**IN THE HIGH COURT OF NEW ZEALAND**
**AUCKLAND REGISTRY**

**CIV-2004-404-1333**

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| BETWEEN | THE COMMERCE COMMISSION<br>Plaintiff |
| AND | TELECOM CORPORATION OF NEW ZEALAND LIMITED<br>First Defendant |
| AND | TELECOM NEW ZEALAND LIMITED<br>Second Defendant |

Hearing: 7 and 8 December 2010

Counsel: JA Farmer QC, GM Coumbe and JS McHerron for Plaintiff
JE Hodder SC, PR Jagose and TE Smith for Defendants

Judgment: 19 April 2011

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**JUDGMENT OF RODNEY HANSEN J**

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*This judgment was delivered by me on 19 April 2011 at 9.30 a.m., pursuant to Rule 11.5 of the High Court Rules.*

*Registrar/Deputy Registrar*

*Date: ………………………….*

Solicitors: Commerce Commission, P O Box 2351, Wellington 6140 for Plaintiff
Chapman Tripp, P O Box 993, Wellington 6140 for Defendants

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## Introduction

[1] In its judgment of 9 October 2009, this Court held[1] that, from 18 March 2001 until late 2004, Telecom breached s 36 of the Commerce Act 1986 (the Act) by using and/or taking advantage of its dominant position/market power in wholesale and retail markets for data transmission for the purpose of deterring potential or existing competitors. The Court upheld the Commission's claim that some of the wholesale prices charged by Telecom for access to its network were so high, in relation to retail prices, as to cause a price squeeze. The Court concluded that the Commission was entitled to relief, both declaratory and pecuniary, and reserved the determination of a pecuniary penalty for a consideration at a further hearing.

[2] The Commission seeks an order, pursuant to s 80(1) of the Act, that Telecom pay a pecuniary penalty. It argues for a significant penalty to be imposed, having regard to the maximum penalty available, the duration and seriousness of the breaches and the commercial gains which resulted. A penalty in the range $20-25 million is suggested. Telecom submits that no penalty should be fixed, leaving the breach to be marked by declaratory orders and an order for costs. For Telecom, it is said that the very limited nature of the proven contravening conduct and the absence of evidence of material commercial gain or exclusionary effects tell against the imposition of a pecuniary penalty in this case.

## Approach to fixing penalty

[3] The approach to the determination of penalties under the Act is well established. The primary objective is deterrence.[2] The purpose of deterrence for breaches of the Act is explained in the following passages from the Select

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1 *Commerce Commission v Telecom* HC Auckland CIV-2004-404-1333, 9 October 2009 ["Liability judgment"] per Rodney Hansen J and Professor Martin Richardson.

2 *New Zealand Bus Ltd v Commerce Commission* [2007] NZCA 502, [2008] 3 NZLR 433 at [197]-[199]. See also *Commerce Commission v New Zealand Bus Ltd (No 2)* (2006) 3 NZCCLR 854 at [17].

Committee Report which commented on the proposed increase in the maximum pecuniary penalty provided by the Commerce Amendment Bill in 2001:[3]

> The dominant reason for penalties under competition law is the forward looking aim of promoting general deterrence. To promote deterrence, illegal conduct must be profitless, which means that the expected penalty should be linked to the expected illegal gain. The courts should severely penalise today's offender to discourage others from committing similar acts.

And:[4]

> The [Supplementary Order Paper] seeks to increase the maximum pecuniary penalty from $5 million to $10 million, while retaining the other options. As noted previously, the purpose of penalty and [remedial] provisions in competition law is to penalise today's offender with sufficient severity to discourage others from committing similar acts. The proposed changes are consistent with that approach. They will provide a much stronger signal than the current provisions that the deterrence objective will only be served if anti-competitive behaviour is profitless.

[4] As Miller J observed in *Commerce Commission v New Zealand Bus Ltd (No 2),*[5] the legislative history demonstrates that policymakers wanted to employ an orthodox economic approach to deterrence in the Commerce Act:

> ... It holds not only that effective deterrence requires that the wrongdoer's unlawful gains or intended gains be eliminated but also that a rational wrongdoer takes into account ex ante, when contemplating the wrong, the probability that it will be detected and penalised. This rational approach is appropriate because general deterrence is concerned with violations that have yet to occur, viewed from the perspective of those who may be contemplating them. It recognises that firms must have an incentive to comply where enforcement resources are limited and enforcement is costly.

In short, penalties imposed must be such as to amount to a real deterrent "and not merely some kind of acceptable licence fee".[6]

[5] Section 80(1) of the Act provides for the imposition of such pecuniary penalty as "the Court determines to be appropriate". The discretion is subject to the provisions of subss (2A) and (2B) which provide:

> (2A) In determining an appropriate penalty under this section, the Court must have regard to all relevant matters, in particular,—

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3 Commerce Amendment Bill 2001 (Select Committee report) at 3.
4 Ibid, at 23.
5 *New Zealand Bus Ltd (No 2),* above n 2, at [25].
6 *Commerce Commission v BP Oil New Zealand Ltd* [1992] 1 NZLR 377 (HC) at 383.

(a) any exemplary damages awarded under section 82A; and

(b) in the case of a body corporate, the nature and extent of any commercial gain.

(2B) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed,—

(a) in the case of an individual, $500,000; or

(b) in the case of a body corporate, the greater of—

(i) $10,000,000; or

(ii) either—

(A) if it can be readily ascertained and if the Court is satisfied that the contravention occurred in the course of producing a commercial gain, 3 times the value of any commercial gain resulting from the contravention; or

(B) if the commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

[6] The Court is required by subs (2A) to have regard to all relevant matters and, in the case of a body corporate, must give consideration to the nature and extent of any commercial gain. For the purpose of identifying and weighing relevant factors, it has been said that assistance may be derived from the approach to sentencing in the criminal jurisdiction.[7] The analogy is not inapt but should not be taken too far. While the approach to sentencing in the criminal jurisdiction may provide a helpful framework for assessing the gravity of the contravention and weighing factors specific to the contravener, the identification of relevant factors and the way in which they are measured and weighed must be informed by the distinctive character and consequences of anticompetitive conduct and the overriding objective of the pecuniary penalty regime.[8] Civil penalties are not to be confused with fines.[9]

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7 *Commerce Commission v Alstom Holdings SA* [2009] NZCCLR 22 (HC) at [14]. See also *Commerce Commission v New Zealand Bus (No 2),* above n 2, at [19].

8 *Commerce Commission v EGL Inc* HC Auckland CIV-2010-404-5474, 16 December 2010 at [14]. See also *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 (HC) at 446-447.

9 *Trade Practices Commission v CSR Ltd* [1990] FCA 521, (1991) 13 ATPR: 41-076 at [38]-[40].

[7] The factors relevant to an assessment of penalty will vary from case to case. Those which provide an appropriate framework for considering the contravening conduct in this case are:

(a) The nature and extent of the contraventions.

(b) The duration of the contravening conduct.

(c) The deliberateness of the conduct.

(d) Knowledge of senior management.

(e) The commercial gain derived.

(f) Loss or damage to others.

I will consider later factors specific to Telecom which are relevant to penalty.

**Nature and extent of contravention**

*Liability findings*

[8] Telecom's dominance in data transmission markets arose because in large areas of the country outside central business districts (CBDs) only Telecom has a local access network. In order to provide data services to retail customers, rival telecommunications service providers (TSPs) had to acquire the right to connect to potential customers through Telecom's network. That connection – between the customer's premises and the TSP's own network – is known as a data tail.[10]

[9] For the purpose of determining whether Telecom used its dominant position (which term encompasses use of market power), the Court applied the so-called counterfactual test. That requires an examination of whether Telecom acted in a way in which a hypothetical firm, not in a dominant position but otherwise similarly

[10] See Liability judgment, above n 1, at [41] and [42].

placed, would have acted.[11] Telecom would not have misused its dominant position if the prices it charged its competitors were no greater than the prices it would have charged in the hypothetical competitive market which constituted the counterfactual.[12]

[10] In a market in which network access is dominated by a single vertically integrated provider of network infrastructure and services, the eponymous Baumol-Willig Rule or, as it is referred to in the liability judgment, the Efficient Component Pricing Rule (ECPR), is the economic model used for the purpose of determining the price that would be charged in the hypothetical competitive market. ECPR was accepted as providing the appropriate model for the pricing of data tails in this case.[13]

[11] The Commission's evidence established that when a retail customer required connection to two sites and the competing TSP provided no access component itself (the so-called two-tail scenario), Telecom's prices to competitors for data tails consistently exceeded ECPR.[14] That, together with evidence that in many cases Telecom supplied two-tail circuits to TSPs at prices that exceeded its price to retail customers for the equivalent end-to-end circuits, supported an inference that Telecom used its dominance in breach of s 36 of the Act.[15]

[12] There are important differences between the Commission and Telecom as to precisely what is meant by these findings, the extent of the contravening conduct and the commercial gain likely to have ensued.

*Extent of violations*

[13] The first issue is whether violations are confined to two-tail circuits. The liability judgment, relying on Professor Gabel's evidence, proceeded on the basis

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11 *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) [*Telecom v* Clear] at 403; *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145 (PC) at [29] and [52].

12 Liability judgment, above n 1, at [43]; *Telecom v Clear,* and *Carter Holt Harvey,* above n 11, at [29] and [52].

13 Liability judgment, above n 1, at [45]–[47] and [128].

14 Ibid, at [124] and [132].

15 Ibid, at [132] and [151].

that ECPR violations occurred when Telecom provided both tails in a two-tail circuit. The Commission pointed out that Professor Gabel's unchallenged evidence was that the addition of further tails would not change this result, so that violations would occur in any situation where a TSP leased all the tails in a network from Telecom. Although there was no explicit finding to this effect, this is unquestionably what the evidence establishes. I see no reason not to proceed on that basis for the purpose of determining penalty.

[14] The second issue bearing on the extent of the breach is whether the evidence of ECPR violations extends to 64 kbps circuits. Telecom submitted that, contrary to the Court's finding in the liability judgment of a universal breach in the two-tail scenario,[16] Telecom's pricing for 64 kbps circuits satisfied ECPR. That is because the lower discount preferred by the Court (43 per cent versus 50 per cent used by Professor Gabel) when calculating retail prices by reference to Telecom's List of Charges (TLoC) resulted in ECPR compliant prices. On that basis, TSPs could purchase two 64 kbps and compete with Telecom's 64 kbps retail offering.

[15] That is correct as far as it goes. But Professor Gabel's evidence established that a price squeeze nevertheless resulted in the circumstances that arose after Telecom introduced its Streamline pricing in 1999. The price of the superior 128 kbps retail service available under Streamline was exceeded by the wholesale price of the slower 64 kbps service. TSPs could not have profitably sold the 64 kbps service at the same price as Telecom's faster 128 kbps service. While theoretically the pricing of the 64 kbps service was ECPR compliant, the practical consequence of Streamline pricing was otherwise.

[16] It follows that in all cases where a TSP could not self-provide a tail, the data tails offered by Telecom breached ECPR. It did not offer any viable data tails at a price that did not exceed its end-to-end retail price for an equivalent or superior service. This affected all TSPs who did not have their own network.[17] It is, however, unclear on the evidence adduced at the liability hearing how TelstraClear was affected. There was no evidence of the number of circuits self-provided by

16 Ibid, at [124].
17 Ibid, at [132].

TelstraClear,[18] although the indications are that over the period TelstraClear would have self-provided at least one tail in most of the circuits in which it leased tails from Telecom.[19] There was no evidence of either the number and distribution or geographical location of the two-tail circuits of other TSPs.

[17] Telecom submitted that, as the onus of establishing the facts upon which penalty fundamentally rests, together with any matters in aggravation, lies upon the Commission,[20] it should have adduced evidence of the magnitude and distribution of ECPR contraventions. Telecom contended that an inference should be drawn against the Commission that such evidence would not have assisted it or, indeed, would have been unhelpful.[21]

[18] The absence of evidence of the number and distribution of two-tail circuits, self-evidently precludes an informed assessment of the full implications of the breach. It led the Commission to focus on the exclusionary effects of the breach. Mr Farmer submitted that evidence of the actual number of tails leased in violation of ECPR has limited relevance; what is important is the fact that Telecom's two-tailed data tail offerings all breached ECPR. He said the damage to the competitive process is to be measured not so much by the tails provided by Telecom (despite prices that were in breach of ECPR), as by the tails that were not provided because they were too expensive. These effects will be explored in greater depth when I discuss Telecom's likely commercial gains and the loss or damage to others arising from the breach.

**Duration**

[19] Professor Gabel's evidence showed ECPR violations dating from 1999. However, the Commission accepted that s 80(5) of the Act operates to preclude a penalty in respect of conduct before 18 March 2001. The contravening conduct continued until Telecom introduced Unbundled Partial Circuit (UPC) pricing in July 2004 when Telecom entered into an agreement with TelstraClear to provide UPCs.

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18 Ibid, at [100].
19 Ibid, at [104].
20 *Commerce Commission v Taylor Preston Ltd* [1998] 3 NZLR 498 (HC) at 510-511.
21 *Ithaca (Custodians) Ltd v Perry Corp* [2004] 1 NZLR 731 (CA).

## Deliberateness of conduct

[20] Mr Hodder described the breach as an "inadvertent mistake" – inadvertent because Telecom's objective of providing an end-to-end service to other TSPs at a price below its retail price failed only when, unknown to it, a TSP did not self-provide a tail. In the vast majority of cases pricing was ECPR-compliant. Indeed, it was submitted that if the wholesale market was viewed as a whole, unlawful gains arising from breaches of ECPR were outweighed by lawful gains that would have been made in the hypothetical competitive market that constitutes the counterfactual. The breach of s 36 arose because prices in the market were not, to use Mr Hodder's term, "de-averaged", to reflect the way in which data tails were used by TSPs.[22]

[21] ECPR violations were, however, an inevitable result of Telecom's strategy of pricing data tails as an end-to-end service for resale rather than as an essential wholesale input. There was evidence that it deliberately set out to price at a level that precluded TSPs competing on price alone in the retail market for data services.[23] Telecom maintained at the liability hearing that it was entitled to price on the basis that it was not providing an essential component but a data circuit. The Court held that could not be the case in areas where it was uneconomic for a rival to establish its own network.[24] The way in which Telecom introduced its pricing packages in 2000 and the statements of those responsible for their introduction were consistent with a strategy on the part of Telecom to deny rival TSPs access to data tails at prices that would permit them to utilise and develop their own networks for the purpose of data transmission.

## Knowledge of senior management

[22] Telecom's strategy was understood and approved at the highest levels of management. Mr Bruce Parkes, who headed Telecom's Industry Services Unit, which was responsible for the development and sale of commercial products to other

[22] Liability judgment, above n 1, at [130].
[23] Ibid, at [145].
[24] Ibid, at [151].

service providers, said in a memorandum to Ms Teresa Gattung, the then Chief Executive Officer of Telecom:

> Our negotiations to date with carriers have been to treat them exactly like other large corporate customers ...
>
> ... carriers such as Telstra are obviously competitors in the retail market for any services but for data they are actually primarily resellers of our retail data services ... and as such are growing the market for our benefit and theirs.

Mr Stuart Goodin, Telecom's Strategy and Pricing Manager, worked under Mr Parkes in developing CDPs. He acknowledged in evidence that Mr Parkes' philosophy was that there would not be price competition between Telecom and other TSPs, only competition on service quality.[25]

## Commercial gain

[23] The wholesale and retail markets affected by the breach each provided a potential source of commercial gain for Telecom. The Commission's position is that both generated benefits, very likely to be significant but inherently speculative and/or unquantifiable.

[24] Telecom argued that, whatever the assumed consequences of the breach, they did not result in any or any significant commercial gain. Telecom's position is that the only available source of commercial gain was the wholesale market and any profit derived from sales at or in excess of ECPR were outweighed by additional revenue that would be generated from higher prices for other circuits in the counterfactual.

### *Gains from wholesale revenue*

[25] The commercial gain derived by Telecom from selling two-tail circuits to TSPs at prices in excess of ECPR could not be quantified on the basis of the evidence given at trial. As already noted, the evidence did not permit findings to be

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25 Ibid, at [145].

made on the magnitude and distribution of the violations. Telecom, nevertheless, sought to analyse gains derived from non-compliant sales over the period, relying on evidence of revenue filed in accordance with leave granted to file "uncontroversial relevant" evidence supported by detailed submissions drawing on, among other things, the evidence of economists given at trial. In summary, Telecom's position is:

(a) Telecom's wholesale revenue for the penalty period attributable to services potentially affected by the liability judgment totalled $41.0 million, of which $36.5 million was attributable to TelstraClear.

(b) After excluding circuits outside major CBD areas, circuits for resale and one-tail or multi-tail circuits, it can be assumed that no more than one-third, and likely less than 10 per cent, of revenue can be attributed to circuits sold for use in the two-tail scenario, that is, no more than $13.67 million and likely less than $4.1 million in revenues were affected by breaches of ECPR.

(c) There was no commercial gain as a result of non-compliant pricing because, in the counterfactual, a non-dominant firm in Telecom's position would not rationally have priced circuits used in conjunction with self-provisioned access (the one-tail circuit) at a price less than ECPR. The price of such circuits would be higher in the counterfactual than in the actual and would have led to greater revenue in the counterfactual than in the factual. The additional revenue generated by the higher price of such circuits in the counterfactual would exceed the reduction in revenue resulting from ECPR compliant prices for two-tail circuits in the counterfactual.

(d) Even if the higher revenues from the one-tail circuits in the counterfactual are excluded, Telecom's gain would at most be approximately $1.1 million.

[26] This summary does scant justice to the submission of bewildering complexity which supported it. The submission rests on assumptions (many disputed by the

Commission) and economic theory and modelling which Mr Farmer submitted, rightly in my view, should have been the subject of expert economic evidence. Without expert assistance, I am not competent to resolve the plethora of issues which must be determined in order to quantify gains from non-compliant sales.

[27] In the circumstances, I consider that the fair and sensible way to proceed is to assume in Telecom's favour that it derived no or no significant commercial gains from the wholesale revenue generated by non-compliant sales. The onus on the Commission to prove otherwise has not been discharged. In any event, it is not a matter on which the Commission places great reliance for the purpose of penalty. As earlier noted, it is the exclusionary gains rather than wholesale revenue that the Commission contends are important. It was submitted that the issue is not so much the two-tail data tails that *were* leased by TSPs, but the two-tail data tails that *were not* leased because of the price squeeze.

*Gains from retail sales*

[28] The Commission says that Telecom's commercial gain includes the revenue from additional retail sales it achieved because of the price squeeze. This follows from such exclusionary effects as:

- Deterring efficient entry into the market; [26]
- Driving new entrants out of the market;
- Foreclosing competitors from bidding for new business where all data tails in the client network needed to be purchased from Telecom;
- Discouraging competitors from utilising and developing their own networks for the purposes of data transmission, and instead limiting their competitive activities to re-selling Telecom's end-to-end data services.

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26 Assumed where there is a breach of ECPR and acknowledged in the liability judgment: ibid, at [133].

The gains are said by the Commission to be inherently unquantifiable but their assumed effects support a severe penalty.

[29] The Commission identified three specific consequences of these exclusionary effects resulting in commercial gain to Telecom:

(a) Higher retail prices.

(b) The opportunity to cross-sell other telecommunications business.

(c) The benefits consequent on a slower roll-out of rival networks.

*Higher retail prices*

[30] Telecom accepts that orthodox economic principle, as recognised by the Privy Council[27] is that in ordinary circumstances a refusal to supply an input at ECPR-compliant prices could be expected to lead to higher retail prices. This is because ECPR prices, leading to competition in the contested area, will drive out any inefficiencies in the incumbent's costs and lead to monopoly profits being competed out. However, Telecom submitted that the conduct in this case is characterised by two factors which mean that neither competitive effect could be expected to occur. Those factors are:

(a) Telecom's avoided backbone costs were less than the additional incremental costs of interconnection; and

(b) Telecom in fact supplied alternative inputs at ECPR-compliant pricing which allowed competing out of any monopoly profits.

On this basis, Telecom says the evidence shows that no retail price reductions could have been expected even if two-tail circuits had been priced in accordance with ECPR.

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27 *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at [396]-[397].

[31] In the two-tail scenario, two areas of competition theoretically arise: the supply of backbone network services and the retailing of the end-to-end product. Telecom submitted that, in practice, the only contested area was the retailing of the end-to-end product. That is because it was unlikely that TSPs could supply a backbone more cheaply than Telecom and, unlike Telecom, they had to meet the cost of interconnection. In the retailing area it was submitted that throughout the period there was effective competition because Telecom made circuits available at ECPR-compliant prices. Further, throughout the period Telecom is said to have faced competition from TSPs, in particular TelstraClear, which self-provided at least one tail using data tails provided at prices below ECPR.

[32] The evidence of the experts on both sides appears to support the proposition that an entrant could not compete with Telecom for backbone services because the ECPR price of interconnection would exceed Telecom's network costs. However, the evidence does not show that there was effective competition in the retail area.

[33] The evidence at trial was that resale did not act as a constraint. TSPs were not interested in simply reselling Telecom's end-to-end services and rarely did so. Senior TelstraClear managers who gave evidence were adamant that TelstraClear did not wish to be a "mere reseller" of Telecom's end-to-end retail services. That course would have taken data traffic from their own core network and devalued their substantial capital investment. TelstraClear was also concerned that it would be unable to differentiate its services from those of Telecom and would lose control of the ability to provide customers with a choice of price and service.

[34] The contention that competition from TelstraClear in other areas of the market was effective to constrain retail prices in the two-tail scenario was not supported by economic evidence. Without such evidence, I would not be prepared to find that competition in one area of the market would negate the effect of ECPR violations in another area. Further, I see merit in the Commission's argument, which finds support in the evidence given at the liability hearing, that the ECPR violations may have had the effect of raising TelstraClear's costs by compelling it to build its own infrastructure in cases where it may have been more efficient for it to rent data tails from Telecom at ECPR prices.

[35] Telecom contended that its position was corroborated by the absence of any evidence that Telecom extracted monopoly rents during the period. Mr Hodder pointed to the fact that Streamline pricing continued to be applied throughout the penalty period, notwithstanding the competitive pressures emanating from rivals. He also relied on the absence of evidence of price discrimination between competitive (major CBD) and non-competitive (non-major CBD) areas or between customers that could be serviced by TelstraClear self-provisioning at least one tail and those that could not. This was said to suggest that retail prices charged by Telecom were not higher than a competitive level.

[36] Nothing can be taken from the fact that Streamline prices stood unchanged for over four years. It is equally arguable that this indicated a lack of price competition. The Commission disputed the argument that the absence of price discrimination indicated competitive pricing levels. That is another argument which could not be resolved without the benefit of expert economic assistance.

[37] Telecom's arguments have not displaced the expectation that the breaches led to higher retail prices.

*Cross-selling of other products*

[38] The second exclusionary effect relied on by the Commission is that Telecom gained the opportunity of cross-selling other telecommunications business to customers (for example, package services such as internet/voice) as well as data transmission. Telecom submitted that this is contrary to the Court's finding[28] that when an incumbent loses a data service customer it does not lose the ability to offer other components of a bundle of services such as voice or internet and that while there may be some additional profit in supplying services as a bundle, it is doubtful that it is significant.

[39] These observations were made in the context of the Court's finding that the bundling of services was irrelevant to the calculation of ECPR prices for data tails.

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28 Liability judgment, above n 1, at [70]-[71].

It is not inconsistent with the proposition that the breach interfered with the ability of TSPs to enter into business relationships. A TSP which was unable to offer a data tail would have been prejudiced in its ability to compete for the supply of other telecommunication services.

*Slower rollout of other networks*

[40] The third exclusionary effect contended for by the Commission is that Telecom benefitted from a slower roll-out of rival networks. As submitted by Telecom, this effect does not logically flow from the exclusionary conduct identified. An access-seeker able to self-provide at least one tail would still be incentivised by the ECPR violations to roll-out its own network in order to avoid two-tail pricing. However, in areas where there was a lower level of demand, it may be surmised that the price squeeze would cause TSPs to retract their level of operation.

**Loss or damage to others**

[41] In discussing whether the ECPR violations involved the use by Telecom of its dominant position, the Court commented as follows on the exclusionary effects: [29]

> Pricing at above ECPR will have had the effect of discouraging efficient competition for backbone services and in the retail data services market. Rivals would have higher costs than Telecom. Potential entrants would be discouraged or would enter on a smaller scale. These outcomes can be expected, though on a reduced scale, when violations are confined to the supply of two-tail circuits.

[42] The anecdotal evidence supported this finding. Following the introduction of Streamline and its associated Carrier Data Pricing (CDP), TelstraClear would not normally bid on a customer network unless it could self-provide at least one tail. This would have excluded TelstraClear from networks operating outside CBDs. There was anecdotal evidence referred to of a company being forced out of business by Telecom's pricing policies and claims that TelstraClear lost substantial sums as a result of Telecom's pricing strategy. Other TSPs were able to remain in the market

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29 Ibid, at [133].

only by introducing value-added products and other services and selling products that subsidised their losses on data services.[30]

[43] The Court acknowledged[31] that a multitude of factors are likely to have contributed to these outcomes. They are, however, consequences of a kind that economic theory would predict when wholesale prices exceed ECPR and, in some cases, the retail prices charged by Telecom.

## Penalty

*Maximum penalty*

[44] By s 80(2B) where the defendant's commercial gain can be "readily ascertained" and the Court is satisfied that the contravention occurred in the course of producing a commercial gain, the maximum penalty is the greater of $10 million or three times the value of the commercial gain resulting from the contravention.

[45] I accept the Commission's submission that a defendant's commercial gain cannot be "readily ascertained" in terms of subpara (2B)(b)(ii) unless it can be quantified in a timely, efficient and relatively straightforward manner and with reasonable precision and specificity. This accords with the context and purpose of s 8.

[46] It is clear from the foregoing discussion that Telecom's commercial gain cannot be readily ascertained. Accordingly, the maximum penalty is the greater of either $10 million or 10 per cent of turnover. Turnover is defined in s 2 as:

> [T]he total gross revenues (exclusive of any tax required to be collected) received or receivable by a body corporate in an accounting period as a result of trading by that body corporate within New Zealand.

"[A]ccounting period" is defined as having "the same meaning as in s 2(1) of the Financial Reporting Act 1993", that is, "a year ending on a balance day of the [body

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30 Ibid, at [134].
31 Ibid, at [135].

corporate].”

[47] Telecom’s annual report for the most recent accounting period establishes its group annual turnover as $2.792 billion. The maximum penalty is, accordingly, $279.2 million.

*Assessment*

[48] In submitting that no penalty should be imposed or no more than a modest sum based on assumed commercial gain of $1.1 million, Mr Hodder characterised the breach as “limited and minor” in its effects and arising from inadvertent error.

[49] Absent evidence of the magnitude and distribution of two-tail circuits, it must be inferred that non-compliant sales were a small proportion of Telecom’s data transmission business. But the price squeeze inevitably led to the exclusionary effects identified which, though unquantifiable, cannot be dismissed as limited and minor. They were injurious to competitors, brought significant benefits to Telecom and were damaging to the competitive process.

[50] The breach was the result of a deliberate strategy, apparently sanctioned at the highest levels of Telecom, to price data tails at a level that would preclude price competition between Telecom and other TSPs. As a result, a TSP acquiring two data tails was required to pay Telecom more than Telecom’s retail price for the end-to-end service. The strategy derived from Telecom’s view that in the area of data transmission it was not providing an essential input but a data circuit and was entitled to price accordingly. That view may have been genuinely held. It may have caused Telecom to believe that it was not in breach of the Act. It may be, as Mr Hodder said, that the ECPR issues involved were difficult and took Telecom into ”uncharted waters”. But there was no evidence that Telecom had carried out an ECPR analysis or sought advice on the issue. It is not tenable to contend, in the circumstances, that the contravention was the result of inadvertent error. The dominant firm is expected to keep a weather eye out for shoals and to take evasive action.

[51] It has been said that determining the quantum of penalty is not an exact science.[32] That is especially so in present circumstances. There is no quantification of the commercial gain which may sometimes provide a pointer to the penalty required to meet the goal of deterrence.[33] There is only limited assistance to be gained from previous authorities. Many of the Australasian cases to which I was referred relate to contraventions which preceded the significant increases in maximum penalties of the last ten years.[34] Most involved the approval of agreed penalties. None of them involved contraventions arising in closely comparable circumstances.

[52] Closest on its facts because it involved denial of access to interconnection by a dominant telecommunications provider is *Australian Competition and Commerce Commission v Telstra Corp Ltd*[35] where penalties totalling $A18,550,000 were imposed after deducting 30 per cent for mitigating factors. Telstra admitted that over a period of two years it denied access-seekers interconnection to exchange facilities in various locations. Telstra also admitted to engaging in misleading or deceptive conduct. Although the contraventions were breaches of both the Trade Practices Act 1974 and the Telecommunications Act 1997, it was accepted that the assessment of pecuniary penalties should be informed by the approach of the courts in considering penalties under the Trade Practices Act. Penalties of between $A750,000 and $A1 million were imposed in respect of each contravention.

[53] Any commercial gain to Telstra appears to have been unquantifiable, as the subject was not discussed. Similarly, there was insufficient evidence to permit the Court to conclude that loss or damage was sustained by any access seekers. The Court relied on the prima facie case that contraventions did lead to some harm to consumers and end users.[36]

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32 *Trade Practices Commission v TNT Australia Pty Ltd* [1995] FCA 1046 [1995] ATPR 41-375 at [6]. See also *NW Frozen Foods Pty Ltd v Australian Competition and Consumer Commission* (1996) 71 FCR 285 at 291; *Australian Competition and Consumer Commission v April International Marketing Services Australia Pty Ltd (No 5)* (2010) FCA 17 at 43.

33 As in *Commerce Commission v New Zealand Bus Ltd (No 2)*, above n 2.

34 In 2001 in New Zealand – Commerce Amendment Act 2001. In 2006 in Australia – s 76 Trade Practices Act 1974.

35 *Australian Competition and Consumer Commission v Telstra Corp Ltd* [2010] FCA 790.

36 Ibid, at 187.

[54] Another recent Australian case in a broadly similar category is *Australian Competition and Consumer Commission v Cabcharge Australia Ltd*[37] where penalties totalling $A14 million were imposed for contraventions of s 46 of the Trade Practices Act (the equivalent of s 36 of the Commerce Act). The Court approved agreed penalties of $A9 million and $A2 million for refusals to deal and $A3 million for predatory pricing. The total penalty was said to be the largest total penalty imposed for contraventions of s 46 of the Act, partly reflecting the new penalty regime and partly the seriousness of the contraventions. Among the relevant considerations were the period of time over which the contraventions occurred (three years); the fact that Cabcharge is a prosperous public listed company (assets of $A419 million) with substantial market power; the fact that the conduct was deliberate, although Cabcharge was not conscious that it was in breach of the Act; and that its most senior employees and management participated in the contravening conduct.

[55] In mitigation, the Court referred to the absence of previous contraventions and the discount for cooperating with the Australian Competition and Consumer Commission (ACCC). It also worked in Cabcharge's favour that no parties had exited the market as a result of the predatory pricing: "Although there were three competitors which were affected there are no bodies".[38]

[56] While I have accepted that Telecom's conduct was sustained, deliberate and injurious, I consider it important to recognise in fixing the penalty that its pricing regime was shown for the most part to be ECPR-compliant. The violations directly affected only a small proportion of its data transmission business. Although countenanced at a high level, the breach was not flagrant or wilful. Nor did it involve the covert or collusive behaviour which is a serious aggravating factor. That said, Telecom cannot rely on the uncharted waters of ECPR pricing. No weight can be given to the complexity and uncertainty of the law. The comments of the Full Court of the Federal Court in *Universal Music Australia Pty Ltd*[39] are on point:

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37 *Australian Competition and Consumer Commission v Cabcharge Australia Ltd* [2010] FCA 1261.

38 Ibid, at [58].

39 *Universal Music Australia Pty Ltd v Australian Competition and Consumer Commission* [2003] FCAFC 193, (2003) 131 FCR 529 at [308] and [310].

> As we have said, the contravening conduct was plainly and deliberately anti-competitive in its intent. It was conduct which, at least, ran a serious risk of being in breach of the Act. If this was appreciated, then the fact that the risk came home against expectations does not entitle the perpetrator to a discount. If the existence of the risk was not appreciated, then the company concerned misunderstood the law applicable to an important area of commerce and would not be entitled to any discount.
>
> ...
>
> In our opinion, to give a substantial discount for these factors sends the wrong signal to the commercial community. It will encourage risk-taking and pushing the boundaries of anti-competitive conduct. If, nonetheless, a proceeding is instituted, it will encourage the most vigorous possible defence, in an endeavour to demonstrate the supposed complexity and uncertainty of the law. Many cases of contravening conduct can be described as complex and uncertain as a result. ...

[57] The penalty should reflect the size and financial circumstances of Telecom and its position of influence and importance in the telecommunications industry.[40] The goal of specific deterrence requires that the penalty take account of the size and resources of the contravening company.[41]

[58] I understood the Commerce Commission to argue that the absence of evidence of a corporate culture conducive to compliance with competition law should be taken into account. Evidence that such a culture existed may well be a mitigating factor[42] but its absence is not an aggravating factor. The Commission also urged me to have regard to the breach of s 36 which was found to have occurred when Telecom refused interconnection soon after Clear Communications Ltd began to offer competitive telecommunication services.[43] I am disinclined to place great weight on this historical contravention. The telecommunications market had only just been opened for competition when it occurred. The High Court observed that Telecom's ground was still being developed and some of its reactions were almost instinctive.[44] Telecom's previous experience of ECPR is, however, a further reason

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40 Regarded as a "very significant factor" in *Telstra*, above n 35, at [210].

41 *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* (2001) 10 TCLR 247 (CA) at [94].

42 See, for example, *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* [2010] FCA 929 at [47] and [50].

43 *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1992) 5 TCLR 166 (HC), upheld on appeal, affirmed in *Telecom v Clear,* above n 11, at 400, 402, and 409-410.

44 *Clear Communications Ltd v Telecom Corp of New Zealand Ltd* (1993) 5 TCLR 413 (CA) at 423.

why it cannot rely on uncertainties about the application of the law to the pricing of data tails.

[59] After weighing all relevant matters, I have decided that a penalty of $12 million is warranted. This will be the highest penalty imposed in New Zealand to date for a breach of the Commerce Act. Comparisons with previous penalties do not, however, afford any real insight into the relative seriousness of the contravention. In recent years most penalties have been negotiated under the Commerce Commission's Leniency Policy[45] and, of course, earlier penalties reflected the much lower maximum penalties that applied before 2001. In contrast, the penalty in this case can make no allowance for an acknowledgement of wrongdoing or the advantages of a negotiated settlement and must, perforce, give full effect to the new penalty regime and the overriding goal of deterrence.

**Result**

[60] I order, pursuant to s 80 of the Act, that Telecom pay a pecuniary penalty in the sum of $12 million in respect of its contravention of s 36 of the Act. Costs are reserved.

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45 Alix Boberg "Fixing the Price at Liberty: The Case for Imprisoning Price-Fixers in New Zealand" (2010) 16 Auckland U L Rev 81 at 87.