

## IN CONFIDENCE

### OFFICE OF THE MINISTER OF COMMERCE AND CONSUMER AFFAIRS

#### The Chair Cabinet Business Committee

#### Commerce Commission Self-initiation of Market Studies under the Commerce Act

##### Proposal

- 1 This paper seeks Cabinet approval to amend the Commerce Act 1986 to empower the Commerce Commission to self-initiate market studies to supplement earlier Cabinet decisions to introduce a new market studies regime.

##### Executive summary

- 2 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.
- 3 On 6 and 26 June 2017, Cabinet agreed to amend the Commerce Act to empower the Commerce Commission to undertake market studies at the direction of the Minister of Commerce and Consumer Affairs. The Minister was only to give such a direction if he or she was satisfied that undertaking the market study was likely to be in the public interest [CAB-17-MIN-0274, CAB-17-MIN-0320 refers].
- 4 I support the introduction of a new market studies function for the Commerce Commission. This will fill a current institutional gap in New Zealand's competition regime relating to competition problems that cannot be addressed by the Commerce Commission in an enforcement action or merger determination.
- 5 I consider, however, that this regime could be strengthened by also allowing the Commerce Commission to self-initiate a market study. As an independent expert competition body, the Commerce Commission is likely to be better placed to identify markets that are not performing well and where a market study can have the most impact.
- 6 If the Commerce Commission is to be able to initiate market studies, I recommend that the legislation is also amended to include measures to promote good regulatory practice and ensure the market study is a good use of government resources.
- 7 First, the Commerce Commission should only be able to initiate studies if it is satisfied that undertaking the market study is likely to be in the public interest (or wording with a similar effect). While maintaining the Commerce Commission's statutory independence, I anticipate that the Commerce Commission will consult with relevant departments and Ministers as part of its process for selection of markets for study and it will scope any study within its funding constraints to get the greatest impact from this work.
- 8 Second, the Commerce Commission should be required to publish its terms of reference for the study setting out the scope of the study and the deadline for publishing its final report. Third, in carrying out a market study the Commerce Commission should be required to publicly release a draft of its report and consider any submissions received.

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- 9 I also recommend that the Commerce Commission is invited to prepare administrative guidelines on how it proposes to carry out this new market studies function. This will improve transparency. Officials will also be directed to initiate an evaluation of the market studies function within five years of it coming into effect.
- 10 On 26 June 2017, Cabinet also agreed to establish a new dedicated appropriation of \$1.5 million per annum to fund the Commerce Commission to undertake market studies.
- 11 A Commerce Amendment Bill is currently being drafted which will include the new market studies regime. I am seeking priority [REDACTED] for this Bill on the 2018 Legislation Programme.

### Background

#### *Market studies by competition authorities*

- 12 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. The outcome of a market study may include a range of recommendations, such as for:
- 12.1 changes in policy for central or local government
  - 12.2 changes in industry behaviour, or the behaviour of industry regulators
  - 12.3 greater or different information disclosure by market participants.
- 13 Most overseas competition authorities, including in Australia and the United Kingdom, have some form of market studies function. This function offers competition authorities the possibility to investigate concerns with competition in a sector outside of the context of an investigation into specific anticompetitive behaviour or mergers.
- 14 An example of the existence of this gap in New Zealand's competition regime was identified when the Commerce Commission cleared Z Energy's proposed acquisition of the assets of Chevron New Zealand in April 2016. Although there were concerns about competition in some regional fuel markets, clearance was granted on the basis that the acquisition was unlikely to substantially lessen competition further. The Commerce Commission noted that it was unable to look further at existing barriers to competition or make recommendations around these.
- 15 Given the level of concern with the performance of the fuel market, the Ministry of Business, Innovation and Employment ('MBIE') subsequently undertook a financial performance study into fuel markets, but this was not a complete solution to filling this institutional gap. In particular, despite most companies cooperating in good faith, the lack of information gathering powers meant that MBIE was unable to draw conclusions on the causes of the fuel price differentials around the country or the increase in fuel margins.
- 16 The OECD and the New Zealand Productivity Commission have both recommended that the Commerce Commission should be provided with the power and resources to conduct market studies.

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### *Previous Cabinet decisions*

- 17 In June 2017, Cabinet made a number of decisions relating to amending the Commerce Act to empower the Commerce Commission to undertake market studies. These decisions were the outcome of a review carried out by MBIE.
- 18 On 6 June, [CAB-17-MIN-0274 refers] Cabinet agreed that:
  - 18.1 Part 1 of the Commerce Act be amended so that the Minister of Commerce and Consumer Affairs can direct the Commerce Commission to undertake market studies
  - 18.2 the Commerce Commission, in undertaking a market study, be able to use appropriate information gathering powers.
- 19 On 26 June, [CAB-17-MIN-0320 refers] Cabinet agreed:
  - 19.1 to set out in the Commerce Act a high-level principle that requires the Minister, before initiating a market study, to have reason to believe that a study into the provision of the relevant goods or services is likely to be in the public interest, or in the long-term interests of consumers (or wording with a similar effect)
  - 19.2 to establish a new Market Study Inquiries appropriation of \$1.5 million per annum to fund the Commerce Commission to carry out market studies. This appropriation is effective from the 2018/19 financial year, subject to the passage of the amending legislation
  - 19.3 that an exposure draft of the amendment bill giving effect to the decisions on market studies (and other matters relating to alternative enforcement mechanisms) would be released for consultation.
- 20 This paper seeks to supplement the above decisions to also allow the Commerce Commission to self-initiate a market study if satisfied that such a study into the provision of the relevant goods or services is likely to be in the public interest (or wording with a similar effect).

### **Comment**

#### *Reasons for Minister-only initiation*

- 21 The initiation of a market study by the Commerce Commission was one of the key issues considered by the previous government in the design of the new market studies function.
- 22 While supporting the introduction of a market studies function, the previous government's decision that only the Minister responsible for the Commerce Commission could initiate a market study was intended to provide the government with more control in order to manage concerns identified. Submissions received as part of the MBIE review were narrowly in favour of introducing a market studies function for the Commerce Commission.
- 23 Those in favour (such as 2degrees, the Law Society, the Insurance Council of New Zealand, BNZ, Matthews Law, Chorus, the Food and Grocery Council, Consumer New Zealand) considered that market studies are an important tool in the kit of a

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competition authority to address market problems and ultimately improve the welfare of consumers.

- 24 Those opposed (such as the Building Industry Federation, Orion, Metals New Zealand, DLA Piper, IAG, ANZ, Business New Zealand, Retail New Zealand, Russell McVeagh, Bell Gully and Spark) raised concerns it 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 government agencies.
- 25 Similar discussions about the relative advantages and disadvantages of markets studies by competition authorities have been raised in other forums, such as in roundtables at the OECD Competition Committee and in submissions to the Productivity Commission.
- 26 In response, the previous government decided that the process of initiating the market study would require the responsible Minister to prepare terms of reference for the market study, in consultation with the Commerce Commission. Once transmitted, the Commerce Commission would be required to comply with these terms of reference.
- 27 This process would enable the government to control the selection of the markets to be investigated and the timing of the investigation, so that any recommendations for action resulting from the Commerce Commission findings would be more likely to be consistent with the government's priorities. In addition, through the setting of the terms of reference, the government could focus the inquiry and the reporting deadline to limit the potential for 'fishing expeditions'. The relatively modest size of the appropriation to carry out this work, set at \$1.5 million per annum, was also seen as a control to encourage targeted enquiries.
- 28 The additional requirement that a market study could only be initiated if the Minister was satisfied that undertaking the study would likely be in the public interest, was intended to mitigate the risk of political pressure to carry out 'populist' inquiries that would be a poor use of government resources.

### *Case for Commerce Commission self-initiation*

- 29 The main disadvantage with restricting initiation of market studies to the Minister is that it places a political element in the selection of markets for investigation. As an independent expert competition authority, the Commerce Commission is likely to be better placed to identify those markets that are functioning sub-optimally and to scope the focus of its investigation. Commerce Commission self-initiation also avoids any perceived conflicts if the government also has a commercial interest in the market or if it is impeded from investigating a market due to strong lobbying by vested interests.
  - 30 Furthermore, if the Commerce Commission is able to self-initiate a market study, the concerns outlined above that were raised by some interested parties are able to be addressed by other means, including in the legislative design. A proposed scheme for Commerce Commission-initiated studies is outlined below.
- A *Selection of markets and scoping of study*
- 31 One of the critical factors for the success of this regime is in the selection of markets for study and the scoping of the inquiry.

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- 32 First, before the Commerce Commission could initiate a market study, the legislation will require it to be satisfied that undertaking the study would likely be in the public interest (or wording with a similar effect).
- 33 In making this assessment the Commerce Commission will analyse information drawn from a wide variety of sources to identify markets that have competition concerns that may merit in-depth study and determine the scope of any study. The types of prioritisation criteria that are considered by overseas competition authorities in deciding to initiate a market study, and which may be relevant, include:
- 33.1 *Likely impact:* The scale and significance of possible competition problems in the market and the potential impact of a study on consumers, businesses and the wider economy.
  - 33.2 *Strategic significance for the competition authority:* Whether the study ties in with the authority's strategy and objectives, whether the authority is best placed to act, and how the balance of the authority's work would be affected by the study?
  - 33.3 *Risks:* What is the likelihood of a successful outcome from the study, including the ability to design effective remedies and the likely influence of the report?
  - 33.4 *Resources:* What are the resource implications for the authority of doing the study?
- 34 In its 2008 roundtable on market studies, the OECD Competition Committee concluded that market studies are most effective when they are focused on the prospects for change rather than simply the importance of the competition problem. Consequently, while respecting the Commerce Commission's statutory independence, I anticipate that it would consult with relevant departments and Ministers as part of its prioritisation process, as appropriate, to promote the likelihood of adoption of its report.
- 35 In addition, in the case of Minister-initiated market studies, I anticipate early discussions with the Commerce Commission, such as in the course of the normal accountability arrangements, in order to minimise the potential for competing demands on the Commerce Commission's limited resources. I consider that this prioritisation process should be left to administrative arrangements rather than being formalised in legislation. This would protect the Commerce Commission's independence and limit grounds for judicial review.
- B Commerce Commission process for undertaking market study*
- 36 Second, as part of initiating a market study, the Commerce Commission would be required to publish its terms of reference for the market study. This would promote transparency and provide a focus for the Commission's enquiries. In particular, clear terms of reference and a reporting deadline would guard against 'scope-creep' and the potential for a period of prolonged uncertainty created by the study.
- 37 Third, in order to ensure that the Commerce Commission's findings are well consulted and analysed, the statute would include obligations for the Commerce Commission to:
- 37.1 release a draft of its market study report for consultation
  - 37.2 have regard to any submissions received from interested persons in finalising its report

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37.3 publish its final report setting out its findings and, if relevant, any recommendations to improve the performance of the relevant markets. For example, a report may include recommendations to government relating to law reform or other matters, but such recommendations would not be binding and there would be no obligation on the government to respond.

38 These requirements, including the requirement to publish the terms of reference and to publicly consult on a draft report, should be standard features of a market study regardless of whether the Minister or the Commerce Commission initiates the study. This will mitigate the risk that the Commerce Commission's findings are based on inaccurate or incomplete information. The non-binding nature of the Commerce Commission's reports also reflects that these competition studies are anticipated to inform the government's policy processes rather than be a full analysis of wider economic and social impacts.

### *Conclusion on Commerce Commission self-initiation*

39 Taking into account these matters, I propose that the Commerce Amendment Bill currently being drafted to give effect to the earlier Cabinet decisions on market studies should also include provisions that allow the Commerce Commission to self-initiate market studies.

40 The effect of this change is that market studies would not just be a tool for the government to inform its policy processes. The Commerce Commission would also be able to use market studies as a tool to support its other functions, including as part of its advocacy function to promote competition in markets. The requirements to promote transparency around the terms of reference and consultation with interested parties, coupled with constraints on funding and reporting deadlines, should address many of the concerns identified by stakeholders such that the benefits of this proposal outweigh the costs.

### *Commerce Commission guidelines and ex-post evaluation*

41 The introduction of a new market studies function for the Commerce Commission will be an important addition to New Zealand's competition regime. As with any function, there will be some initial uncertainty as to how it will operate and the implications for affected businesses, such as relating to the treatment of confidential information. I recommend that the Commerce Commission is invited to prepare a guideline on how it would administer this new function.

42 I also recommend that MBIE officials carry out an evaluation of the effectiveness of the market studies regime within five years of it coming into effect.

## **Consultation**

43 The following departments and agencies were consulted on the contents of this Cabinet paper: The Treasury, the Commerce Commission, the Ministry of Foreign Affairs and Trade, the Ministry for Primary Industries and the Department of the Prime Minister and Cabinet (Policy Advisory Group).

### *The Treasury comment*

44 Treasury supports the Commerce Commission's ability to self-initiate market studies, subject to appropriate safeguards preventing excessive industry burden. These safeguards are incorporated through limited funding (\$1.5m per year), the requirement

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to publish terms of reference and draft results of studies, and a requirement to be satisfied that a study is in the public interest.

### Financial implications

- 45 The proposals in this paper will have financial implications for MBIE and the Commerce Commission, but these costs should be met within existing baselines.

#### *Commerce Commission*

- 46 In the case of the Commerce Commission, on 26 June 2017 Cabinet agreed to establish a new dedicated appropriation as follows:

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

- 47 The Cabinet paper outlined that the Commerce Commission would only be able to access this funding once a market study has been transmitted by the Minister of Commerce and Consumer Affairs to the Commerce Commission. Any unused appropriation may be carried forward to the next financial year with the approval of the Ministers of Finance and Commerce and Consumer Affairs [CAB-17-MIN-0320 refers].
- 48 If the Commerce Commission is to be able to self-initiate market studies, it should also be able to access this funding to carry out market studies. However, no increase in the appropriation is sought for this purpose. A dedicated appropriation of \$1.5 million limited only for carrying out market studies should be sufficient to allow for one significant study or a number of smaller targeted studies each year.
- 49 An Output Agreement between the Minister of Commerce and Consumer Affairs and the Commerce Commission sets out any requirements relating to disbursement of appropriations. I intend to amend the current Output Agreement to include requirements that would apply for disbursement of this new Market Studies Inquiries appropriation to allow for this standing capacity.

#### *MBIE*

- 50 The proposals in this paper may also have financial implications for MBIE, being the primary department responsible for providing advice to ministers in response to any Commerce Commission market study that includes recommendations for the government. If the Commerce Commission is able to self-initiate studies, it is expected that the number of reports that MBIE will need to provide advice on will increase.
- 51 The number of additional reports requiring MBIE to action, their frequency and the amount of resources required is uncertain. The initial assessment is that these costs will be met within MBIE existing baselines through reprioritisation and phasing of work as required.

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### Human rights

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

### Legislative implications

- 53 A Commerce Amendment Bill ('the Bill') has been submitted for priority [REDACTED] [REDACTED] for the 2018 legislative programme to empower the Commerce Commission to carry out market studies. If approved, the proposals in this paper will be included in that Bill.
- 54 On 26 June 2017, Cabinet agreed that an exposure draft of the Bill would be released for consultation [CAB-17-MIN-0320 refers]. I do not now intend to conduct an exposure draft consultation.
- 55 The Parliamentary Counsel Office has been consulted.

### Regulatory impact analysis

- 56 Regulatory Impact Analysis (RIA) recommending introduction of a market studies function for the Commerce Commission was prepared for the original Cabinet decision [CAB-17-MIN-0274 refers]. A new or amended RIA is not required for the proposals in this paper as the option of allowing the Commerce Commission to self-initiate market studies was considered in that RIA (as option 2) as MBIE's preferred option and officials' advice is unchanged.
- 57 The Regulatory Impact Analysis Team (RIAT) at Treasury previously considered that the RIA met the quality assurance criteria. The reviewers considered that the RIA demonstrated that providing the Commerce Commission with full market studies powers would 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 suggested that, if the market studies 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

- 58 The Minister of Commerce and Consumer Affairs will issue a media release when the the Bill is introduced to the House.
- 59 Approval is also sought to publish this paper on MBIE's web site.

### Recommendations

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

- 1 **note** that on 6 and 26 June 2017, Cabinet agreed:
- 1.1 to amend the Commerce Act 1986 to empower the Commerce Commission to undertake market studies at the direction of the Minister of Commerce and Consumer Affairs;



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- 1.2 a direction to the Commerce Commission is only to be given if the Minister has reason to believe that the market study to be undertaken into the relevant goods or services is likely to be in the public interest or in the long-term interests of consumers (or wording with a similar effect); and
- 1.3 the Commerce Commission, in undertaking a market study, should be able to use appropriate information gathering powers;

[CAB-17-MIN-0274, CAB-17-MIN-0320 refers]

- 2 **agree** to also empower the Commerce Commission to self-initiate a market study if the Commerce Commission has reason to believe that the market study to be undertaken into the relevant goods or services is likely to be in the public interest (or wording with a similar effect);
- 3 **agree** that, as soon as possible after the Minister or the Commerce Commission has initiated a market study, the Commerce Commission must publish a terms of reference for that study, the contents of which would include:
  - 3.1 the scope of the inquiry to be undertaken; and
  - 3.2 the date by which the Commerce Commission will publish its final report;
- 4 **agree** that as part of any market study the Commerce Commission would be required to:
  - 4.1 release a draft of its market study report for public consultation; and
  - 4.2 have regard to issues raised in submissions received from interested parties in its final report; and
  - 4.3 publish its final report;
- 5 **invite** the Commerce Commission to prepare guidelines on how it will undertake its market study function;
- 6 **direct** MBIE officials to initiate an evaluation of the Commerce Commission's market studies function within five years of it coming into effect;

### Financial implications

- 7 **note** that on 26 June 2017, [CAB-17-MIN-0320 refers] Cabinet agreed to establish a new Market Study Inquiries appropriation of \$1.5 million per annum to fund the Commerce Commission to carry out market studies;
- 8 **note** that the Minister of Commerce and Consumer Affairs intends to set requirements for the disbursement of this funding to allow the Commerce Commission to maintain standing capacity to carry out market studies;

### Legislative implications

- 9 **note** the Minister of Commerce and Consumer Affairs is seeking [REDACTED] on the 2018 legislation programme for a Commerce Amendment Bill which will include the new market studies provisions;
- 10 **note** Cabinet approved the release of an exposure draft of the Commerce Amendment Bill for consultation [CAB-17-MIN-0320 refers];

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- 11 **note** that the Minister of Commerce and Consumer Affairs considers that consultation on an exposure draft is not required;
- 12 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to recommendations 2–4 above;
- 13 **authorise** the Minister of Commerce and Consumer Affairs to make minor or technical changes, consistent with the policy framework in this paper, on any issues that arise during drafting; and

### Communication

- 14 **agree** that the Ministry of Business, Innovation and Employment will publish a copy of this paper on its website to coincide with the introduction of the Bill to the House.

Authorised for lodgement

Hon Kris Faafoi

**Minister of Commerce and Consumer Affairs**