

## BUNDLING: AN OVERVIEW OF NEW ZEALAND AND AUSTRALIAN TRADE PRACTICES LAWS

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### I INTRODUCTION

This article considers what happens, under New Zealand and Australian trade practices laws, when distinct products or services are sold together, or are “bundled” or bundled discounts are offered.

'Bundling' occurs either where:

- two products or services are sold in a fixed proportion and are not available for purchase as stand-alone products or services (this is known as a “pure bundle”): or
- the products or services are sold on a stand alone basis as well as a bundle (this is known as “mixed bundling”).<sup>1</sup>

In other words, the products or services could be packaged together or the products could be physically integrated.

In today's economy, bundling is widespread: resorts provide vacation packages that include transportation and meals; fast food outlets offer “meal deals” that include more than one product and the bundling of financial services has become one of the most commonly used and effective means for banks to acquire new deposits, sell a wider range of financial products to customers and build new business.

There is currently no clear test for determining when bundling will breach either New Zealand or Australian trade practices laws. Bundling practices can be pro-competitive. Whether a firm has acted in breach of the New Zealand Commerce Act 1986 or the Australian Trade Practices Act 1974 by offering bundled packages, will depend on the purpose and likely effect of its bundling strategies.

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<sup>1</sup> SG Corones *Competition Law in Australia* 4<sup>th</sup> edn Thomson Lawbook Co 2007 at p 443

For example, if a firm has market power in relation to one or more products or services in the bundle, then bundling may be practised for the purpose of leveraging market power and as such, will likely to cause issues under both Acts.

## II RELEVANT LEGISLATIVE PROVISIONS

### *A Anti-competitive contracts, arrangements or understandings*

In New Zealand and Australia, trade practices laws prohibit the inclusion of a term in a contract, arrangement or understanding that has an anti-competitive effect.

The relevant New Zealand provisions are contained in ss 27 and 30 of the Commerce Act 1986. The equivalent Australian provisions are ss 45 and 45A of the Trade Practices Act 1974.

Section 27 of the Commerce Act and s 45 of the Trade Practice Act both provide that it is illegal to enter into a contract or arrangement, or arrive at an understanding, which contains a provision that has the purpose, effect or likely effect, of substantially lessening competition in a market.

Section 27 of the Commerce Act states:

- (1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (3) Subs (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.
- (4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

Section 45(2) of the Trade Practices Act states:

- (2) A corporation shall not:
  - (a) make a contract or arrangement, or arrive at an understanding, if:

- (i) the proposed contract, arrangement or understanding contains an exclusionary provision;
  - or
  - (ii) a provision of the proposed contract, arrangement or understanding has the purpose, or would have or be likely to have the effect, of substantially lessening competition; or
- (b) give effect to a provision of a contract, arrangement or understanding, whether the contract or arrangement was made, or the understanding was arrived at, before or after the commencement of this s, if that provision:
- (i) is an exclusionary provision;
  - or
  - (ii) has the purpose, or has or is likely to have the effect, of substantially lessening competition.

If a contract, arrangement or understanding contains a requirement for a party to accept bundled products or services or bundled discounts then such a requirement will contravene both New Zealand and Australian trade practices laws if it substantially lessens competition. This is unlikely to be the case, however, unless the party imposing the bundling requirement has market power in one of the products or services and that is subject to the bundle.

Under s 3(5)(b) of the Commerce Act and s 45(4)(b) of the Trade Practices Act, when a person has entered into a number of contracts, the relevant provisions of the contracts can be looked at together to see if combined they have the effect of substantially lessening competition.

It is necessary to compare the level of competition and competitive constraints in the market with the provision in place and in the absence of the provision (a ‘with’ and ‘without’ test).

Competition is substantially lessened if it is lessened to a degree that is real or of substance and more than just trivial, minimal, or nominal. A ‘likely’ effect on competition does not mean more likely than not. It just means something that might well happen ie there is a “real and substantial risk” or a “real chance” that something will occur<sup>2</sup>. A 30% chance is probably sufficient.

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<sup>2</sup> Commerce Commission v Woolworths Ltd (2008) 12 TCLR 194 at para

### B *Misuse of market power*

Section 36 of the Commerce Act and s 46 of the Trade Practices Act both inhibit the ability of entities in competition that have a substantial degree of power in a market, from taking advantage of that power if it has a purpose of eliminating or substantially damaging a person from a market, or preventing the entry of a person to a market, or deterring a person from engaging in competitive conduct in a market (referred to in s 46(1) of the Trade Practices Act as a “proscribed purpose”).

Under both the Commerce Act and the Trade Practices Act, there are three elements in establishing a misuse of market power:

- the firm must have a substantial degree of power in a market;
- it must take advantage of that market power; and
- it must do so for an anti-competitive or “proscribed” purpose.

Market power is more than just high market share. Market power is the absence of significant constraint from the conduct of competitors or customers.

A firm has market power when it can behave persistently in manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions. In particular market power is indicated by an ability to raise prices above supply costs without rivals taking away customers in due time, supply costs being the minimum cost an efficient firm would incur in producing the product.

It is usually the case that a firm with market power wants to exclude its rivals.<sup>3</sup> A purpose of excluding a person from a market need not be the only purpose, a substantial purpose is sufficient to breach either New Zealand or Australian trade practices law.

The firm only takes advantage of market power when it does something that it would not have done in a competitive market. If a firm acts in a way that it would have done even if it were in a fully competitive market, then it cannot be said to have taken advantage of market power.

In assessing whether there is a taking advantage of market power consider whether the firm had a business rationale for the conduct independent of the question of market power, how the firm acted before it acquired market power and whether the firm’s conduct would have been profitable in a competitive market. For example in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd (t/as Auto Fashions Australia)*<sup>4</sup>,

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<sup>3</sup> See for example *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385, at 403 where the Privy Council referred to Telecom’s attempt to show that it did not have an anti-competitive purpose as a “hopeless task” noting that “it would be most improbable that Telecom lacked the purpose to deter its bitter rival, Clear”

<sup>4</sup> (2001) 205 CLR 1

the High Court of Australia, referring to the dissenting judgment of Heerey J in the Full Federal Court of Australia, stated:

“...[Heerey J] observed that Melway had adopted its segmented distribution system before it secured its position of market dominance, and there was no reason to believe that it would not be both willing and able to continue that system in a competitive market...”<sup>5</sup>

In this case, Melway Street Directory held in excess of 80-90% of the retail market share for Melbourne street directories. Melway could have arranged for the distribution of its street directories in a number of ways. For example, it could have supplied the street directories itself to retail outlets. Instead it decided to appoint independent wholesalers who were given exclusive responsibility for a particular segment of the market. The effect of the exclusive appointments was to restrict intra-brand competition at wholesale level, although there was strong competition between retailers within a segment of across segments especially in relation to price.

A dispute arose between the owners of the exclusive wholesale distributor appointed to serve the automotive parts segment and they went separate ways. Melway decided to appoint one of the owners as its sole distributor to retailers of automotive parts and to terminate the appointment of the respondent. The respondent wished to continue business as a wholesale distributor but Melway refused to supply the respondent. The trial judge found Melway's conduct contravened s 46 of the TPA and the Full Federal Court of Australia confirmed his finding. However, the High Court of Australia allowed the appeal.

### III THE APPROACH OF NEW ZEALAND COURTS AND THE COMMERCE COMMISSION

The *Port Nelson* case in 1995 dealt with bundling and bundled discounts in two respects<sup>6</sup>.

Port Nelson had market power in the supply of tugs but insisted that it would only supply tugs if users also purchased pilotage services from the Port. This bundling was held to be in breach of s 36. Subsequently the court imposed a penalty of \$300,000. The Court of Appeal upheld this finding and penalty.<sup>7</sup>

The Port was also penalised for a bundled discount arrangement. The Port had market power in aspects such as port access and wharfage not in other services such as pilotage. The Port offered a 5% discount if customers used all its services. The Court held that s 36 was not breached as the Court held that if the Port was not in a dominant position it could well have given a competitive discount across all services (although this seems questionable if there were no economies of scope

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<sup>5</sup> (2001) 205 CLR 1 at [62].

<sup>6</sup> *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406

<sup>7</sup> *Port Nelson Ltd – Commerce Commission* [1996] 3 NZLR 554

between the services). However the Court did hold the bundled discount was in breach of s 27. The Court held that the Port had a purpose of substantially lessening competition. That unilateral purpose was held enough for the contractual provision to have a purpose of substantially lessening competition in breach of s 27. A penalty of \$100,000 was imposed on the Port. The Court of Appeal upheld this finding and penalty.

Since the Port Nelson case the Commerce Commission has dealt with questions of bundling in two investigation reports in 2007.

The first related to alleged anticompetitive conduct by the Hermitage. The compulsory tying by the Hermitage of dinners to bed and breakfast was held to be in breach of ss 36 and 27 of the Commerce Act.

The Hermitage had market power in the provision of accommodation but faced competition from another restaurant in respect of dinners.

In relation to s 36 the approach taken by the Commerce Commission was to consider if the tying conduct was likely to be profitable if offered in a competitive market. The Commerce Commission said this was not the case. In a competitive market the Hermitage would have lost business to competitors if it tied the provision of dinners to accommodation.

The Commerce Commission was also of the view that there was a breach of s 27. The Commission said that the tie was likely to have had the effect of substantially lessening competition in the dinner market.

The second investigation report by the Commerce Commission in 2007 was in respect of Telecom bundling of broadband services. Telecom introduced a bundled discount price for customers purchasing homeline (local calls), tolls and broadband internet. Customers were given a \$10 discount on broadband if they purchased all of these services. Telecom had market power in local calls but not in tolls and broadband.

In relation to s 36 the Commerce Commission looked at whether competitors would still be able to compete in the broadband market. They asked the question of whether the bundled discount makes it impossible for an equally efficient independent supplier of a competitive product to compete.

The Commission applied an approach that spread the discount (in this case \$10) across the products that are provided on a competitive basis. This is used to then determine what are the effective prices for those products (in this case broadband and tolls).

The Commission held that there would be a taking advantage of power if it was shown that the average margin made by Telecom on toll and broadband products

was negative and therefore equally efficient competitors could not compete with Telecom in the provision of the bundle.

The Commerce Commission estimated that Telecom's margins in the provision of broadband services were positive. Accordingly in the Commission's view there was no taking advantage of market power. An equally efficient competitor in the provision of broadband and tolls was able to compete.

In relation to s 27 the Commission held that the fact that an equally efficient competitor for broadband and tolls is able to compete also leads to the conclusion that the conduct was unlikely to have the effect of substantially lessening competition.

#### IV THE APPROACH OF THE AUSTRALIAN COURTS

The most recent Australian bundling decision is *ACCC v Baxter*.<sup>8</sup>

Baxter had an effective monopoly in Australia for the production of sterile fluids and foreign manufacturers provided little constraint on Baxter in the domestic market. Baxter also manufactured peritoneal dialysis (PD) fluids but faced real competition from imports in relation to these fluids. In other words, Baxter had market power in sterile fluids but not in PD fluids.

Between 1998 and 2001, Baxter successfully tendered for the supply of sterile fluids and PD fluids to state purchasing authorities (SPAs) in New South Wales, South Australia, Western Australia, Queensland and the Australian Capital Territory (ACT). The tenders included alternative offers. These were either on high item-by-item pricing or a much cheaper bundled tender for the exclusive supply of sterile fluids and PD fluids. The strategy was to make the choice of supply of PD fluids by other than Baxter an expensive alternative.

The Australian Competition and Consumer Commission (ACCC) commenced proceedings against Baxter in 2005, alleging that:

- the bundled offers amounted to Baxter misusing its market power to deter competitive manufacturers of PD fluids from competing with it in contravention of s 46 of the Trade Practices Act; and
- the likely effect of the bundled offers was to substantially lessen competition in the national market for PD fluids in contravention of s 47 of the Trade Practices Act.

At first instance, Justice Allsop held that the Trade Practices Act did not apply to Baxter, as it was entitled to derivative Crown immunity. His Honour said that he

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<sup>8</sup> (2008) ATPR 42-247

would otherwise have found that Baxter contravened s 46 in relation to one offer and s 47 in relation to all offers except for in the ACT. The High Court of Australia reversed that decision and remitted the matter to the Full Court of the Federal Court of Australia (FCFCA).

The FCFCA unanimously held that Baxter had had a substantial degree of power in the sterile fluids market and had taken advantage of its market power in breach of s 46 of the Trade Practices Act, which is equivalent to s 36 of the Commerce Act. The FCFCA held that Baxter took advantage of its market power in the sterile fluids market through its alternative offer strategy and in particular through its unrealistically high item-by-item prices for sterile fluids. This meant SPAs had no real choice but to accept the bundled tender which required taking PD fluids from Baxter as well. This was effectively bundling conduct that deterred Baxter's competitors from engaging in competitive conduct in the PD fluids market as such competitors could not make a realistically competitive bid.

The FCFCA also dealt with s 47 of the Trade Practices Act which is a section dealing with exclusive dealing. The practice of exclusive dealing is defined in that section to refer to the supply or acquisition of goods or services subject to a restrictive condition or to the refusal to supply or acquire for a restrictive reason.<sup>9</sup> There is no comparable section in the Commerce Act. However, part of the analysis under s 47 requires the court to determine whether there was a substantial lessening of competition. That analysis is relevant to s 27 in the Commerce Act.

The ACCC also contended on appeal that Baxter's conduct had both the purpose and effect, or likely effect of substantially impeding or hindering the "wider competitive process" in the market. The court agreed with the trial judge that the conduct did not have the purpose or effect of substantially lessening competition in the "wider" PD fluids market. Potential competitors would be able to compete with Baxter in the next call for tenders and Baxter's purpose was not, in the long term, to cause its competitors to drop out of that market.

However, the majority upheld Justice Allsop's finding that Baxter's conduct had the purpose and effect of substantially lessening competition in the tender process (except in the ACT). Again, the purpose of Baxter's offer strategy was to hinder or prevent competitors from competing in the SPA tender process. Each tender process gave suppliers an opportunity to contract to supply PD fluids and Baxter could essentially exclude competitors from this process. The FCFCA held that the supply to the SPAs was an important component of the market for the supply of PD fluids and that to affect each state tender process was to lessen competition or be likely to do so in a meaningful way for the Australian market.

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<sup>9</sup> The five main types of exclusivity are product exclusivity, customer exclusivity, territorial exclusivity, third-line forcing and exclusivity in relation to leases.

## V OVERSEAS EXAMPLES OF BUNDLING

### A *Microsoft cases*

There have been two major cases involving bundling by Microsoft bundling. First, there was the case of Microsoft bundling the operating system with the internet browser. This led to the exclusion of Netscape – *US v Microsoft*<sup>10</sup>. The issue which confronted the trial judge<sup>11</sup> in this case was whether the Microsoft corporation integrated its Windows 98 and Internet operating software for reasons of efficiency to benefit consumers or whether its purpose was to damage a competing internet browser, Netscape Navigator, which posed a potential platform threat to Microsoft's Windows operating system.

The trial judge found that Microsoft had refused to offer computer manufacturers who requested it, a version of Windows without web browsing software and it prevented computer manufacturers from removing Internet Explorer prior to shipment.

Similarly, consumers were compelled to purchase Internet Explorer along with Windows 98 by Microsoft's decision to stop including Internet Explorer on the list of programs subject to the Add/remove function and by its decision not to respect their selection of another browser as their default. The fact that Microsoft was giving away its browser for free did not matter. Microsoft would be able to recoup its money by charging higher prices in the future for Windows.

The trial judge held that Microsoft's decision to bundle or "integrate" Windows 98 and Internet Explorer did not derive from technical necessities or business efficiencies but was a deliberate and purposeful choice to suspend competition before it reached higher proportions. The trial judge also held that ease of use for consumers does not dictate that operating and browser software be pre-installed into personal computers.

The bundling of Windows 98 and Internet Explorer harmed Microsoft's relations with computer manufacturers and denied consumers the right to choose their preferred Web browser. It made no business sense except as a means of removing Netscape Navigator as a platform threat and thereby protecting the Windows operating system monopoly. As such, the conduct was unlawful.

On appeal, Microsoft contended that the products were in fact a single product in a single market, that it was exercising its rights under copyright law and that the licence restrictions would reduce the value of Microsoft's copyrighted work. These claims were dismissed as frivolous and unsubstantiated. The Court of Appeals (D.C. Circuit)<sup>12</sup> held that some of Microsoft's conduct in diverting browser usage

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<sup>10</sup> 253 F2d (D Cir 2001);[2001-1] Trade Cases (CCH) 73,321

<sup>11</sup> [2001-1] Trade Cases (CCH) 72,389

<sup>12</sup> [2001-1] Trade Cases (CCH) 73,321

from Netscape to Microsoft's Internet Explorer was anti-competitive. However, Microsoft's distribution of its browser free of charge, although diversionary, was seen as a form of price cutting and identified by the Court as pro-competitive.<sup>13</sup>

The second case involved Microsoft tying of the Windows Media Player to the Windows operating system – *Microsoft v Commission of the European Communities*<sup>14</sup>. This led to a €497 million fine for breaches of Article 82 of the European Community Treaty<sup>15</sup>.

The European Court of First Instance substantially upheld the European Commission's finding that Microsoft had abused its dominant position by:

- refusing to supply its competitors with sufficient 'interoperability information' to enable their software to interoperate seamlessly with computers using Windows software, and
- bundling Windows Media Player with the Windows PC operating system.

The Court made the following observations:

- It was not disputed that Microsoft had a dominant position in the client PC operating systems market.
- Windows Media Player is a separate product to the Windows operating system. There are separate independent corporations that supply competing media products independently of other operating systems and, despite the bundling, a not insignificant number of consumers continue to acquire competing media players separately.
- It was immaterial to the Court's consideration that Microsoft did not charge customers for Windows Media Player and that customers were free to acquire other media players.

By bundling, Microsoft created a significant risk of foreclosing the market for media players to effective competition.

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<sup>13</sup> Ibid at 90,798

<sup>14</sup> [2007] ECR II-3601

<sup>15</sup> Article 82 prohibits entities with dominant position within the common market from abusing that dominant position so far as it affects trade between member states of the common market. To that extent it is similar to s 36 of the Commerce Act and s 46 of the Trade Practices Act, although unlike those sections which are triggered when a dominant entity acts with an anti-competitive or "proscribed purpose" (ie s 46), Article 82 uses an objective assessment of the entity's conduct to assess whether abuse of market power has occurred.

The Court observed that Microsoft retained the right to offer the bundled product but was required to make it possible for consumers to obtain the Windows PC operating system without Windows Media Player.

In New Zealand and Australia, similar conduct may be unlawful if it results in a substantial lessening of competition or a misuse of market power, which are less likely to be present where a vigorously competitive corporation adds features to popular products or licenses intellectual property to rivals.

### B *Pharmaceutical/medical cases*

In addition to the cases discussed above, there have been some bundling cases in the pharmaceutical and medical field.

The first is *Smith Kline Corp v Eli Lilly & Co*<sup>16</sup>. This case was in relation to cephalosporin, a form of antibiotic. Eli Lilly had three cephalosporin products. It had a monopoly of Keflin and Keflex because of patents but in relation to Ketfol it had competition from a Smith Kline product Ancef. Eli Lilly gave a percentage discount on all purchases to customers that were purchasing minimum quantities of the cephalosporins. It also gave a three per cent bonus discount to hospitals that purchased specified quantities of any three of its cephalosporins. This was held to be a breach of s 2 of the United States' Sherman Act 1890 (the equivalent to s 36 of the Commerce Act and s 46 of the Trade Practices Act).

To match the discount Smith Kline had to offer discounts averaging 16% and as high as 35% to large customers. The Court seems to have regarded it relevant that Smith Kline couldn't match Eli Lilly's prices even if it was as equally efficient.

The second medical case is *Ortho Diagnostics Systems Inc. v Abbott Laboratories Inc*<sup>17</sup>. Abbott manufactured all five commonly used tests to screen blood supplies for viruses. Abbott had market power over at least two of these tests. Abbott offered a discounted price to blood banks if they purchased four or five of the tests. The Court held that to establish a breach of s 2 of the Sherman Act the plaintiff had to prove that the monopolist had priced below average variable cost or that the other competitor was at least as efficient but the monopolist's pricing made it unprofitable for the other competitor to continue to produce. In the particular case the discount package pricing was held not to breach the Sherman Act.

#### *Le Page*

A more recent bundling case is *Le Page's v 3M*.<sup>18</sup> 3M had a large share in the market for transparent tape. It offered a discount if distributors bought both transparent tape and private label tape. It offered higher rebates when distributors bought products in a number of 3M's different product lines. It was held that 3M

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<sup>16</sup> [1978] USCA3 267; 575 F2d 1056, United States Court of Appeals, Third Circuit

<sup>17</sup> 920 F Supp 455 (1996)

<sup>18</sup> 324F 3d141 (3 Cir 2003).

had breached s 2 of the Sherman Act. The Court held that below cost pricing was not required to establish liability. There was no legitimate business justification given for the bundled discount.

## VI CONCLUSION

The general principle is that there will not be an issue with bundling unless the firm in question has market power in relation to one or more of the products or services involved in the bundle.

If the firm has market power in relation to a product or service, then bundling is likely to cause issues under both the Commerce Act and the Trade Practices Act. For example, if the firm has substantial market power in relation to product A, then requiring customers as a condition of purchasing product A to also purchase product B (in which the firm does not have market power), is likely to cause problems under both Acts.

If the firm offers supply on the basis of a bundled discount across all products, including products in which the firm has market power, then the question is whether this would prevent an equally efficient competitor from being able to compete. By way of example, say the firm sells products in 3 markets; product A in which it has 90% market share and has market power and products B and C, where the firm does not have market power. The firm then offers the customers a discount across all three products, perhaps subject to the customer taking certain minimum quantities of each product. In these circumstances, the discount on product A (which the customer effectively has to purchase from the firm because of the firm's market power) is only available if the customer also purchases products B and C.

The key question under both the Commerce Act and the Trade Practices Act is whether this effectively means that competitors in respect of products B and C are unable to compete in those markets. To assess this, a calculation should be done under which the total discount provided by the firm over products A, B and C through the bundled discount is spread over just products B and C and allocated between those products. If the result of that is that the firm would effectively be supplying product B or product C below cost, then an equally efficient competitor of product B or product C could not compete. In those circumstances, the firm would be considered to be taking advantage of its market power in product A, and a trade practices problem would occur.

The fact that a buyer may have asked for bundled pricing will not necessarily be a defence and suppliers need to exercise caution when responding to tenders that request or allow bundled pricing. In this regard, the supplier's purpose for making a bundled offer and including a discount in the bundled price will also be important.

Therefore, businesses with market power in relation to one product need to carefully consider the purpose and likely effect of their bundling strategies,

particularly if they are offering bundled packages at significantly higher discounts to item-to-item prices or when offering discounted pricing in return for an exclusive (or near) exclusive deal for that product and another product for which they may face greater competition. Unbundled prices should be realistic prices so that the customer has a genuine choice as to whether to accept the bundled offer.

