OFFICE OF THE MINISTER
OF COMMERCE AND CONSUMER AFFAIRS

Chair
Cabinet Economic Growth and Infrastructure Committee

Outcomes of the Targeted Review of the Commerce Act 1986 and other measures to promote competition

Proposal

1 This paper seeks Cabinet policy decisions in response to the Targeted Review of the Commerce Act 1986. It also seeks Cabinet approval for the release of a Business Growth Agenda (BGA) document which sets out an action plan for promoting competition.

Executive Summary

2 Competition stimulates increased efficiency and encourages innovation, leading to improvements in productivity and consumer welfare and contributing to the Government's goal of a more productive and competitive economy. New Zealand's competition law and our Commerce Commission are well regarded internationally, but there remain opportunities to lift competition further.

3 To lift competition we need to: maintain the effectiveness of our competition laws and institutions; identify barriers to competition and opportunities to promote competition in specific sectors and across the economy; and actively seek open trade and investment policies.

Targeted review of the Commerce Act 1986

4 As part of ongoing efforts to monitor and systematically review our competition laws and in response to the Productivity Commission's 2014 Inquiry into *Boosting Productivity in the Services Sector*, MBIE has undertaken a Targeted Review of the Commerce Act 1986. The review covered:

a. whether a formal 'market studies' power should be given to an agency as a tool for promoting competition in individual markets;

b. whether section 36 of the Commerce Act, which prohibits firms from taking advantage of their market power, should be amended; and

c. whether some of the Commerce Commission's alternative (to court action) enforcement mechanisms should be amended, with a particular focus on the cease-and-desist regime.

Market studies

5 There is an institutional gap in New Zealand's competition regime regarding the ability to promote, as opposed to merely protect, competition. Internationally, this gap has been filled by granting competition authorities a market studies power. A 'market study' is detailed research by an agency into a particular market, or markets, where there are concerns that the market could be functioning sub-optimally. Market studies support a more sector-led approach to promoting competition.

6 To avoid unnecessary costs/fishing expeditions, I propose a market studies power for the Commerce Commission that would only be exercisable at the direction of the Minister of Commerce and Consumer Affairs and making use of appropriate information gathering powers.

7 Any decision to initiate a market study is likely to be a 'significant policy issue' and, depending on the market being studied, is likely to affect the portfolio interests of a number of Ministers. The Cabinet Manual states that such matters must be submitted to Cabinet.

8 I do not propose that we instate a formal recommendation process where the Commerce Commission recommends studies to the Minister of Commerce and Consumer Affairs. Market studies are envisaged as a competition tool to be initiated by the Government on an 'as required' basis, following advice received from officials.

9 I am aware that various concerns have been raised regarding giving a market studies power to the Commerce Commission (particularly regarding costs to businesses). These concerns can be addressed by:

a. Only allowing market studies to be undertaken at the direction of the Minister of Commerce and Consumer Affairs (and, by implication, Cabinet) – this prevents fishing expeditions;

b. Ensuring that particular criteria are taken into account before the initiation of a market study – for instance that:

   i. the market involved has a significant impact on consumers or the broader economy (e.g. the retail fuel market – petrol and diesel is a significant part of weekly household budgets);

   ii. there is evidence of outcomes or features of a market which are adversely affecting competition (e.g. a small number of players and rising margins in the retail fuel market);

   iii. the issues require a substantial amount of detailed competition analysis; and

   iv. the market would benefit from analysis from an independent agency;

c. Using the terms of reference to set a clear timeframe and scope for each study; and

d. Potentially enabling the Commerce Commission to work with other agencies (such as the Productivity Commission) to bring a wider perspective to the issues considered.

10 The Fuel Market Financial Performance Study currently being undertaken by Minister Collins is a good example of a study which would have benefitted from a market studies power. The market has a significant impact on the economy and there are indications of low competition. While most of the companies involved have cooperated in good faith with the study, some have resisted providing the data that was sought. This means that the

study will not be able to fully answer the original questions posed, although it will provide a framework for further analysis of competition issues in the market.

11 A market studies power would have significantly reduced the cost that the current approach is creating for retail fuel businesses. The current approach has resulted in multiple requests for little benefit. Following the conclusion of the Fuel Market Financial Performance Study it is likely that the Government will still not have a good understanding of the severity of competition problems in the market.

12 It is also likely that the Commerce Commission would have been the first port of call for the retail payments system study that MBIE recently undertook. MBIE picked this up because the Commerce Commission did not have a market studies power.

Section 36

13 Section 36 is an important provision to get right in a small market like New Zealand. The formulation of section 36 and its judicial interpretation lead to three problems:

a. The potential for wrong answers that could harm competition and, in particular, fail to deter or penalise some types of conduct that may undermine the long-term benefit of consumers;

b. Costly and complex enforcement that reduces the incentive for businesses to comply with the law;

c. Some unpredictability for day-to-day business decision making, reducing the incentive for businesses to vigorously compete.

14 However, it has proven difficult to categorically identify actual cases where the problems have led to harm. This uncertainty about the likely scale of the problem makes it difficult to compare the net benefits of alternative options with the status quo.

15 I propose that officials should seek further empirical evidence of harm occurring and the costs and benefits of alternatives to the current formulation of section 36, with a view to me reporting back to Cabinet before the end of 2018.

Alternative enforcement mechanisms

16 The Commerce Act includes two main alternative enforcement mechanisms for dealing with anticompetitive behaviour: negotiated settlements (agreements between the Commerce Commission and a firm accused of anticompetitive conduct) and a 'cease-and-desist' regime (under which the Commerce Commission can seek injunction-like orders from specially appointed commissioners). Negotiated settlements are, in theory, difficult to enforce and the cease-and-desist regime's cumbersome procedural requirements offer no practical advantages over the standard approach of seeking an interim injunction from the courts.

17 I propose that the Commerce Act's cease-and-desist regime should be repealed and an enforceable undertakings regime established in the Commerce Act. An enforceable undertakings regime would allow a negotiated settlement to be immediately enforced as if it were a court decision.

Promoting Competition in the BGA

18 In consultation with my colleagues I have finalised a *Promoting Competition* document and propose to release this as part of the BGA Innovation workstream. The intentions of

the *Promoting Competition* BGA document are to give greater prominence to the Government's competition work programme, in order to:

a. communicate the Government's existing competition work programme more effectively to business stakeholders; and

b. place additional focus within government on promoting competition as a tool for driving economic growth.

19 In order to do this, the *Promoting Competition* BGA document:

a. sets out the importance of promoting competition in a small, distant economy such as New Zealand;

b. outlines some of the key things that we know about competition in New Zealand;

c. highlights recent work by the Government to promote competition; and

d. outlines ongoing actions to promote competition across the economy.

20 I propose that we release the *Promoting Competition BGA* document.

Background

21 Competition stimulates increased efficiency and encourages innovation, leading to improvements in productivity and consumer welfare. When businesses compete vigorously for customers, it results in:

a. lower prices and better-quality goods and services;

b. businesses that are more competitive on the international stage; and

c. higher living standards driven by higher productivity, higher incomes and greater consumer choice.

22 The existing competition regime has a number of strengths. New Zealand's competition law and our Commerce Commission are well-regarded internationally. For instance the International Institute of Management Development's 2016 competitiveness rankings place New Zealand first in the world for whether competition legislation is efficient in preventing unfair competition. New Zealand is also ranked first in the world for ease of starting a business (implying that, in a general sense, barriers to new competitors entering a market are low). Between 2000 and 2010 competition intensity has been either static or increasing in most sectors.

23 However there remain opportunities to lift competition further.

24 Our productivity remains relatively low compared to other OECD countries. We are also not seeing the benefits that we might expect if competition were a stronger force in our economy. New Zealand prices, for example, are on average about 15 per cent higher than other countries in the OECD. And while our innovation performance is improving, our business expenditure on research and development is still lower than many OECD countries.

25 Recent work has been a step in the right direction. There have been a number of recent decisions by the Government that are likely to reduce barriers to competition, or prevent the creation of a barrier to competition. These include:

a. placing all small passenger transport operators under one regime, reducing barriers to entry and levelling the playing field in the industry;

b. removing ownership restrictions on pharmacies in order to better-facilitate the entry of competitors that may operate on lower-cost business models (e.g. supermarkets);

c. the Trade (Anti-dumping and Countervailing Duties) Amendment Bill, which was given royal assent on 29 May 2017, introduces a bounded public-interest test before anti-dumping duties are applied and will potentially lower the price of some imported goods and increase international competition; and

d. the current MBIE-led study into the financial performance of fuel markets.

26 Nevertheless, there is more work to be done across government.

27 We need to maintain the effectiveness of our competition laws and institutions. New Zealand's competition laws are generally well-regarded internationally but it is important to monitor and systematically review our competition laws and institutions to ensure they remain fit for purpose. In response to the Productivity Commission's 2014 Inquiry into *Boosting Productivity in the Services Sector,* the previous Minister of Commerce and Consumer Affairs undertook a targeted review of the Commerce Act. This has now been completed and I am proposing some changes.

28 We also need to identify barriers to competition and opportunities to promote competition in specific sectors. Whilst our existing laws protect the current level of competition in New Zealand, they are insufficient, alone, to lead to meaningful increases in competition. It is likely that the biggest gains to be had will come from looking beyond competition law and working to systematically reduce barriers to competition across the economy.

Policy decisions: Targeted Review of the Commerce Act

29 An issues paper on the Targeted Review of the Commerce Act (the "Issues Paper") was released in November 2015. This paper considered three issues:

a. whether some of the Commerce Commission's alternative (to court action) enforcement mechanisms should be amended, with a particular focus on the cease-and-desist regime;

b. whether section 36 of the Commerce Act, which prohibits firms from taking advantage of their market power, should be amended; and

c. whether a formal 'market studies' power should be given to an agency as a tool for promoting competition in individual markets.

30 The three issues are discrete, meaning action in response to one of the issues (e.g. market studies) would not – and is not intended to – serve as an answer to problems that may exist under another issue (e.g. section 36).

31 This review is separate to other proposed amendments to the Commerce Act 1986, such as the Commerce (Cartels and Other Matters) Amendment Bill, which is awaiting Committee of the Whole stage in Parliament.

32 Consultation on the Issues Paper closed in February 2016, with 39 submissions received. On 2 June 2016, a supplementary submission was received from Dr Mark Berry, Chair of the Commerce Commission, which argued strongly in favour of reform to section 36 of the Commerce Act, and critiqued a number of points made by other submitters. In this context, it was considered appropriate to launch a cross-submission process. Twenty-six cross-submissions were received, which focussed almost exclusively on section 36.

33 In addition to this, officials met informally with more than 20 stakeholders to discuss the Targeted Review.

Market studies

34 As part of the Targeted Review of the Commerce Act, I have been considering whether the Commerce Commission should be given a 'market studies' power under the Commerce Act, to sit alongside its market studies power under the Telecommunications Act, exercisable at the direction of the Minister of Commerce and Consumer Affairs.

35 I note that my colleagues recently considered a parallel proposal from the Minister for Communications to strengthen the Commission's market studies role in the telecommunications domain [EGI 17 MIN 0096 refers].

36 In addition, the Minister for Energy and Resources has recently been working on a fuel market financial performance study. This has been hampered by the refusal of some companies to provide sufficient information to enable the Study to be carried out to the extent originally set out in the Terms of Reference. This means that the core question about whether prices are reasonable or not will not be able to be answered.

37 In this context, on 3 May 2017, the Economic Growth and Infrastructure committee [EGI 17 Min 0096 refers], having been authorised by Cabinet to have power to act:

a. **noted** that the Minister of Energy and Resources' experience with the Study highlights the merits of granting a market studies power to the Commerce Commission as part of the Targeted Review of the Commerce Act 1986

b. **agreed** that further consideration be given to a proposed amendment to the Commerce Act 1986 to enable the Commerce Commission, at the direction of the Minister of Commerce and Consumer Affairs, to undertake market studies using its power to compulsorily acquire information; and

c. **invited** the Minister of Commerce and Consumer Affairs, as part of the Targeted Review of the Commerce Act, to report back to EGI before the end of June 2017 with advice on a possible market studies power that could be provided to the Commerce Commission.

38 I reported back on 24 May 2017 and the Economic Growth and Infrastructure committee referred the paper to Cabinet.

<u>Background</u>

39 The purpose of New Zealand's Commerce Act is "to *promote* competition in markets for the long-term benefit of consumers within New Zealand." However, in practice, the Act only allows for the *protection* of the competitive process and for regulation in the absence of competition. The Act does not grant the Commerce Commission the ability to consider steps that could be taken to actually increase competition in New Zealand.

40 A recent example of how this plays out was the Commerce Commission's consideration of the merger between Z Energy and Chevron. The Commission, under the Commerce Act, was limited to examining whether the merger would substantially *lessen* competition in a market. It was not able to examine whether the existing level of competition in the market was optimal, nor could it suggest options for raising the level of competition in the market.

41 In practice, this means that many sectors of the economy rarely – if ever – receive a

robust, external examination of their structure, conduct, and performance.

42 MBIE and other policy agencies currently fill this gap (for instance undertaking studies looking at building and construction markets, aspects of the milk market, retail payment systems and the fuel market). However, MBIE and other policy agencies face some limitations in undertaking such studies. Firstly, they often do not have deep competition expertise as possessed by the Commerce Commission. Secondly, they do not have information gathering powers, a fact which can undermine the efficacy of a market study in some instances.

43 An example of these limitations in practice is the current Fuel Market Financial Performance Study that is being led by MBIE. Unless Ministers initiate a costly Ministerial inquiry, MBIE is reliant on voluntary provision of information from the firms involved (which may not be forthcoming), and is procuring the necessary expertise from a small market. It has necessitated another large data request to businesses in the fuel industry in a short period of time (when at least some of the required information was recently supplied to the Commerce Commission as part of the Chevron/Z merger).

44 Market studies are performed by the vast majority of competition authorities overseas. A 2015 OECD survey of competition authorities found that out of the 62 competition authorities that responded, only New Zealand's and Chile's did not possess market studies powers. Of these, 80 per cent have information gathering powers (the power to require firms to provide information) and 72 per cent are able, to some extent, to use the information collected for enforcement purposes. With regard to who can initiate a market study, there is a roughly even split between competition authorities with a market studies power who have the sole responsibility to initiate a study, and those who can either self-initiate or have one externally-initiated. A small number can only undertake a study if it is externally initiated (e.g. by Ministers).

45 Some agencies in New Zealand already have market study powers. The Commerce Commission has several quasi-market studies functions. These include monitoring competition in telecommunications markets, inquiries under Part 4 of the Commerce Act to investigate markets in which there is little or no competition (largely confined to natural monopolies or near-monopolies) and, under the Fair Trading Act 1986, studying matters affecting the interests of consumers (but not extending to consider competition issues).

46 Several other agencies also have what can be considered to be partial market studies powers. For example, the Productivity Commission may hold inquiries and report on productivity-related matters, on referral by Ministers. The Electricity Authority has the power under the Electricity Industry Act 2010 to carry out and make publicly-available reviews, studies and inquiries into any matter relating to the electricity industry. The Reserve Bank and Financial Markets Authority also have various powers relating to financial markets, including information-gathering and dissemination, monitoring, research and inquiries.

<u>Proposal for how a market study power would work</u>

47 A "market study" is detailed research by an agency into a particular market, or markets, where there are concerns that the market could be functioning sub-optimally. Unlike a Commerce Act investigation into anticompetitive behaviour, it is not the actions of a specific company that are the focus of a market study, but the structure, conduct and performance of the whole market. Among other things, a market study could consider: the structure of a market, the behaviour and profitability of market players, rates of innovation,

barriers to entry and customer satisfaction. New Zealand examples of where a market studies power would have been useful include: the residential construction markets study undertaken by MBIE in 2015, and the retail payments system and fuel market financial performance studies currently being undertaken by MBIE.

48 The findings of a market study are generally published in a report. The report may dispel views that a market is restricted or distorted, giving the market a "clean bill of health". Or it may confirm market problems, and include recommendations for action such as deregulation of a market, reform of its institutions, the introduction of some form of business self-regulation, the improvement of information dissemination amongst consumers or suppliers, or industry-specific regulation.

49 To avoid unnecessary costs/fishing expeditions, I propose a market studies power for the Commerce Commission that would only be exercisable at the direction of the Minister of Commerce and Consumer Affairs and making use of appropriate information gathering powers.

50 Any decision to initiate a market study is likely to be a 'significant policy issue' and, depending on the market being studied, is likely to affect the portfolio interests of a number of Ministers. The Cabinet Manual states that such matters must be submitted to Cabinet.

51 I do not propose that we instate a formal recommendation process where the Commerce Commission recommends studies to the Minister of Commerce and Consumer Affairs. Market studies are envisaged as a competition tool to be initiated by the Government on an 'as required' basis, following advice received from officials.

52 I am aware that various concerns have been raised regarding giving a market studies power to the Commerce Commission (particularly regarding costs to businesses). These concerns can be addressed by:

a. Only allowing market studies to be undertaken at the direction of the Minister of Commerce and Consumer Affairs – this prevents fishing expeditions;

b. Ensuring that particular criteria are taken into account before the initiation of a market study – for instance that:

   i. the market involved has a significant impact on consumers or the broader economy (e.g. the retail fuel market – petrol and diesel is a significant part of weekly household budgets);

   ii. there is evidence of outcomes or features of a market which are adversely affecting competition (e.g. a small number of players and rising margins in the retail fuel market);

   iii. the issues require a substantial amount of detailed competition analysis; and

   iv. the market would benefit from analysis from an independent agency;

c. Using the terms of reference to set a clear timeframe and scope for each study; and

d. Potentially enabling the Commerce Commission to work with other agencies (such as the Productivity Commission) to bring a wider perspective to the issues considered.

53 At this point, it is helpful to note that a number of constraints on the Commerce Commission, and the use of its powers generally, will exist regardless of those introduced into the Commerce Act, such as:

a. the opportunity for appointment and re-appointment of Commissioners with the appropriate skills;

b. the Commission's concern for its reputation and relationship with stakeholders;

c. the Commission's obligations under the Crown Entities Act 2004 (such as involving the Minister in setting its statement of performance expectations); and

d. the Commission's intention to enhance its accountability by reporting from 2017/18 on 'outcomes achieved', through the provision of case studies illustrating the actual impact of its work.

54 The Fuel Market Financial Performance Study currently being undertaken by Minister Collins is a good example of a study which would have benefitted from a market studies power. The market has a significant impact on the economy and there are indications of low competition. While most of the companies involved have cooperated in good faith with the study, some have resisted providing the data that was sought. This means that the study will not be able to fully answer the original questions posed, although it will provide a framework for further analysis of competition issues in the market.

55 A market studies power would have significantly reduced the cost that the current approach is creating for retail fuel businesses. The current approach has resulted in multiple requests for little benefit. Following the conclusion of the Fuel Market Financial Performance Study it is likely that the Government will still not have a good understanding of the severity of competition problems in the market.

56 It is also likely that the Commerce Commission would have been the first port of call for the retail payments system study that MBIE recently undertook. MBIE picked this up because the Commerce Commission did not have a market studies power.

57 Finally, first principles would suggest that the funding approach should be agreed at the same time as policy decisions are taken. To do otherwise creates a financial risk to the Commerce Commission and a risk to our competition regulatory system. For instance, if the power is granted but not funded and the Minister directs the Commission to use it then the Commerce Commission is forced to trade off their adjudicative or enforcement activity with work on market studies. This would be detrimental to the competition regulatory system as a whole.

58 It is likely that a market studies power will be exercised more frequently than, for example, inquiries initiated under Part 4 of the Commerce Act 1986 (which concern markets such as electricity distribution in which there is little or no competition). If a fuel market study were initiated this would mean up-front investment is required. After that, officials would envisage lumpy expenditure in the medium-to-long term.

Stakeholder views

59 Submissions were narrowly in favour of introducing a market studies power. Those in favour of introducing a market studies power argued that market studies are an important tool in the kit of a competition authority, and that a market studies power would allow the Commerce Commission to make recommendations to address market problems and barriers to competition. This would ultimately serve to improve the welfare of consumers.

60 Those opposed to market studies were concerned that they would add to the regulatory burden faced by firms, that any responses to recommendations would have a low or

negative marginal benefit, and that a formal market studies power would duplicate the partial market studies powers already held by existing government agencies.

Section 36 of the Commerce Act

61 I have identified a number of issues with section 36. This is a contentious area, with stakeholders presenting polarised views on the case for change. I am also conscious of the desirability of trans-Tasman alignment (where beneficial) and note that Australia is in the process of changing their equivalent provision. I am therefore proposing that officials should seek further empirical evidence of harm occurring and the costs and benefits of alternatives to the current formulation of section 36, with a report back by the end of 2018. There is however no assumption that reform is necessary.

Background

62 Section 36 of the Commerce Act sets out New Zealand's rule against anticompetitive exclusionary conduct. The rule is one of New Zealand's main prohibitions on anticompetitive unilateral conduct (the other being the prohibition against resale price maintenance)[1]. Section 36 is used to sanction firms with substantial market power when they engage in anticompetitive conduct that prevents or deters rivals and potential rivals from competing.

63 This is a critical component of any competition regime but is particularly important in New Zealand as we have a small and remote economy, meaning that there are likely to be fewer players, and therefore more dominant players, than in equivalent markets abroad. Consequently, a provision that fails to deter anticompetitive conduct is likely to lead to greater harm for consumers in New Zealand than in larger markets. Also, a provision that over penalises and deters procompetitive conduct is likely to have a greater impact on businesses' confidence to engage in pro-competitive behaviour than in larger markets.

64 Examples of the types of anticompetitive conduct that are sanctioned by the provision include:

a. Predatory pricing: for example, where a powerful business lowers its prices for a sustained period of time to drive a competitor or competitors out of the market. This may be prohibited if these prices are below an appropriate measure of cost and the business has the ability to recoup its losses by increasing its prices later, without likely entry into the market by others.

b. Refusal to deal: where a vertically-integrated business refuses to supply a competitor with an input or to give the competitor access to infrastructure, which the competitor needs to be able to compete in downstream markets.

c. Tying: where a business only sells a product if the customer purchases it together with another product. For example, if a firm dominant in respect of one product market sells that product together with another product (in which the firm is not dominant), competition for the latter product could be impeded if the combined price of the tied products is significantly less than the prices of the products when sold separately.

[1] The Commerce Act also covers anticompetitive multilateral arrangements (such as price fixing and group boycotts), anticompetitive mergers and acquisitions and provides for regulation in the absence of competition (for instance where monopolies exist).

65 The prohibition has three elements: a firm must have substantial market power; it must take advantage of that market power; and it must have at least one of the three exclusionary purposes listed (restricting the entry of a person into that or any other market, preventing or deterring a person from engaging in competitive conduct in that or any other market or eliminating a person from that or any other market). The reference to a firm's purpose distinguishes between a straight exercise of market power (such as monopoly pricing, which is not illegal) and the exercise of market power to impede competition.

66 The requirement that a firm with substantial market power take advantage of that market power means that the market power must have in some way contributed to the ability of the firm to undertake the conduct (i.e. there must be a 'causal connection' between the firm's market power and the conduct it undertakes). The courts have interpreted this requirement to mean that the plaintiff must construct a hypothetical market in which the defendant firm is without a substantial degree of market power and demonstrate that in that hypothetical market the defendant would not have undertaken the conduct at issue. This detailed inquiry is known as the 'counterfactual test' and is one of the root causes for the problems with section 36.

Problem definition

67 The current formulation of section 36 has been criticised for two primary reasons.

68 The first criticism is of the choice, by the legislature, of a 'causal connection' requirement over a different approach (such as an effects test). The causal connection requirement necessitates a link between the firm's market power and the conduct it undertakes (the power somehow enables the conduct).

69 The second criticism is of the judicial interpretation of that requirement, which has meant plaintiffs must construct a hypothetical market in which the defendant does not have substantial market power (the so-called 'counterfactual test', or 'comparative exercise'). Criticism of the current test and its interpretation has been led by the Commerce Commission, the Australian Competition and Consumer Commission, and Consumer NZ.

70 This formulation and judicial interpretation of section 36 leads to three main problems:

a. The potential for wrong answers that could harm competition and, in particular, fail to deter or penalise some types of conduct that may undermine the long-term benefit of consumers (often referred to as 'false negatives').

b. Costly and complex enforcement that reduces the incentive for businesses to comply with the law.

c. Some unpredictability for day-to-day business decision making, reducing the incentive for businesses to vigorously compete.

71 I am of the view that there are problems with section 36 and that it is an important provision to get right in a small market like New Zealand. However, it has proven difficult to categorically identify examples of actual cases leading to wrong answers or cases foregone because of the nature of the test.

72 For instance, the Commerce Commission has not been able to indicate whether the current formulation and interpretation of section 36 has led them to forego investigations where it considered the long-term interests of consumers were being harmed. The Commission reasons, and rightfully so, that this is because all its analysis of past cases

has been undertaken within the current legal framework for section 36, meaning they have not been able to consider whether harm has occurred outside the bounds of the existing legal test.

73 This means that there is a lack of empirical evidence to indicate the scale of harm occurring, or likely to occur, under the status quo. This uncertainty about the likely scale of the problem with the status quo makes it difficult to compare the net benefits of alternative options with the status quo.

Potential alternatives

74 If we were to reform section 36, the options might include one or more of the following:

a. An 'effects test': Under this approach, a firm with market power would be in breach of section 36 whenever its conduct had a substantial anti-competitive effect. Unlike the current test, this test would not include any requirement that the firm in question must have *used* its market power in some way.

b. A constrained 'effects test': this option would be based on the effects test, but allow firms with market power to seek authorisation for, or invoke a defence excusing, anti-competitive conduct. For example, a defence might be available when the conduct is likely to lead to a net public benefit or to create significant efficiencies. Alternatively, breach might be limited to cases of 'reasonably foreseeable' anti-competitive effects.

c. An 'effects or purpose' test: this is the model currently being considered by Australia. Under this approach, a firm with market power would be in breach of section 36 whenever its conduct had a substantial anti-competitive effect, or whenever its intention was to create a substantial anti-competitive effect.

d. Reversing part of the burden of proof under the current test: for instance, a defendant that held a substantial degree of market power and was proven to have acted with an anti-competitive purpose, could be required to prove that it did not take advantage of its market power in doing so.

e. Supplementing the current (or a new) general test for anticompetitive unilateral conduct, with one or more specific tests for categories of conduct where that general test struggles most (such as where a supplier with market power sets up exclusive dealing arrangements with retail distributors).

75 On 16 March 2016, the Australian Government announced it would adopt an 'effects or purpose' test for its equivalent provision - section 46. Subsequently, on 1 December 2016 the Australian Government introduced the Competition and Consumer Amendment (Misuse of Market Power) Bill 2016 into the House of Representatives. The Bill incorporates an 'effects or purpose' test. The Senate Economics Legislation Committee reported back on the Bill on 16 February 2017, the Bill passed the House of Representatives on 28 March 2017 and had its first reading in the Australian Senate on 29 March 2017.

Stakeholder views

76 Around two-thirds of submitters on the issues paper – including many large firms and the law firms that represent them – supported retaining the current test contained in section 36 of the Commerce Act, on the basis that there was little practical evidence of a problem with the current test at present, and even if there is a problem, the costs of change would outweigh the benefits. For example, through the creation of significant uncertainty until

new case law emerged, and by discouraging larger firms from taking aggressive, consumer welfare-enhancing competitive actions.

77 However, a number of submitters, including the Commerce Commission, supported a change to section 36, on the basis that:

a. the courts have interpreted the 'take advantage' requirement contained in section 36 into a counterfactual test that is too difficult for a plaintiff to prove – that is, regardless of a case's merits, it is extremely difficult to win a section 36 case at present;

b. the 'purpose' requirement is misaligned with the rationale for having competition laws, which is to protect against harmful *effects* on the competitive process; and

c. concerns about the practical difficulties that an amendment would create are overblown.

Proposal

78 I propose that officials should seek further empirical evidence of harm occurring and the costs and benefits of alternatives to the current formulation of section 36, with a view to me reporting back to Cabinet before the end of 2018.

79 The problems identified with section 36 mean that there is a risk of harm occurring to consumers under the status quo, either because anticompetitive behaviour is not deterred or not litigated, or because pro-competitive behaviour is inhibited. However, the lack of empirical evidence on the scale of the problems with section 36 means that the scale of the potential harm from the provision is unclear. It also makes it difficult to robustly assess whether there is a net benefit in changing to an alternative formulation such as an effects test.

80 This is a contentious area, with stakeholders presenting polarised views on the pros and cons of an effects test. Additionally, there is significant variation in how effects tests and other options are designed. If reform progresses, it would therefore be desirable to release an options paper prior to making final decisions on section 36.

81 In the meantime, MBIE would explore further sources of evidence, for example:

a. monitoring (in line with Cabinet's initial expectations for regulatory stewardship (March 2013)) potential or actual instances where the regime fails to adequately deter or penalise misuse of market power; and

b. if possible in the time available, assessing the changes Australia is making to its equivalent provision and any subsequent behavioural changes or developments in its case law.

Repeal of the cease-and-desist regime

82 I am proposing to repeal the current 'cease-and-desist' regime, as it is cumbersome and has only been used once since it was introduced in 2001.

83 At present, except in the case of mergers and acquisitions, standard enforcement of the Commerce Act involves the Commerce Commission (or a private plaintiff) taking a firm to court. To avoid the time and expense involved with such an approach, the Commerce

Commission also has at its disposal two main alternative enforcement mechanisms that are designed to resolve competition issues in a more efficient manner.

84 One of the alternative enforcement mechanisms available is the 'cease-and-desist' regime, in which a specially-appointed Cease and Desist Commissioner can, at the request of Commerce Commission staff, issue an order to restrain a firm's conduct where it is likely to be in breach of the Commerce Act.

85 The main issue with the cease-and-desist regime is that its procedural requirements offer no practical advantages over the standard approach of seeking an interim injunction from the courts. As a reflection of this, since its introduction in 2001, it has only been used once. Nevertheless, the Government is required to appoint two Cease and Desist Commissioners every five years. This wastes government resource, and imposes costs on the Commissioners, such as the inability to take some legal cases due to a conflict of interest.

86 I consider that standard court processes for obtaining an injunction provide the Commerce Commission with sufficient ability to enforce likely breaches of the Commerce Act. Therefore I am seeking agreement to repeal the Commerce Act's cease-and-desist regime.

87 Only nine submissions on the Targeted Commerce Act Review addressed the issue of alternative enforcement mechanisms in any depth. There was unanimous agreement that the cease-and-desist regime should be repealed.

Establishment of an enforceable undertakings regime

88 I propose to establish an enforceable undertakings regime under the Commerce Act as there is a risk that settlements under the Commerce Act may not be effectively enforced in some circumstances.

89 By way of context, alongside the cease-and desist-regime, the Commerce Commission has at its disposal another alternative enforcement mechanism that is designed to resolve competition issues in a more efficient manner – negotiated settlements. This does not apply to mergers or acquisitions but to all other aspects of the Commerce Act.

90 Negotiated settlements are voluntary. A firm under investigation or defending court proceedings may approach the Commission to make a settlement proposal, which will include details on how non-compliance with the Commerce Act has been or will be rectified.

91 Negotiated settlements have been criticised as being difficult to enforce. While the terms of a settlement have never been breached, if they were to be, the Commerce Commission would need to take a civil claim in the High Court, and prove that it (rather than consumers or other firms) has suffered harm. In addition, before the court can order a firm to perform its obligations under the settlement, it must be convinced that monetary damages were an insufficient remedy. These difficulties create a risk that settlements under the Commerce Act may not be appropriately enforced in some instances.

92 An enforceable undertaking is essentially a voluntary negotiated settlement granted special status under legislation to allow it to be immediately enforced as if it were a court decision. In the event of a breach of an undertaking, the Commerce Commission could apply to a court for an enforcement order. Parties would be free, but not obliged, to include in the undertaking an admission of breach of the Commerce Act. This is a much

less onerous process than proving a breach of the settlement and is likely to incentivise greater compliance.

93 Enforceable undertaking regimes are contained in a range of legislation, including the Financial Markets Authority Act 2011, the Fair Trading Act 1986, and the Employment Relations Act 2000.

94 I am seeking Cabinet agreement to establish an enforceable undertakings regime under the Commerce Act.

95 The regime would cover behavioural undertakings (e.g. a commitment to cease certain conduct) but not structural undertakings (e.g. a commitment to divest certain assets). I consider that structural undertakings are appropriate only in merger and acquisition scenarios.

96 Only nine submissions addressed the issue of alternative enforcement mechanisms in any depth. Stakeholders held mixed views on whether there was a need for an enforceable undertakings regime to be introduced: broadly speaking, law firms and the consumer association Consumer NZ were in favour, while the New Zealand Law Society and the telecommunications operators Spark were against.

Business Growth Agenda: an action plan to promote competition

97 I am proposing to release a Business Growth Agenda (BGA) document, entitled *Promoting Competition*.

98 The BGA document, which is attached, sets out the importance of promoting competition in a small, distant economy such as New Zealand, outlines some of the key things that we know about competition in New Zealand, highlights recent work by the Government to promote competition and outlines ongoing actions to promote competition across the economy.

99 Up until this point, the Government's work relating to promoting competition has sat within the *Building Innovation* workstream and chapter of the BGA. At the BGA Investment Ministers' meeting on 12 September 2016, a proposal was discussed to publish a BGA document entitled *Promoting Competition* as a subset of the BGA Innovation workstream. The *Promoting Competition* document was subsequently tested with BGA Innovation Ministers at the BGA Innovation meeting on 31 October 2016. Feedback from Ministers has been incorporated into the document.

100 Releasing an action plan for promoting competition will give greater prominence to the Government's competition work programme and help communicate the Government's existing competition work programme more effectively to stakeholders.

101 Responsibility for this sub-workstream will sit with officials at MBIE. I am not proposing that any additional BGA governance structures be added. Competition-related agenda items for discussion at BGA Ministers' meetings will continue to be discussed at either *BGA Innovation* or *BGA Investment* meetings.

Consultation

102 The following agencies have been consulted: the Treasury, the Ministry of Justice, the Ministry for Primary Industries, the Ministry of Transport, the Ministry of Foreign Affairs and Trade, and the Commerce Commission. The Department of Prime Minister and

Cabinet has been informed.

Treasury comment

103 Treasury agrees that the targeted review has not generated evidence for officials to be confident about how to address the problem with section 36 and agrees with the recommendation to continue to collect evidence about the implications for market conduct and economic outcomes. The relationship between anticompetitive conduct deterrence and actual market behaviour in New Zealand is unclear, and the role of deterrence vis-à-vis underlying structural drivers of New Zealand competition intensity is not yet well-understood, resulting in differing views about the scale of the problem. Given developments in Australia, a 'wait and see' approach that keeps all options on the table (including an effects test) makes sense.

104 While it is unclear when or what may indicate a particular case for reform at this stage, Treasury considers that a broader range of stakeholders could be engaged in the debate and their perspectives incorporated into the evidence base, including smaller market participants or potential market entrants. This may require clearer focus on empirical evidence of market outcomes. While waiting to collect more evidence has a potential cost of risking continued anticompetitive outcomes (if they have occurred), moving to an options paper after reporting back with evidence at the end of 2018 seems reasonable to allow for expanding and reviewing the evidence base. Experience in Australia should also be useful for assessing the relative benefits and risks of reform, although this experience is likely to take more time to emerge.

105 The Treasury supports providing a market studies power to the Commerce Commission at the instigation of the Minister of Commerce and Consumer Affairs. We consider that appropriate information gathering powers are necessary to enable the Commerce Commission to effectively conduct a market study. As New Zealand's competition regulator, the Commerce Commission is well-placed to identify competition issues within markets that are likely to be having a significant impact on New Zealand's economic performance and, alongside the Minister of Commerce and Consumer Affairs, to instigate studies into those issues. The lack of a market studies power is a gap between New Zealand's competition system and world leading systems. These studies will identify issues and provide advice as to how to promote competition in specific markets. We consider that some of the greatest gains for competition in New Zealand will come from removing barriers to competition in specific markets.

Commerce Commission

106 The Commission supports the amendment of the Commerce Act to provide for market studies conducted by the Commission, but this support is contingent on appropriate funding being made available to undertake these studies. The Commission considers that either the Commission or the Minister should be able to initiate a market study, consistent with international practice. The Commission notes that the details of the proposed market study function have not been confirmed, but that safeguards will be needed to ensure that directions to conduct a market study do not interfere with the Commission's adjudicative or enforcement activity.

107 The Commission considers that an options paper is desirable to fully explore and consider the relevant options for reform of section 36. The Commerce Commission considers that section 36 is in urgent need of reform. The Commission notes that it will be a matter of some years before the proposed monitoring is complete, and that the Australian

amendments are unlikely to be in force with sufficient time to generate significant case law in Australia by the end of 2018.

108 The Commission supports the recommendations that the cease and desist regime should be repealed, and that an enforceable undertakings regime should be introduced.

Risks and mitigation

Potential increase in reliance on interim injunctions

109 A risk associated with repealing the cease-and-desist regime is a potential increase in reliance on interim injunctions, which would mean more workload for the District and High Courts. However, in practice, given the fact that the cease-and-desist regime is not being used, the impact is likely to be minimal.

Negative stakeholder reaction to a further delay in relation to section 36

110 The review of section 36 has extended over a significant length of time, with stakeholders investing substantial effort into their submissions. A further delay may frustrate stakeholders, leading to public criticism and a loss of engagement.

111 However, the strongly opposing views on section 36 mean that all possible routes are open to criticism. Many stakeholders would criticise a decision to dismiss the case for reform. On the other hand, moving immediately to an options paper would make it difficult to assess the costs of the status quo and therefore the possible benefits of change – in this scenario the criticism could be levelled that the case had not been made for change.

112 Cabinet has previously been informed that the Issues Paper would be followed by an Options Paper [EGI 15 Min 0142 refers]. MBIE has also indicated as much to stakeholders. I therefore consider that the best way to manage the risk is to seek further evidence without ruling out proceeding to an options paper in the future.

Inability to uncover further evidence regarding section 36

113 There is a risk that efforts to uncover further evidence (particularly of false negatives) will not succeed. However, given the current situation of uncertainty I consider that it is worth instating a forward looking monitoring arrangement to seek further evidence.

Other risks

114 Risks from introducing a market studies power can be mitigated through design choices.

115 I do not foresee any material risks associated with introducing an enforceable undertakings regime.

116 I do not foresee any material risks from releasing the *Promoting Competition* BGA document.

Financial Implications

117 Additional baseline funding is required to ensure that the Commerce Commission's existing statutorily independent enforcement and adjudicative functions are not compromised by the transmission of a market studies inquiry by the Minister of Commerce and Consumer Affairs.

118 It is proposed that a new non-departmental output expense appropriation titled "Market studies inquiries" be established with up to $1.5 million available in each financial year. This funding amount is based on a comparison of costs of New Zealand Productivity Commission (NZPC) inquiries and the estimated costs of economic regulation inquiries under Part 4 of the Commerce Act. Each NZPC inquiry costs around $2.2 million and is generally likely to be broader in scope than the proposed market study inquiries, while Part 4 inquiries are generally narrower in scope and estimated to cost around $1 million.

119 The Commerce Commission would only be able to access this funding once a market studies inquiry has been transmitted by the Minister of Commerce and Consumer Affairs. To recognise that market studies inquiries are unlikely to be homogenous in nature or fit neatly within financial years, it is also proposed that the Ministers of Finance and Commerce and Consumer Affairs be authorised to agree in principle to the transfer of any under expenditure into the following financial year, subject to confirmation of the final amount in each year's October Baseline Update once audited financial statements are available.

120 It is not possible to complete a full cost benefit analysis of a market studies power because it is impractical to estimate the economic benefits of a market studies power in the absence of clarity about the markets that would be studied, or the nature of any economic inefficiencies in these markets. However, international experience suggests that the provision of market studies powers to competition authorities is likely to result in net economic benefits over time.

121 Funding for a market studies power cannot be deferred to Budget 2018 because it would not be appropriate to provide an unfunded market studies power to an independent regulator like the Commerce Commission. In the absence of additional funding, the transmission of a market study to the Commission would result in a reduction in Commission's enforcement activity and/or a decline in the timeliness of their clearance and authorisation work. Reprioritisation within the Commission's Crown funded activities would have the same impact and would also run counter to the reason that the Commission was provided with additional funding as part of Budget 2016 i.e. to provide additional resources for enforcement and to support improved timeliness of clearance and authorisation work.

Human Rights

122 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative Implications

123 Legislative change to the Commerce Act will be required in relation to cease and desist, enforceable undertakings and market studies. In this regard, a Commerce Amendment Bill has a [redacted] priority on the 2017 legislative programme.

124 Legislative change to the Commerce Act may or may not be required in relation to section 36, depending on the report back due before the end of 2018 and subsequent Cabinet decisions.

125 No other proposals in this paper have legislative implications.

Regulatory Impact Analysis

126 The Regulatory Impact Analysis (**RIA**) requirements apply to matters covered in the Targeted Review of the Commerce Act 1986. Three Regulatory Impact Statements (**RISs**) have been prepared by the Ministry of Business, Innovation & Employment and are attached. The following assessments have been made.

a. **Section 36:** The Regulatory Impact Analysis Team at the Treasury (RIAT) has reviewed the RIS prepared by the MBIE. Given the RIS's transparency about the incomplete state of evidence, and the fact that further work is proposed, RIAT considers that the RIS meets the quality assurance criteria.

b. **Alternative enforcement mechanisms:** MBIE's independent RIS review panel has reviewed the RIS, and considers the information and analysis summarised in the RIS meets the quality assurance criteria.

c. **Market studies:** The Regulatory Impact Analysis Team at the Treasury (RIAT) has reviewed the RIS. The reviewers consider that the information and analysis summarised in the RIS meets the QA criteria. The RIS demonstrates that providing the Commerce Commission with full market studies powers will advance the overall outcome sought by competition policy in New Zealand (as reflected in the Commerce Act 1986), which is to promote the long-term benefit of consumers. However, it is difficult to quantitatively assess the costs and benefits of a market studies power in general. RIAT suggests that, if this proposal is implemented, MBIE should be involved not only in responding to the recommendations following a particular market study, but also in formally assessing the costs and benefits arising from the procedure as a whole.

Publicity

127 Subject to Cabinet's agreement to the recommendations in this Cabinet paper, I intend to issue press releases announcing Cabinet's decisions and releasing the *Promoting Competition* document. This will likely be coordinated with announcements by the Minister of Energy and Resources regarding the fuel market financial performance study. MBIE will publish a copy of this Cabinet paper on its website. I intend to hold the release of the *Promoting Competition* document until after the refreshed overall Business Growth Agenda is released.

128 I expect a moderate level of business and media attention to the outcomes of this review.

Recommendations

129 The Minister of Commerce and Consumer Affairs recommends that the Committee:

a. **Note** that the Productivity Commission's 2014 Inquiry into *Boosting Productivity in the Services Sector* recommended that section 36 of the Commerce Act 1986 should be reviewed and that the Commerce Commission should be able to undertake studies on competition in any specific market in the economy;

b. **Note** that MBIE officials have conducted a targeted review of the Commerce Act, covering alternative enforcement mechanisms, section 36 and the value of a market studies power for the Commerce Commission;

Regarding alternative enforcement mechanisms in the Commerce Act 1986:

c. **Note** that the Commerce Act includes two main alternative enforcement mechanisms: a 'cease-and-desist' regime; and negotiated settlements;

d. **Note** that the cease-and-desist regime's cumbersome procedural requirements offer no practical advantages over the standard approach of seeking an interim injunction from the courts;

e. **Agree** to repeal the Commerce Act's cease and desist regime;

f. **Note** that an enforceable undertakings regime in the Commerce Act would allow a negotiated settlement to be immediately enforced as if it were a court decision;

g. **Agree** to the establishment of an enforceable undertakings regime in the Commerce Act;

Regarding section 36 of the Commerce Act:

h. **Note** that section 36 of the Commerce Act is one of New Zealand's main prohibitions on anticompetitive unilateral conduct;

i. **Note** that the formulation of section 36 and its judicial interpretation lead to three main problems:

   i. The potential for wrong answers that could harm competition and in particular, fail to deter or penalise some types of conduct that may undermine the long-term welfare of consumers;

   ii. Costly and complex enforcement that reduces the incentive for businesses to comply with the law; and

   iii. Some unpredictability for day-to-day business decision making, reducing the incentive for businesses to vigorously compete;

j. **Note** that it has proven difficult to obtain empirical evidence to indicate the scale of harm occurring, or likely to occur, under the status quo and that stakeholders hold polarised views on the issues surrounding section 36 and the solutions to these issues;

k. **Invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet by the end of 2018 with:

   i. any further evidence of harm occurring;

   ii. the costs and benefits of alternatives to the current formulation of section 36 of the Commerce Act 1986;

   iii. any further developments in Australia on misuse of market power; and

   iv. recommendations as to whether to proceed to an options paper;

Regarding a market studies power for the Commerce Commission:

l. **Note** that there is an institutional gap in New Zealand's competition regime regarding the ability to promote, as opposed to merely protect, competition, which internationally is typically filled by a market studies power;

m. **Agree** that Part 1 of the Commerce Act 1986 be amended so that the Minister of Commerce and Consumer Affairs can direct the Commerce Commission to undertake market studies;

n. **Agree** that the Commerce Commission, in undertaking a market study, be able to use appropriate information gathering powers;

o. **Agree** to establish the following new appropriation:

Vote	Appropriation Minister	Title	Type	Scope
Business, Science and Innovation	Minister of Commerce and Consumer Affairs	Market Study Inquiries	Non-Departmental Output Expense	This appropriation is limited to market study inquiries undertaken by the Commerce Commission in accordance with Part 1 of the Commerce Act.

p. **Approve** the following changes to appropriations to give effect to the policy decisions in recommendation **m**:

	$m – increase/(decrease)				
Vote Business, Science and Innovation **Minister of Commerce and Consumer Affairs**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
Non-Departmental Output Expense: Market Study Inquiries	-	-	1.500	1.500	1.500

q. **Agree** that the proposed change to appropriations for 2018/19 above be included in the 2018/19 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;

r. **Agree** that expenses incurred under recommendation **p** above be a charge against the between-Budget operating contingency, established as part of Budget 2017;

s. **Authorise** the Minister of Finance and the Minister of Commerce and Consumer Affairs to agree in principle that any under expenditure in the "Commerce and Consumer Affairs: Market Studies Inquiries" Appropriation be transferred into the following financial year, subject to confirmation of the amount in each year's October Baseline Update once audited financial statements are available;

Regarding implementation of decisions

t. **Invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the decisions in this paper on the cease and desist regime, enforceable undertakings, and market studies;

u. **Note** that a Commerce Amendment Bill has a [redacted] priority on the 2017 legislative programme and is the appropriate vehicle for making the amendments to the Commerce Act proposed in this paper;

v. **Note** however that it may be necessary to accelerate Parliamentary consideration of the Commerce Amendment Bill, to ensure that the decisions in this paper can be introduced without undue delay;

Regarding the Promoting Competition BGA document:

w. **Note that the Promoting Competition BGA document:**

i. sets out the importance of promoting competition in a small, distant economy

such as New Zealand;

ii. outlines some of the key things that are known about competition in New Zealand;

iii. highlights recent work by the Government to promote competition; and

iv. outlines ongoing actions to promote competition across the economy.

x. **Note** that the *Promoting Competition* BGA story was tested with BGA Innovation Ministers on 31 October 2016;

y. **Agree** to the public release of the *Promoting Competition* BGA document; and

z. **Authorise** the Minister of Commerce and Consumer Affairs to make editorial amendments to the *Promoting Competition* BGA document prior to its release, including a reference to a market studies power if agreed to by Cabinet.

Authorised for lodgement
Hon Jacqui Dean
Minister of Commerce and Consumer Affairs