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Margin Squeeze and Competition Law – the First Decision in New Zealand

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Margin (aka price) squeeze, as the basis for anti-trust action, was kicked back by the US Supreme Court earlier this year in *linkline*. But it is a well-established principle in the EU. Apart from a largely immaterial injunction skirmish, New Zealand has just had its first margin squeeze decision. However, due to a 1994 Privy Council decision, the High Court decision may not end up being particularly significant as a long term precedent.

In *Commerce Commission v Telecom*, the New Zealand High Court decided that there was a price squeeze as to "data tails", in breach of the monopolisation provision in the Commerce Act. This is a provision which follows the Australasian model rather than the differing US and EU anti-trust provisions (which inform rather than determine the Australasian approach).

What is price/margin squeeze?

The decision, not entirely correctly, describes price squeeze as follows:[1]

> 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 market.

In fact:

- that is one of two related tests (the other uses the vertically integrated supplier's own operations as the benchmark); and
- the price squeeze does not necessarily only flow from the setting of the wholesale price. It can also result from the incumbent's choice of retail price. The key point is that it is not the **absolute** wholesale and retail prices respectively that are at issue. Rather it is the **difference** between them (hence, margin squeeze). See our article, *Margin/Price Squeeze - A Landmark UK Judgment*.[2]

Data tails and the relevant services

Under review by the Court were data tails wholesaled by Telecom to its competitors. The data tails enabled high speed data connectivity between (a) an end user (particularly, business customers) and (b) the wholesale customer's point of presence. The service was provided over local access circuits, a market in which, as in many countries, the incumbent Telecom had dominance. The data tail service enabled Telecom's competitors to provide services such as Wide Area Network connectivity between, say, a business customer's offices in different locations

If the margin between the wholesale data tail price and Telecom's retail price for retail services in the same retail market was too narrow, there would be a price/margin squeeze. If the other ingredients in the anti-trust provision are met, the margin squeeze will be in breach of the legislation (the Commerce Act).

The Court held there was a margin squeeze such that Telecom breached the anti-trust provision disallowing taking advantage of market power.[3]

[1] Para 3

[2] http://wigleylaw.com/Articles/LatestArticles/margin-price-squeeze---a-landmark-uk-judgment/

[3] Section 36 Commerce Act 1994 (NZ). The Court also had to deal with a 2001 amendment to the section.

US, European and Australian approach

In February 2009, the United States Supreme Court held, in *linkline*, and applying *Trinko*, that margin squeeze did not provide a basis for anti-trust action under the US' equivalent provision. However, margin squeeze is well established and accepted as a basis for anti-trust breach in Europe.

See our article: *Competition Law and Telecoms: 2009 Developments in the EU, the US and Australasia*.[4]

Additionally, although there is only limited authority, the Australian regulator (ACCC), under similar legislation to the New Zealand legislation, broadly applies the EU approach.

New Zealand's position following the *Telecom v Clear* Privy Council decision

The New Zealand courts however are unique as they are currently bound to follow the controversial Privy Council decision in *Telecom v Clear*. That decision established both (a) the so-called counterfactual test, and (b) the legal acceptance of the ECPR Rule, known also as the Baumol-Willig Rule. Both closely related tests and rules are controversial and often criticised.

There are indications that the counterfactual test may not survive much longer, and the application of the ECPR rule may follow a similar fate. See our article noted above, as well as our article, *Retail Minus Pricing Panned by the UK Competition Appeal Tribunal*.[5]

For that reason, we don't analyse the test used to determine that there was a price squeeze, related issues such as bundling considerations, and the interface between the Commerce Act and the Telecommunications Act. (However, the Court's conclusions on the latter appear consistent with the Commission's own views in its paper on the same subject).

[4] *Competition Law and Telecoms: 2009 Developments in the EU, the US and Australasia* http://www.wigleylaw.com/Articles/LatestArticles/competition-law-and-telecoms-2009-developments-in-/

[5] *Retail Minus Pricing Panned by the UK Competition Appeal Tribunal.* http://www.wigleylaw.com/Articles/LatestArticles/retail-minus-pricing-panned-by-cat/

No evidence that Telecom carried out a compliance test at the time

It is difficult to draw clear conclusions from judgments on some issues. But one conclusion in this judgment does seem controversial. There was no evidence that an ECPR analysis (to check compliance) had been undertaken by Telecom (either by way of documents disclosed on discovery or by production of witnesses able to address the issue).

Prudent vertically-integrated operators will undertake tests to check compliance. The lack of such a test in the documents (either a produced document or disclosure of documents that existed but no longer exist) may be telling. Likewise as to lack of oral evidence from Telecom on the point. The Commission relied on authority that not calling available witnesses can allow the Court to draw conclusions. The Court concluded however that it could not draw conclusions adverse to Telecom.

As noted above, it is difficult to be definitive on this aspect of the judgment (as not all information is set out in the judgment). However it would not be too surprising, if and when there is an appeal, if this is an issue. The possible inference there was no test undertaken at the time may be telling.

Pecuniary penalties for breach

The judgment decided there was a breach: the question of pecuniary penalties is dealt with next.[6] The maximum pecuniary penalty is the greater of:[7]

- NZ$10M;
- 3 times Telecom's commercial gains from the breach; or
- if the commercial gains can't be determined, then 10% of the turnover of Telecom and its inter-connected companies.

Conclusion

In conclusion there are indications that New Zealand will in due course apply an approach to

[6] Subject to what happens with appeals if any

[7] Section 80 Commerce Act

margin squeeze similar to the EU rather than the US, as the jurisprudence following this High Court decision and the decision/s of the New Zealand Supreme Court (such as in the 0867 case) evolve.

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