THE BATHTUB PRINCIPLE: IS OUR COMMERCE ACT IN HOT WATER?

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In 1776 Adam Smith wrote "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[1] The selfish desire of the producer to maximise profits will drive competition and benefit the consumer. It is when separate producers combine that they can distort market forces at the expense of consumers. Sections 27-29 of the Commerce Act 1986 reflect this 230 year old concept by preventing agreements that can lessen competition. However, the free market is not distorted by agreements within groups of "interconnected"[2] companies because parents and subsidiaries share the interest of maximising the wealth of their common shareholders. This means that although they are separate companies in a legal sense they should be viewed as a single economic unit for antitrust purposes. The repealed section 44(1)(b) of the Commerce Act[3] was an exception to the rule that anticompetitive arrangements are illegal. This exception applied to such contracts, arrangements, understandings or covenants where the only parties are interconnected bodies. The courts are likely to interpret the repeal of section 44(1)(b) as a sign Parliament wants to treat anticompetitive agreements between interconnected companies the same as similar agreements between separate companies. This would be adopting the old 'bathtub' principle; to do so would not take into account the decisions reached overseas and would be inconsistent with the purpose of sections 27-29.

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[1] A. Smith. *An Inquiry into the Nature and Causes of the Wealth of Nations, (a selected edition)* (Oxford University Press, 1993), p. 22.

[2] Any two bodies corporate will be treated as interconnected under section 2(7) of the Commerce Act 1986 if "one of them is a body corporate of which the other is a subsidiary" (section 2(7)(a)), or "both of them are subsidiaries" section 2(7)(b)).

[3] Repealed on 26 May 2001 by section 10(1) of the Commerce Amendment Act 2001 (2001 No 32).

The section 44(1)(b) exception recognised that groups of interconnected companies operate as one economic identity and any arrangement entered into between them could not substantially lessen competition.[4] A wider interpretation would mean any agreement between these bodies, even if it was made purely to harm a third party would not illegal under the Commerce Act. This interpretation appears to be at odds with the purpose of the Act, to encourage competition, and may explain why the section was repealed in May 2001. However, as will be shown, anticompetitive agreements between interconnected bodies would be better served through section 36 action rather than sections 27-29.

Section 44(1)(b) could have been applied in *Direct Holdings Ltd v Feltex Furnishings of NZ Ltd and Smith & Brown Ltd*[5]. In that case, Direct Holdings alleged that Feltex, a furniture manufacturer, refused to supply them with bedding because of an anticompetitive agreement with interconnected body Smith & Brown, a furniture distributor. Direct Holdings gained an interim injunction against Feltex under section 27 and 29 of the Commerce Act 1986, but, strangely, section 44(1)(b) was never raised in argument. Accordingly, the courts have no direct authority on the matter should it arise again.

The 'bathtub' principle that existed in the U.S, meant that two bodies that were not managed independently can be found to have breached anti-trust laws by entering into an agreement with the other. In *Copperweld Corp. v Independence Tube Corp.*[6], Burger CJ overturned the bathtub principle when he held a parent company and its subsidiary are not capable of reaching an anticompetitive agreement in breach of section 1 of the Sherman Act. In that case, Copperweld Corporation purchased Regal Tube Co from Lear Siegler, Inc, the sale and purchase agreement included a non-competition order. Shortly before Regal Tube Co was transferred to Copperweld, an officer of Regal took a position in Lear Siegler, and set up Independence Tube Mills to compete directly with Regal. Copperweld then petitioned those in the industry not to do business with the new company. Independence Tube

[4] Y van Roy, *Guidebook to New Zealand Competition Laws* (Commerce Clearing House (New Zealand), 1987), p. 25.
[5] (1986) 1 NZBLC 102,614.
[6] 467 U.S. 752, p. 769 (1984).

Mills then brought civil action against Copperweld, alleging that Copperweld had entered into an anticompetitive conspiracy with Regal Tube Co.

Burger CJ reached the conclusion that the bathtub principle or 'intra-enterprise conspiracy doctrine' was erroneously founded on a principle that competing bodies could not avoid breaching the Sherman Act by merging into one company[7]. If they did, any subsequent arrangement between the two bodies could be illegal. A misinterpretation of this concept has led to courts finding that any anticompetitive agreements within interconnected companies are illegal. Thus, the bathtub principle could not apply in this case because the Copperweld group was not founded on a breach of the Sherman Act. Moreover, the arrangement in question should not attract liability because it is expected that the subsidiary will act for the benefit of the parent. "If a parent and a wholly owned subsidiary do 'agree' to a course of action, there is no sudden joining of economic resources that had previously served different interests, and there is no justification for § 1 scrutiny."[8]

The Copperweld decision remains authoritative in The United States and has since been extended to include partly owned subsidiaries in *Louisiana Power and Light Co. v. United Gas Pipe Line Co. and Pennzoil Co.,*[9] but could not protect conspiracies between teams in the complex structure of major league soccer in *Fraser v. Major League Soccer.*[10] The Copperweld decision was also applied in obiter in *Queensland Wire Industries Pty Ltd v. Broken Hill Pty Ltd*[11] where it was authority for deciding that any supply agreement between BHP and its subsidiary was irrelevant to the Trade Practices Act 1974. In that case, the plaintiff was successful under section 46 of the Trade Practices Act 1974, the equivalent of our section 36. Europe has taken the same approach, in *Viho v Commission*[12] the European Court of Justice held that because the Parker Pen Group held 100% of the shares in its subsidiaries it was entitled to divide national markets up between them. However, in

[7] *United States v. Yellow Cab Co*., 332 U.S. 218, p. 67 (1947).
[8] *Copperweld Corp. v. Independence Tube Corp.,* 467 US 752 (1984), p. 770.
[9] 479 So.2d 1149 (La.), (1986).
[10] L.L.C. 284 F.3d 47 C.A.1 (Mass.), (2002).
[11] 167 CLR, p. 177.
[12] [1995] 4 CMLR 229.

Gosme/Martell-DMPO OJ[13] the same reasoning could not apply, because the parent, who only held half the voting rights over the subsidiary, could not exercise independent control. This finding is consistent with the original *Copperweld* decision, and the meaning of "interconnected" bodies under section 7 of the Commerce Act. Thus, only when independent control can be exercised over a subsidiary, an otherwise anticompetitive agreement will not be combining separate economic interests.

Section 1 of the Sherman Act provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." The difference between this and our own section 27 of the Commerce Act 1986 is that ours contains the provision: "that has the purpose, or has or is likely to have the effect." As such, it does not need to be an agreement in restraint of trade, merely to have that effect is enough. Notwithstanding that, section 29(1A) provides a defence for exclusionary conduct, our collusive agreement provision is essentially the same as the provision that exists in the U.S.

It is our economic environment where the differences lie. The sudden deregulation of government departments in the 1980s lead to privately owned natural monopolies in telecommunications, power, post and rail sectors. With such a large amount of market power laying in the hands of relatively few companies the misuse of market power could easily restrain anyone trying to compete. Even if these monopolies were split into a group of two or more companies it would be too easy for the resulting interconnected body to combine to unfairly suppress their competition. This does not mean section 27 should be used to control these powerful interconnected groups. *Queensland Wire Industries* shows that the Australian equivalent of our section 36 places sufficient restraints on the use of a group's market power for anticompetitive means. Moreover, since section 36(4) treats interconnected bodies as a single economic unity for assessing market power it would be unfair to treat interconnected bodies as separate identities for the purposes of sections 27-29. This will mean they will have the disadvantage of being treated as having the combined market power of the group for

[13] [1991] L 185/23.

assessing whether an individual subsidiary has misused their market power under section 36, whilst being treated as independent bodies for assessing whether they have reached an anticompetitive agreement under sections 27-29.

To punish anticompetitive agreements between interconnected companies would prevent them from working in unison to shut out a competitor but it will also force them to act independently on more innocent matters. Almost every instruction that a parent company makes to their subsidiary will take the form of a contract, arrangement or understanding, and, even if the subsidiary had no choice in the decision, will be illegal under sections 27-29. In such a situation, the requirement of substantially lessening competition would not be a high enough threshold. As recognised in *Queensland Wire Industries* substantially lessening competition is a common goal amongst many businesses and should only be illegal if separate entities combine for that purpose.

Agreements between companies are targeted in the Commerce Act because it removes the natural competitiveness of the free market. In any such agreement, two or more entities that previously pursued their own interests are combining to act as one for their common benefit. This reduces the diverse directions in which economic power was previously aimed and suddenly increases the economic power moving in one particular direction. When two interconnected bodies reach an agreement, the result is entirely different. It is in the individual interests of each body to pursue the interests of their common shareholders. Thus, there is no other side to assist, and any agreement that they reach would not be a parting, or a compromise in any form, from their interests as an individual company.

Any rule that punished cooperation between interconnected bodies would make companies less likely to divide their structure and deprive the market of any efficiencies that decentralised management may bring. The intention of the Act is to encourage competition but efficiency should not be needlessly targeted, when competition remains unaffected.

Parliament has shown a desire to punish attempts at restricting competition through using the words "for the purpose of" in section

36 and "has the purpose" in section 27(4). Accordingly, it may be argued that it does not matter that agreements between interconnected bodies do not effect competition as an anticompetitive purpose alone may be harmful. However, as a group of interconnected companies should be viewed as a single economic unit, an anticompetitive attempt within such a unit is no more harmful than an anticompetitive attempt by a single company of the same size. The law for these two business structures should be identical. Thus, an anticompetitive attempt within such a group should only be punished if the group satisfies the criteria of section 36.

With no clear answer from the Commerce Act and no binding authority on the matter, the law relating to agreements between interconnected bodies remains uncertain. Although judges are often reluctant to place too much emphasis on economic evidence, such reasoning is necessary on this point to bring true meaning to sections 27-29. An economist will be able to show the court that the object of sections 27-29 is to prevent distortion of the free market. An economist will also be able to show that agreements between interconnected bodies that can be independently controlled by a parent will not distort the free market because the group share common intentions. This is why overseas courts, notably the *Copperweld* decision, have not applied similar sections to agreements between interconnected bodies. Finally, the sections 27-29 should only be interpreted by looking to surrounding sections. To view interconnected bodies as separate companies under sections 27-29 would be inconsistent with section 36(4), which views them as a single economic unit. It is for these reasons that our Commerce Act should reinstate section 44(1)(b); to exclude agreements between interconnected bodies from scrutiny under sections 27-29.