of Microeconomics* (6th ed, Cengage, London, 2011) at 284–288.

Wrongly accepting that the High Court's figures did not include fixed and common costs led the Court of Appeal to accept the Commission's submission that an equally efficient TSP would not be able to enter.[187] This caused the Court to say that ECPR one-tail pricing was inconsistent with the Privy Council in *Telecom v Clear*. In particular, such pricing meant a TSP would be unable to enter – let alone compete. The Privy Council regarded it as significant that Clear never said that Telecom's charges under the ECPR were so high that Clear could not enter. Presumably, if it had, the Privy Council would have found Telecom had breached s 36. The Court of Appeal said it was implicit in the Privy Council judgment that an incumbent cannot charge a price above which makes it impossible for a rival to compete.[188] Holding that an entrant could not compete meant Telecom could not recover the profit foregone on the entire network.[189]

3 Contrary to the counterfactual

The Court of Appeal also held that one-tail pricing was contrary to the counterfactual test.[190] It did not focus on ECPR's vice allowing a defendant to keep its monopoly profits. It was not best pleased with the Privy Council on this. It noted that ECPR pricing preserved such profits and cited Baumol and Sidak to find that to function fully, in addition to the ECPR, market forces or regulation must constrain final product prices so as to preclude monopoly prices.[191]

The Court thought this lack of constraint on Telecom showed a difficulty in the Privy Council's reasoning in finding the ECPR passed the counterfactual test. This was that the ECPR could not calculate a price that a non-dominant firm in a hypothetical market would charge.[192] It said that although the Supreme Court had endorsed the counterfactual test in *0867*,[193] it was not enthusiastic about the way the Privy Council had applied it because of monopoly profits.[194]

The trouble with this is that, in citing Baumol,[195] the Privy Council knew Baumol always claimed that for the ECPR to work fully, market forces or regulation needed to constrain the final price. The

187 *Data Tails* (CA), above n 3, at [234]–[237].

188 At [235].

189 At [237].

190 At [246].

191 At [82]: it cited Baumol and Sidak, above n 86, at 195–196.

192 At [85] and [243].

193 *0867*, above n 133.

194 At [245].

195 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (PC), above n 4, at 404; and Baumol said the same thing in his evidence in the High Court: *Clear Communications Ltd v Telecom Corp NZ Ltd*, above n 96, at 214.

Privy Council said that if this was a problem, then the Government could use pt IV to eliminate monopoly profits. The Privy Council said one could not construe s 36 to eliminate them when pt IV already provides a way to do so.[196] Thus, the ECPR was not "using" as it involved opportunity cost pricing which is how a firm would charge in a competitive market.[197]

The *Data Tails* Court of Appeal ignored the opportunity cost pricing comments and the role of pt IV. It said the ECPR would flunk the counterfactual test, as in the agreed counterfactual rivalry, competition from T2 would prevent T1 from increasing its wholesale price to recover its foregone profits on T3's self-provided tails. In a situation where T3 provides a tail – T1 and T2 would not both raise their profits. It gave the example where T3 initially leases three tails from T1. T3 then self-provides one. T3 continues to lease two tails from T1. T1 would not raise the price of the two tails leased to T3 as T2 would not raise its price as T2 has no incentive to do so as it has no foregone profits, since it did not service T3.[198]

This analysis fails to account for opportunity cost pricing. Under the ECPR, the access price will reflect the opportunity cost to T1 of providing tails. This will be the same whether T3 provides one or none of the tails as T1 can do the service itself. It will be the opportunity cost of providing all the service itself. T3 will only provide a tail if it is profitable for it to do so, ie if it is equally or more efficient than T1. Rival T2 will also provide access at opportunity cost as that is what firms do in competitive markets. This too will be the same whether T2 supplies one or more tails. It also reflects the opportunity cost of providing all the service itself. The issue is not whether T2 will raise its price as it will want to recover its opportunity costs. T2 will offer access which constrains T1. It will, however, still charge its opportunity cost – and that will happen whether the entrant T3 provides one or more tails. Both T1 and T2 will charge access at opportunity cost which means no breach of the counterfactual test.

In any event, when an entrant self-provides a tail, the overall ECPR decreases as the High Court showed.[199] The Court of Appeal adopted a pricing methodology, which a Commission expert advanced, of recovering a proportionate profit share of its leased tails.[200] This, as the High Court showed, is contrary to the ECPR as it is not opportunity cost pricing which the Privy Council endorsed.[201] Contrary to the Court of Appeal, ECPR pricing in the one-tail scenario does not flunk

196 At 405–408.

197 At 406.

198 *Data Tails* (CA), above n 3, at [246].

199 *Data Tails* (HC), above n 147, at [56]–[59].

200 *Data Tails* (CA), above n 3, at [249].

201 At [232].

the counterfactual test, and only if one ignores opportunity costs and adopts the Commission's expert's model can there be a price squeeze of retail price being less than wholesale price.[202]

4 Treatment of United States law

Both Courts dealt with United States law when considering s 36's "use" limb. The High Court, in determining whether Telecom had used its dominant position, first asked whether Telecom had an obligation to supply and if so, whether prices were higher than ECPR.[203] It held, following *Queensland Wire* and *Telecom v Clear*, that a vertically integrated incumbent has a duty to supply an essential wholesale input to a downstream competitor.[204] It held the United States essential facilities doctrine did not apply save as to provide "valuable insights."[205]

The Court of Appeal considered United States law more in depth as one of Telecom's grounds of appeal was that the High Court should have followed *Trinko* and *LinkLine* and concluded that price squeezes do not fall within s 36.[206] It rejected this. After outlining the decisions it said the effect of the cases is unsettled, with some commentators arguing they do not overrule any of the prior refusal to deal or price squeeze decisions and are limited to their regulatory context.[207]

This is dubious. The regulatory context was unimportant in Scalia J's *Trinko* opinion and his Honour found that even though the Telecommunications Act regulated the industry, competition law applied.[208] While his Honour did not overrule prior authority, such as *Aspen*, he said it was at or near the outer boundary of s 2 liability.[209] As for *LinkLine*, the Court of Appeal went astray. Roberts CJ did not rely on the regulatory context in dismissing the price squeeze claim. As in *Trinko*, it was unimportant in holding the incumbent had no antitrust duty to deal.[210]

---

202 At [251].

203 *Data Tails* (HC), above n 147, at [126].

204 At [127]–[128].

205 At [127].

206 *Data Tails* (CA), above n 3, at [104].

207 At [112].

208 *Verizon Communications Inc v Law Office of Curtis Trinko, LLP*, above n 57, at 407.

209 At 408–409.

210 *Pacific Bell Telephone Co v LinkLine Communications Inc*, above n 62, at 1119.

As for United States law's uncertainty, the Court of Appeal cited the Hovenkamp's commentators who said that the cases did not overrule previous authority and are limited to their regulatory context.[211] However, the Hovenkamps do not say this. They actually said:[212]

> In its *LinkLine* decision the Supreme Court went a long way to toward shutting the door on price squeeze claims. While, the Court did not expressly overrule Judge Learned Hand's famous decision in *[Alcoa]* it did so in fact.

In his treatise Hovenkamp senior says: "It is difficult to read the majority opinion as doing anything other than overruling *Alcoa*."[213] Other commentators have said the same.[214] Shulman, whom the Court of Appeal cite, is an outlier and his statement:[215]

> Thus, there is nothing in *TrinkLine* to preclude reliance on pre-*TrinkLine* jurisprudence, particularly in the event of a future change of direction in the Court's philosophy and outlook on antitrust

expresses a hope rather than states the law.

Ironically, while rejecting *LinkLine*, the Court of Appeal adopted *LinkLine*'s methodology in first asking whether Telecom had an obligation to supply data tails.[216] Here, New Zealand differs from the United States. The High Court, following *Queensland Wire* and the apparent duty in *Telecom v Clear*, said Telecom did. Telecom said the High Court erred in not considering the counterfactual test.[217] The Court of Appeal said the High Court, although not expressly referring to why a counterfactual would result in supply, relied on counterfactual analysis as it referred to *Queensland Wire* and *Clear* which involved counterfactuals.[218] *Clear* is unhelpful as Telecom undertook to supply access.[219] The Court of Appeal is correct that *Queensland Wire* means Telecom had to supply. Saying a firm is obliged to supply means that firm would breach s 36 if it did not.

---

211 *Data Tails* (CA), above n 3, at [112], citing E and H Hovenkamp, above n 5, and Daniel Shulman "Refusals to Deal: Is Anything Left; Should There Be?" (2010) 11 Sedona Conf J 95 at 108–109.

212 E and H Hovenkamp, above n 5, at 274 and 281.

213 Herbert Hovenkamp *Federal Antitrust Policy: The Law of Competition and its Practice* (4th ed, West Publishing St Paul, 2011) at 331.

214 Hay and McMahon, above n 5, at 268.

215 Shulman, above n 211, at 108. Shulman refers to *Trinko* and *LinkLine* as *Trinkline*.

216 *Data Tails* (HC), above n 147, at [126]; and *Data Tails* (CA), above n 3, at [132].

217 *Data Tails* (CA), above n 3, at [126].

218 At [130].

219 Letter from Patrick Troughton (Managing Director of Telecom) to the Ministers for State Owned Enterprises and Finance (8 June 1988); and Ross Patterson "Light-handed Regulation in New Zealand Ten Years On" (1998) CCLJ 1.

Queensland Wire means Telecom would breach if it did not supply. This would not happen under *Trinko* because, in that case, there was no obligation to supply as the defendant had never voluntarily dealt with rivals.[220] In all United States cases, particularly *Aspen*[221] and *Otter Tail*,[222] where the Court found a breach, the defendant had previously supplied rivals. This was not so in *Queensland Wire*. The defendant had never sold Y-Bar to anyone. Under United States law, BHP would not be obliged to supply.

Furthermore, although the Court of Appeal said it did not rely on any nascent essential facility doctrine for a duty to supply,[223] it referred to *NT Power Generation Pty Ltd v Power and Water Authority*[224] where the High Court of Australia found a breach for failing to interconnect to a power network. Berry has pointed out that this involved a classic essential facility, and how s 36 captures such situations.[225] The case introduced essential facilities into Australasia, whereas *Trinko* doubted the doctrine existed.[226]

New Zealand price squeeze and refusal to supply law has departed significantly from the United States. But *Data Tails* departs from overseas jurisprudence not only on this point. It also differs on the equally efficient competitor standard. In its "one-tail" decision, the Court of Appeal rejected the ECPR as a price squeeze defence. This has profound consequences. ECPR requires an entrant to be as efficient as the incumbent. This is in line with other monopolisation doctrines viz Posner's equally efficient competitor standard.[227] While this test is not ubiquitous in monopolisation law, it is part of predatory pricing law. In predatory pricing, a defendant must price below its costs.[228] If it prices above cost, then such prices would not force an equally efficient competitor from the market. The benchmark for escaping liability is that above cost pricing cannot harm an equally or more efficient competitor. Similarly, the ECPR cannot harm an equally or more efficient competitor as it can survive

---

220 *Verizon Communications Inc v Law Office of Curtis Trinko, LLP*, above n 57, at 409.

221 *Aspen Skiing Co v Aspen Highlands Skiing Corp* 472 US 585 (1985).

222 *Otter Tail Power Co v US* 410 US 366 (1973).

223 *Data Tails* (CA), above n 3, at [132], n 153.

224 *NT Power Generation Pty Ltd v Power and Water Authority* [2004] HCA 48, (2004) 219 CLR 90.

225 Mark Berry "Competition Law" [1996] NZLR 599 at 605–607.

226 *Verizon Communications Inc v Law Office of Curtis Trinko, LLP*, above n 57, at 411. It said it had never recognised the doctrine.

227 Richard A Posner *Antitrust Law: An Economic Perspective* (2nd ed University of Chicago Press, Chicago, 2001) at 194–195.

228 *Brooke Group Ltd v Brown & Williamson Tobacco Corp* (1993) 509 US 209 (US); *Boral Besser Masonry Ltd v ACCC* [2003] HCA 5, (2003) 215 CLR 374 (Australia); and *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145 (New Zealand).

after having paid ECPR access prices. The ECPR also accords with Judge Posner's *Olympia Equipment* comment that competition law should not hold an umbrella over inefficient competitors.[229]

The ECPR is also consistent with European price squeeze law. From *Deutsche Telekom AG v European Commission*[230] and *Konkurrensverketk v Teliasonera Sverige AB*[231] a price squeeze will only be anticompetitive and breach art 102 of the Treaty on the Functioning of the European Union if the input price is likely to hinder the ability of equally efficient competitors to trade in the output market.[232] This is the same as the ECPR.

The *Alcoa* transfer price test is an early version of the equally efficient competitor standard and is consistent with ECPR as it bans a vertically integrated monopolist from foreclosing equally efficient rivals.[233] Commentators support ECPR's equally efficient competitor standard. Salop advocates a version of the ECPR called the protected profits benchmark (PBB) as his test for price squeezes. If an input price complies with the PBB no liability results. The PBB is identical to the ECPR except it requires the vertically integrated monopolist and access seeker to sell identical outputs. If the entrant sells a different output, this complicates the concept of the equally efficient competitor. If outputs differ, then calculating profit sacrifice is harder. Some of the entrant's sales may not be lost sales to the incumbent. They may be new customers who only want the entrant's output.[234]

This raises the question why the Court of Appeal rejected ECPR. Its prime reason was that it read the Privy Council decision as requiring an incumbent to charge an access price that enables an entrant to compete and that ECPR totally prevents entry.[235] It went further by citing Ahdar and said prevention was misplaced, and that conduct that seriously restricts or deters competition breaches s 36.[236] One can take this too far as any access levy means an entrant will make less profit and be deterred from entry. Furthermore, an incumbent's efficiency will deter a less efficient entrant. The result downplays efficiency which is less important than ensuring an entrant's survival. An incumbent

---

229 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (PC), above n 4, at 402–403,

230 *Case C-280/08 P Deutsche Telekom AG v European Commission* [2010] 5 CMLR 27, [2010] ECR I-955.

231 *Konkurrensverket v Teliasonera Sverige AB* [2011] 4 CMLR 18, [2011] ECR I-527.

232 For European law see O'Donoghue and Padilla, above n 5, at 303–350; Einer Elhauge and Damien Geradin *Global Competition Law and Economics* (2nd ed, Hart Publishing, Oxford) at 485–493: and McLachlan, above n 73, at 287–292.

233 E and H Hovenkamp, above n 5, at 275; and Salop (2010), above n 10, at 719.

234 Salop (2010), above n 10, at 720 and 725–731; and Steven C Salop "The Protected Profits Benchmark: Responses to Comments" (2013) 79 Ant L J 381.

235 *Data Tails* (CA), above n 3, at [236]–[237] and [248].

236 At [236], citing Rex Ahdar "Battles in New Zealand's Deregulated Telecommunications Industry" (1995) 23 ABLR 77 at 104.

must make its facility available at low prices to firms seeking to become viable rivals.[237] This is Sidak's nightmare of substituting a rule of competitor welfare for consumer welfare.[238] Whether the rival is as efficient is irrelevant.

The Court of Appeal's reasoning is somewhat inconsistent as in places it adopts the equally efficient competitor standard. It adopted the High Court's definition of a price squeeze saying:[239]

> [A] price squeeze occurs when a dominant vertically integrated supplier sets prices in the upstream wholesale market in a manner that prevents equally or more efficient competitors from profitably operating in the downstream retail market.

However, the Court correctly describes the Privy Council's reasoning. This is contradictory as some parts downplay efficiency when talking of an entrant's ability to enter, whereas others emphasise it. It cited *Olympia* which said the law should not hold an umbrella over inefficient competitors.[240] ECPR ensures the incumbent is not holding that umbrella. This suggests that the price level of access, and that price level's effect on an entrant is not key but rather relative efficiency is. By noting that Clear had not established that Telecom's charges would be so high that it would be unable to enter the market,[241] the Privy Council has moved away from *Olympia*. If Clear could not compete under Baumol-Willig prices, it is not as efficient as Telecom. It should not have an umbrella placed over it. Yet it is evident that if Clear could show the prices were so high it could not compete, then Telecom would have breached. This should be irrelevant if the Court was endorsing ECPR and *Olympia*. Given this, referring to *Olympia* was empty rhetoric and the Court of Appeal was correct in holding that the price level was the important thing rather than overall efficiency.

Data Tails is consistent with *Queensland Wire* as the High Court stressed the input's price resulted in the plaintiff not being able to sell the output competitively.[242] BHP would not have breached had it supplied Y-Bar at a price that enabled QWI to compete with BHP in selling fences. This is consistent with the Privy Council as BHP's price was so high that QWI was unable to enter the market. The High Court did not ask whether QWI was as efficient as BHP. It was irrelevant.

One feature of the cases is that none of the courts regard dynamic efficiency, property rights or preserving an incumbent's incentives to innovate as important. Only the *Data Tails* Court of Appeal

---

237 Matt Sumpter "Price/Margin Squeezing" (paper presented to Competition Law and Policy Institute, Auckland, August 2013) at 16.

238 Sidak, above n 16.

239 *Data Tails* (CA), above n 3, at [2].

240 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (PC), above n 4, at 402.

241 At 407.

242 *Queensland Wire Industries Pty Ltd v Broken Hill Pty Ltd*, above n 72, at 184, 185, 195, 204 and 216.

decision refers to it and then ignores it.[243] Such incentives are not so important in the New Zealand telecommunications market as the incumbent neither innovated nor invested in creating its facility. Rather it acquired it. Further New Zealand's size means that in many markets, customers will often depend on a sole supplier, so increased liability is justified. Given this, the New Zealand courts were correct in rejecting an access rule partly based on preserving those incentives. Rather than requiring entrants be equally as efficient as incumbents ECPR ensures the better policy position is to ensure that entrants can begin to compete. If they succeed, prices will fall and consumers will benefit. If not, that is the market at work.

VI CONCLUSION

In killing off the ECPR and consequently the equally efficient competitor standard, the *Data Tails* Court of Appeal has imposed the world's strictest liability on price squeezes. The contrast with the United States is stark. The United States Supreme Court has virtually done away with the concept. Any case is now either a refusal to deal or predatory pricing. Both are difficult to establish. Conversely New Zealand courts will not disaggregate price squeezing into components. This is sensible. One can treat a price squeeze as a constructive refusal to deal. However, determining how high it should be so as to amount to a refusal to deal is complicated. Relying on price squeeze law so that only a price that prevents a downstream rival from competing is outlawed is more tractable. Relying on predatory pricing which requires below cost pricing would mean anticompetitive price squeezes escape liability. So the concept of price squeezes is of competition law utility. New Zealand's law, while strict, is in line with authority – particularly *Queensland Wire* even if it involves answering a question which Judge Breyer claimed was unanswerable.[244] The Courts' decisions show that it was not. Given this, it is ironic that the Government is going to amend s 36.

---

243 *Data Tails* (CA), above n 3, at [66], n 73, citing Brenda Marshall "Pricing Third Party Access to Essential Infrastructure: Principles and Practice" (2005) 24 ARELJ at 172.

244 See *Town of Concord v Boston Edison Co*, above n 6.