MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Kris Faafoi	**Portfolio**	Commerce and Consumer Affairs
Title of Cabinet paper	Review of Section 36 of the Commerce Act and Other Matters: Policy Decisions	**Date to be published**	18 February 2020

List of documents that have been proactively released		
Date	**Title**	**Author**
18 February 2020	Review of Section 36 of the Commerce Act and Other Matters: Policy Decisions	Office of Hon Kris Faafoi
18 February 2020	Cabinet Economic Development Committee Minute of decision: Review of Section 36 of the Commerce Act and Other Matters: Policy Decisions	Cabinet Office
18 February 2020	Impact Statement: Review of Section 36 of the Commerce Act and other matters	MBIE

Information redacted **YES / ~~NO~~**

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MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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Coversheet: Review of section 36 of the Commerce Act and other matters

Advising agencies	Ministry of Business, Innovation and Employment
Decision sought	• Strengthen the Commerce Act's prohibition against anti-competitive unilateral conduct • Repeal the Commerce Act's intellectual property-related provisions • Other minor changes to improve the functioning of the Act
Proposing Ministers	Minister of Commerce and Consumer Affairs

Section A: Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

Section 36 of the Commerce Act 1986 (**the Act**) prohibits firms with substantial market power from taking advantage of their market power for an exclusionary purpose. It is intended to prevent firms with market power from harming competition by engaging in conduct such as exclusive dealing, refusal to supply, or predatory pricing.

However, the current section 36 is flawed because the courts have interpreted the 'take advantage' test in a way that:

- has the potential to fail to deter or penalise some forms of anti-competitive conduct;
- is costly and complex to enforce; and
- arguably creates some unpredictability for day-to-day business decision making.

The Act also contains three provisions relating to intellectual property (**IP**), which shield some IP arrangements from competition law scrutiny. These provisions are outdated, unnecessary, and poorly understood.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

The proposal is that, like Australia, New Zealand should prohibit firms with a substantial degree of market power from engaging in conduct that has the purpose, effect, or likely effect of substantially lessening competition. This removes the 'take advantage' test, would focus the prohibition directly on the anti-competitive nature of the conduct, and is likely to significantly decrease the cost and complexity of enforcement.

It is also proposed that each of the Act's IP provisions be repealed, which will result in IP being treated like any other form of property.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
Potential benefits include: • Gains to the economy, particularly in concentrated markets, from a general increase in the level of competition over time, with flow on benefits in terms of increased productivity and efficiency, lower prices, and higher quality goods and services. • If more anti-competitive unilateral conduct is deterred, other businesses, including new entrants, may find it easier to grow and develop. • It being easier for businesses to access, utilise, and build upon existing IP, in situations where this is currently constrained by anti-competitive conduct. • Less complex enforcement produces cost savings for the Commerce Commission (**the Commission**). Greater certainty of outcomes enables the Commission to be a more effective regulator.

Where do the costs fall?
Costs include: • One-off transition costs for firms with market power and creators of IP as businesses become acquainted with the new laws. These groups may also have greater uncertainty about the law in the initial stages. • The potential for higher ongoing compliance costs than the status quo, partly reflecting the under-capture of the existing anti-competitive unilateral conduct prohibition. • Costs for the Commission to produce rules and guidelines, assess applications for authorisation of conduct that would otherwise breach the Act's anti-competitive unilateral conduct provisions, and take enforcement action in respect of anti-competitive IP-related conduct that is currently exempt from the Act. Although the costs of the proposals may outweigh the costs of the status quo, we consider that the overall benefits of reform will materially exceed the costs.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
There is a genuine risk that some businesses may act in an overly conservative and compliance-focused way to avoid any risk of contravening the amended section 36 or other provisions of the Act in respect of IP. This would impose some costs, and could lead to some firms not engaging in conduct that is ultimately pro-competitive. This risk would lessen once case law has developed. However, it could be a number of years before there are court judgments relating to a reformed section 36 or IP under the Act. These issues should be able to addressed, at least in part, through the Commission issuing guidance, and through appropriate transition periods to allow businesses to become acquainted with the changes.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
None, although some stakeholders argue that the proposals will not produce predictable outcomes for regulated parties.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
The content of this RIS has been informed by public consultation. However, it can be difficult to quantify the costs and benefits of changes to competition law. We have little information on the prevalence of anti-competitive unilateral or IP-related conduct, and even in individual cases assessing the magnitude of harm is difficult when competition has been foreclosed. The benefits of change would come from improved static and dynamic efficiency across the economy, but this is all but impossible to isolate and measure.

Quality Assurance Reviewing Agency:
Ministry of Business, Innovation and Employment
Quality Assurance Assessment:
MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement prepared by MBIE. The Panel considers that the information and analysis summarised in the Regulatory Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Impact Statement: Review of Section 36 of the Commerce Act and other matters

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis
The content of this RIS has been informed by public consultation. The issue of section 36 has been subject to three rounds of formal consultation, in 2015, 2016, and 2019. The issue of the IP exemptions was consulted on in 2019. In addition to the release of discussion papers, we have also met with a range of stakeholders to discuss the review. There are no specific constraints on the scope for decision-making. However, the options considered in this RIS are focused on generic interventions to improve the functioning of competition law. This means that the RIS does not consider options for sector- or conduct-specific regulation, for direct changes to New Zealand's intellectual property (**IP**) statutes, or for addressing conduct that does not harm competition, but is nevertheless considered to be 'unfair'. It can be difficult to quantify the costs and benefits of changes to competition law. We have little information on the prevalence of anti-competitive unilateral or IP-related conduct and even in individual cases, assessing the magnitude of harm is difficult when competition has been foreclosed. The benefits of change would come from improved static and dynamic efficiency across the economy, but this is all but impossible to isolate and measure.
Responsible Manager
Authorised by: Jennie Kerr Manager, Competition & Consumer Policy Ministry of Business, Innovation and Employment 12 February 2020

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Context

The New Zealand Government has a goal of building a productive, sustainable and inclusive economy. Key to achieving this goal is increasing New Zealand's productivity. Competition – the process by which firms compete with each other in order to attract customers and revenue – is a key mechanism for boosting productivity.

Effective competition gives New Zealand businesses an incentive to increase their efficiency and innovate, leading to improvements in productivity and consumer welfare. Businesses competing for customers and market share can lead to outcomes such as lower prices, better quality goods and services, and increased levels of innovation.

New Zealand's competition legislation – the Commerce Act 1986 (**the Act**) – and associated enforcement body – the Commerce Commission (**the Commission**) – are important contributors to domestic competition and are generally well regarded internationally. However, New Zealand is a small, geographically distant economy. In some sectors and markets, this restricts the process of competition by limiting the number of firms that can efficiently operate at scale, and by restraining the role that imports can play in driving competition.

Measuring competition is difficult, with no one optimal level of competition. Nevertheless, some measures show good or improving indications of competition. For example, recent research indicates that most New Zealand industries showed improvements in competition between 2001 and 2016, as measured by the profit elasticity of individual firms (the impact of changes in firms' costs on their profit levels, after controlling for fixed effects).[1]

However, we are not seeing all the benefits that we might expect if competition was a strong force in our domestic economy. This is supported by some domestic and international measures. For example, the World Economic Forum ranks New Zealand 33rd internationally for the extent of competition in service sectors and 34th for the extent of market dominance (indicating that New Zealand markets are perceived to be relatively concentrated).[2] Similarly, when asked how they would describe their business's competition, a significant proportion of businesses (around 21 per cent) state that they have either "no effective competition" or "no more than one or two competitors".[3]

What would happen if no action was taken?

Without action being taken, firms would continue to operate and compete in New Zealand as they do currently. It is possible that competition – and the outcomes associated with it – could improve or worsen over time, depending on market conditions. However, as will be set out in section 2.3, the problems associated with New Zealand's law relating to anti-competitive unilateral conduct will continue to persist, and some arrangements involving IP will continue to be shielded from analysis under the Commerce Act. This has the potential to hold back competition in New Zealand into the future.

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[1] Schiff, A. & Singh, H. (2019). *Competition in New Zealand: Highlights from the latest data.* Retrieved from: https://www.productivity.govt.nz/assets/Documents/competition-in-new-zealand/75b795cc4f/NZPC-Competition-in-New-Zealand-highlights-from-the-latest-data.pdf.

[2] World Economic Forum. (2018). *The Global Competitiveness report 2018.* Retrieved from: http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf

[3] Statistics New Zealand Business Operations Survey 2017

2.2 What regulatory system, or systems, are already in place?

Goals and features of competition law

Generally, competition law regimes seek to protect and promote competition in markets by prohibiting firms from undertaking certain types of exclusionary (i.e. anti-competitive) conduct that prevents, hinders or deters rivals (and potential rivals) from competing on their merits. Importantly, competition law regimes generally seek to protect the competitive process itself, rather than individual competitors.

International regimes typically seek to achieve these goals by prohibiting:

- anti-competitive agreements, such as price-fixing and output restrictions;
- anti-competitive mergers; and
- anti-competitive unilateral conduct (otherwise known as misuse of market power).

In addition, many international jurisdictions provide for information disclosure or regulation of the price and quality of goods or services provided in 'natural monopoly'-type markets where there is little or no competition.

All of these features are replicated in various forms in New Zealand through the Commerce Act 1986[4], which has the purpose of promoting competition in markets for the long-term benefit of consumers within New Zealand. New Zealand also has a number of sector-specific regulatory regimes such as the Telecommunications Act 2001 and the Dairy Industry Restructuring Act 2001 which also contribute to these goals.

Issue 1: Anti-competitive unilateral conduct

Overview of anti-competitive unilateral conduct provisions

Across jurisdictions, anti-competitive unilateral conduct prohibitions typically seek to prevent firms with market power from harming the competitive process by increasing or extending their market power in a way that limits the benefits to consumers and the economy associated with competition. Anti-competitive unilateral conduct can lead to higher prices, lower quality goods and services, and weak incentives for investment and innovation.

Anti-competitive unilateral conduct provisions are intended to address conduct such as:

- **Exclusive dealing**: This is where a powerful business has contracts with retailers, distributors, or suppliers that require or induce them to only sell that business's products or only supply that business. This may be harmful if the arrangement denies a competitor access to an important supply or distribution channel.
- **Refusal to supply (or high access pricing)**: This occurs where a vertically-integrated business refuses to supply a competitor with an input (or will only supply at a high price), such as a raw material, or to give access to infrastructure (such as port services) that the competitor needs to compete in downstream (e.g. retail) markets.
- **Predatory pricing**: This is where a business lowers its pricing with a view to pushing a competitor out of the market. To be unlawful, it needs to occur over a sustained period and the price charged must be below cost, with it being likely that the business will increase its prices again after the competitor exits.
- **Tying**: This is where a business only sells a product if the customer purchases it together with

[4] The Commerce Act forms part of the competition regulatory system. More information is available here: https://www.mbie.govt.nz/cross-government-functions/regulatory-stewardship/regulatory-systems/competition-regulatory-system/

another product. For example, if a firm with market power in one product market sells that product together with a second product (for which the firm has no market power), competition for the latter product could be reduced if the combined price of the tied products is significantly less than the prices of the products when sold separately.

- **Buying up scarce intermediate goods or resources required by a competitor**.

Anti-competitive unilateral conduct provisions are generally aimed at prohibiting exclusionary conduct by firms with market power. They generally do not seek to prevent:

- **Businesses innovating or reducing prices to pass on cost savings and efficiency improvements.** Such conduct is pro-competitive and generally benefits consumers, even if it results in less efficient firms exiting the market.
- **Firms holding a monopoly position in a market or charging high prices to customers**. Short-term monopolies may arise from innovations or technological advances. High prices in such circumstances are part of the normal competitive process and send a signal to other businesses to expand or enter the market. Where such issues persist, these are best addressed by other means (such as by reducing barriers to entry), or, in cases where market entry is not likely (such as for electricity distribution or fixed-line broadband), by directly regulating businesses' revenues.
- **Powerful businesses negotiating hard deals with their suppliers (or vice versa)**. This is because suppliers and their business customers are generally not in competition with each other and therefore suppliers have no incentives to harm competition in their customers' markets. These issues will are being addressed to an extent through the Government's work on unfair commercial practices.[5]

New Zealand's anti-competitive unilateral conduct provision – section 36

Section 36 of the Commerce Act – New Zealand's prohibition against anti-competitive unilateral conduct – currently prohibits firms with a substantial degree of market power from taking advantage of that power for an exclusionary purpose. This means a purpose of:

- 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 elements of the prohibition are outlined in further detail below.

Substantial market power

The first element of the prohibition, that a firm must have substantial market power, recognises that unilateral conduct by a firm is generally unlikely to be harmful if a firm does not have substantial market power. This element effectively provides a 'safe harbour', so that firms that do not have market power do not have to assess their compliance with a provision that they are unlikely to be in danger of breaching in any case.

Take advantage

The second element of section 36 is a requirement that a firm with substantial market power take advantage of that market power. This has been interpreted by the courts as a requirement for a 'causal connection' between the market power and the conduct at issue (i.e. the market power somehow enables or leads to the conduct).

[5] See here: https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-law/protecting-businesses-and-consumers-from-unfair-commercial-practices/

In 1994, the Privy Council effectively ruled that a firm only takes advantage of its market power (and thus breaches the Act) if a business without substantial market power (but otherwise in the same circumstances) would not have engaged in the same conduct. In order to show this, plaintiffs are required to construct a hypothetical market in which the defendant firm is without market power, and demonstrate that the defendant would not have undertaken the conduct at issue in that hypothetical market.[6] This detailed inquiry is known as the 'counterfactual test' or the 'comparative exercise'.

Despite the unusual step of an intervention by the Attorney-General seeking a different approach, in 2010 the Supreme Court cemented the requirement for section 36 cases to use the counterfactual test when it stated:

> *"Anyone asserting a breach of section 36 must establish there has been the necessary actual use (taking advantage) of market power. To do so, it must be shown, on the balance of probabilities, that the firm in question would not have acted as it did in a workably competitive market, that is, if it had not been dominant."*[7]

These judicial interpretations of the 'taking advantage' requirement are summarised in the following table:

Judicial question	Answer	Legal consequence
What would the firm have done if it did not have substantial market power?	The firm would <u>still</u> have undertaken the conduct at issue	The firm has not taken advantage of its market power
	The firm would <u>not</u> have undertaken the conduct at issue	The firm has taken advantage of its market power

The problems with this element are discussed further in section 2.3 below.

Purpose

The third element of the prohibition involves a reference to a firm's purpose for engaging in the alleged anticompetitive conduct. Currently, the plaintiff has to prove that the firm had an exclusionary purpose[8]. The purpose element distinguishes such conduct from that which is simply a straight, non-exclusionary, exercise of market power (such as monopoly pricing).

While the third element is framed in terms of 'purpose', section 36B enables 'purpose' to be inferred from conduct and any other relevant circumstances (rather than, for example, needing to provide evidence of the internal thought processes of management).

No authorisation or defence

There is no legal defence to a breach of section 36.[9]

The Commerce Act provides an authorisation regime where firms can apply for authorisation from the Commission to carry out an activity that – on the face of it – breaches the Act, if the benefits from it are likely to exceed the costs. However, authorisation is not available in respect of conduct that will or is likely to breach section 36.

[6] *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (1994) 6 TCLR 138. Before 2001, section 36 referred to "use" instead of "take advantage of". The Supreme Court concluded that the expressions "use" and "take advantage of" are equivalent. *Commerce Commission v Telecom Corp of New Zealand Ltd* [2010] NZSC 111 at [1].

[7] *Commerce Commission v Telecom* (2010) 12 TCLR 843 at [34] per Blanchard and Tipping JJ.

[8] As discussed above, an exclusionary purpose could be to restrict the entry of a person into that or any other market; prevent or deter a person from engaging in competitive conduct in that or any other market; or to eliminate a person from that or any other market.

[9] For example, there is no explicit defence to prosecution that the conduct was justified on efficiency grounds.

Section 36A: Taking advantage of market power in trans-Tasman markets

As part of the Closer Economic Relations review in 1988, the Australian and New Zealand governments agreed to remove protections against dumping (the situation where a business sells its goods at a cheaper price in a foreign country than its home country) for goods traded across the Tasman. Instead, reliance was placed on generic competition law to protect against conduct such as predatory pricing (which can be a factor in dumping).

To enable this, section 36A was inserted into the Act to enable consideration of market power in Australia or a trans-Tasman market. The theory is that firms with market power in Australia could leverage that power in New Zealand and vice versa. The Australian legislation was amended with an equivalent provision. There has been little reliance on section 36A or the Australian equivalent to date, and situations in which it is able to be successfully invoked are likely to be relatively rare.

Previous consideration of section 36

In May 2014, the Productivity Commission set out a number of recommendations in a report titled *Boosting Productivity in the Services Sector*. On the topic of section 36, the Commission summarised its views as follows:

> *"Monopolisation provisions (as they are termed) are tricky to get right and contentious in many countries. In New Zealand, those in favour of retaining the status quo suggest that changes to s 36 could create uncertainty for large firms and discourage them from innovation and other desirable competitive activities. However, other commentators consider that the counterfactual test is complicated to apply, suffers from conceptual problems, and can lead to wrong conclusions about whether firms are abusing their market power.*
>
> *The [Productivity] Commission considers that s 36 should be reviewed, through a thorough legal and economic analysis that assesses reform options against the objectives of economic efficiency (particularly dynamic efficiency) and the long-term interests of consumers. The review should take into account the impact of small domestic markets, which may not be large enough to support firms that are big enough to exploit economies of scale, at the same time as maintaining sufficient competition and challenge to the market power of those firms."*

On 17 November 2015, MBIE released an Issues Paper seeking views on a number of Commerce Act issues, including whether New Zealand's current section 36 was functioning adequately. In total, 39 submissions were received.[10]

On 2 June 2016, the Chair of the Commerce Commission sent the Minister of Commerce and Consumer Affairs a supplementary submission, which critiqued a number of points made by other submitters. Given the issues raised, it was considered appropriate to launch a cross-submission process, under which stakeholders could respond to the comments raised by submitters in the first round of consultation. In total, 26 cross-submissions were received.

The previous Government considered the review in June 2017 and invited the Minister of Commerce and Consumer Affairs to report back to Cabinet by end of June 2018 on whether it was appropriate to proceed to an options paper regarding reform of section 36.

Following the change in Government, in January 2019 the current Minister of Commerce and Consumer Affairs released a discussion paper titled *Review of section 36 of the Commerce Act and other matters,* which proposed reform to section 36. 23 submissions addressed the issue of section 36.

[10] The Issues Paper, submissions and cross-submissions are all available at: https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/reviews-of-the-commerce-act-1986/targeted-review-of-the-commerce-act-2015/

Corresponding review in Australia

In December 2013, the Australian government announced a competition policy review to be undertaken by a panel led by Professor Ian Harper (**the Harper Panel**). The Harper Panel's final report covered a wide range of competition law and policy matters, including a chapter on Australia's prohibition against anti-competitive unilateral conduct (section 46 of Australia's Competition and Consumer Act).[11]

On 11 December 2015, the Australian government issued a consultation document, seeking views on the Harper Panel's recommendation to amend section 46.

86 submissions were received. Of the submissions that were made public, those from economists and lawyers appeared to be roughly split on whether an effects test (which focuses on whether the conduct in question is likely to substantially lessen competition) should replace the formulation of section 46 (which focuses on whether the conduct in question was in some way enabled by the firm's substantial market power). Large businesses overwhelmingly supported the status quo, while small businesses strongly supported the move to an effects test. Although the submissions on Australia's review of its anti-competitive unilateral conduct provision were not solicited by MBIE, MBIE has considered them due to the fact that the previous Australian prohibition was similar to the current New Zealand prohibition.

In March 2016, the Australian Government announced it would adopt an effects test for section 46. In August 2017, the Australian Competition and Consumer Act was amended, giving effect to those policy decisions.

Now that Australia has changed its law, to our knowledge New Zealand is the only country requiring a strict causal connection between market power and the conduct in question.

Issue 2: Commerce Act's IP provisions

Intellectual property statutes

At a high level, IP rights are the protections assigned to creations of the mind. IP can be protected by statutory IP rights. New Zealand's IP legislation includes:

- The Copyright Act 1994, which protects artistic works (such as photographs), graphic works (such as paintings) literary works (such as books), musical works, sound recordings, performances, films, dramatic works (such as a film script), and communications works (such as TV broadcasts).
- The Designs Act 1953.
- The Patents Act 2013, which protects new inventions.
- The Trade Marks Act 2002, which protects signs that distinguish the goods or services of one person from those of another.
- The Plant Variety Rights Act 1987, which protects new plant varieties.
- The Layout Designs Act 1994.

IP can also be protected via the common law. For example, the tort of 'passing off' can protect unregistered trade marks, while an action for breach of confidence can protect trade secrets or 'know-how'.

Statutory IP rights give creators and innovators the exclusive right, for a limited time, to control what others may do with their work. This exclusive right is based on the idea that IP rights give people an opportunity to make a return on their investment in creativity or innovation. It also provides an incentive for creative or innovative activity that might not take place otherwise. The benefits that

[11] Competition Policy Review. (2015). *Competition Policy Review: Final Report.* Retrieved from: https://treasury.gov.au/sites/default/files/2019-03/Competition-policy-review-report_online.pdf.

result from this additional creativity and innovation are generally considered to outweigh the costs imposed on society by IP rights (such as reduced choice for consumers and higher prices for products protected by IP rights).

Commerce Act's IP provisions

The Commerce Act currently contains three sections which shield some IP-related conduct from assessment under competition law:

- Section 45 exempts the granting of IP licences (to the extent that they authorise something that would otherwise be prohibited by the existence of a statutory IP right) from provisions of the Act relating to cartels and agreements.
- Section 36(3) provides that a firm does not breach section 36 solely by enforcing an IP right.
- Section 7 provides that the Act does not limit any law relating to breaches of confidence (such as sharing trade secrets), and that no law relating to breaches of confidence affects the interpretation of any of the provisions of the Act.

Corresponding review in Australia

As part of the Australian competition policy review mentioned above, in 2015, the Harper Panel recommended, among other things, repeal of subsection 51(3) of the Competition and Consumer Act, which exempts certain conditions of IP licences or assignments from many of that Act's anti-competitive conduct provisions. This recommendation echoed calls from the Australian Competition and Consumer Commission and consumer advocates. This section was subsequently repealed in 2019.

The Harper Panel's review was one of seven separate reviews in Australia that recommended repeal or significant narrowing of the provision since 1999.

Reviews of IP statutes

Along with assessing the Commerce Act's IP exemptions, MBIE is currently reviewing the Copyright Act and Plant Variety Rights Act. These other reviews are outside of the scope of this RIS, but form part of the landscape for IP users.

2.3 What is the policy problem or opportunity?

Issue 1: Anti-competitive unilateral conduct

Introduction

MBIE considers that section 36 in its current form does not fully meet the Act's purpose (i.e. it does not succeed in promoting competition in New Zealand markets for the long-term benefit of consumers). We think this is largely as a result of the prohibition's 'take advantage' test, and the way the courts have interpreted this.

Concerns with the outcomes produced by section 36 – while not shared by all stakeholders – have existed for more than two decades, since the decision of the Privy Council outlined above. Various legislative and non-legislative attempts to amend the test used to assess anti-competitive conduct under section 36 have not had the intended effect.

In MBIE's view, the 'take advantage' test leads to three main problems with section 36:

- It has the potential to fail to deter or penalise some forms of anti-competitive conduct.
- It is costly and complex to enforce, which reduces the incentive for businesses to comply with the law.
- It creates some unpredictability for day-to-day business decision making.

These problems are explored further below.

The potential to fail to deter or penalise some forms of anti-competitive conduct

Section 36 relies on the 'take advantage' test to distinguish harmful conduct from harmless conduct. The test requires a causal connection between the firm's market power and its conduct. As explained above, the courts have interpreted this to require a complex counterfactual test.

The counterfactual test is particularly unsuited to differentiating competitive conduct from anti-competitive unilateral conduct. Conduct undertaken by a firm with substantial market power may have exclusionary effects, even though the same conduct would be neutral or even pro-competitive when undertaken by a firm with little market power. The stripping away of market power in the counterfactual assumes away the very issue in question. As one commentator has put it: "[Use of the counterfactual] is akin to saying that because a person can walk into a room with a lighted match without setting off an explosion, doing so in a room where there is a suspected gas leak did not 'cause' the explosion."[12]

The current test fails to deter some types of conduct that may undermine the long-term benefits of consumers, such as 'exclusive dealing'. Exclusive dealing frequently occurs in competitive markets as businesses seek to control the distribution of their products; it is therefore unlikely to be penalised under the counterfactual test. However, when carried out by a business with substantial market power, exclusive dealing can foreclose a large portion of the market and result in significant competitive detriment. At worst, it could eliminate all competitors from the market. In such a scenario there would likely be a 'false negative' under section 36 (i.e. section 36 would fail to deter anti-competitive conduct).[13]

The Australian Competition and Consumer Commission's submission to the Australian Treasury[14] during the review of their equivalent provision cited the following example of a false negative:

> "A firm with substantial market power in the South East Queensland cement market contracted all the available supply of a cement ingredient with the purpose of excluding and/or increasing costs of rivals. The Court held that the firm with substantial market power had not 'taken advantage' of market power because a small firm could have done the same. [However]…the Court found the contracts… had the purpose and effect of substantially lessening competition."

One international commentator also set out "several examples of conduct that have … resulted in findings of liability [abroad], but [where] the results might have been different had the conduct been judged under New Zealand's version of the counterfactual test." This included Microsoft bundling its Internet browser and/or its media player into its operating system. The same commentator also cited refusals to deal – while acknowledging that intervention in such conduct is likely to only be justified in limited circumstances – as another example of conduct where the counterfactual test is "unlikely to yield any reliable inferences" in terms of delivering the correct result.[15]

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12 Veljanovski, C. (2017). *The Flawed Market Power Counterfactual.* NZLJ August 2017 247-252.

13 The plaintiff might nevertheless in some such cases be able to take a case based not on section 36 but on section 27 of the Commerce Act.

14 Australian Competition and Consumer Commission. (2016). *Options to strengthen the misuse of market power law: Submission to the Treasury.* Retrieved from: https://www.accc.gov.au/system/files/ACCC%20submission%20to%20the%20Treasury%20-%20Options%20to%20strengthen%20the%20misuse%20of%20market%20power%20provision.pdf. The case referenced was ACCC v Cement Australia [2013] FCA 909.

15 Gavil, A. (2015). *Imagining a Counterfactual Section 36: Rebalancing New Zealand's Competition Law Framework.* 46 VUWLR.

False negatives, to the extent that they occur, can have a significant negative impact on competition. The International Competition Network[16] has expressed this in the following economic terms:

> "The cost of under-enforcement is the risk of exclusion and the resulting reduction in competitive pressure faced by the dominant firm. Under-enforcement may also lead to a loss of dynamic efficiency flowing from competitors' lessened incentives to innovate and enter the market. It may furthermore result in redistribution of resources from consumers to producers, potentially inflated costs by dominant firms, and the inefficient devotion of resources to rent-seeking by firms that seek to obtain or maintain dominance…."

The Commission has not been able to indicate whether it has foregone investigations where it considered there was a substantial lessening of competition but it believed the conduct would not constitute taking advantage of market power (a 'false negative'). However, the Commission rightly argues that this would be difficult to do, given that its analysis of past cases has been undertaken within the current legal framework for section 36. The Commission has, however, identified its investigations into Sky TV and Winstone Wallboards as examples of cases where the counterfactual test has permitted conduct by large firms without regard to the anti-competitive effect.[17]

Overall, it is difficult to provide concrete evidence of the extent to which section 36 is leading to false negatives. However, theory suggests that there is likely to have been false negatives in the past. Furthermore, there is clear evidence in Australia, which had substantially similar legislative provisions, of cases such as Cement Australia which produced false negatives.

Cost and complexity of enforcement

Taking a section 36 case is a costly and complex exercise. While this is also true of cases taken under other provisions of the Act, the counterfactual test adds an extra degree of complication to section 36 cases.

In particular, a mandatory requirement to construct a hypothetical competitive market of at least two participants requires difficult assumptions to be made. These difficulties are compounded by the courts' observation that the analysis need not depend on realistic or practical assumptions, so that unrealistic scenarios are permitted. Given the array of possible inputs, assumptions and value judgements involved, it is difficult for the Commission or private litigants to predict which scenario the court will use as the counterfactual.

This makes section 36 cases unnecessarily complicated and resource intensive, with outcomes potentially determined on the counterfactual analysis rather than the conduct at issue. As such, the Commission has to carefully consider when it is appropriate to take such cases. The Commission has limited resources and has to weigh these issues up against other enforcement priorities. Similarly, costly and complex enforcement can deter private plaintiffs from taking their case to court. This is concerning as it may incentivise large firms to risk conduct that is likely to breach section 36. It is concerning that, after more than 30 years of experience with section 36, the Commission regards a central plank of the Act as difficult to enforce.

The Australian cases demonstrate some of these difficulties. *Melway*, *Boral*, and *Rural Press* all had the trial and appellate courts taking opposite views on the outcome of the "taking advantage" question, and there have been similar reversals in New Zealand cases. This suggests that the "take advantage" limb is not sufficiently clear and predictable in interpretation and application, and thus increases the cost and complexity of enforcement. This uncertainty also reduces the deterrence

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[16] International Competition Network. (2012). *The Objectives and Principles of Unilateral Conduct Laws.* Unilateral Conduct Workbook, Chapter 1, at [45]-[46].

[17] Commerce Commission (2019). *Submission on the Review of Section 36 of the Commerce Act and other matters discussion paper.* It should be noted that both cases could be assessed under section 27 of the Commerce Act. In the Winstone Wallboards investigation, no substantial lessening of competition was found. In the Sky case, court action was not taken due to a lack of public interest in doing so.

effect of any enforcement action.

Predictability for pro-competitive decision making

Businesses require some degree of predictability when planning their conduct, so that they can aggressively compete with rivals without being deterred by concerns that their conduct will breach section 36 (or other parts of the Act). Submitters on the 2015 Issues Paper were generally divided on whether the status quo provides sufficient predictability.

Some submitters argued that the status quo has the advantage of a relatively simple thought experiment for businesses ('would we do this if we didn't have market power?') which, in the time-pressured environment of daily business decisions, offers a higher level of predictability to firms with substantial market power considering market conduct.

For example, in their response to the Issues Paper, Orion[18] stated that the counterfactual test "delivers a known compliance standard that can be readily applied by firms with market power to assess commercial conduct", and Air New Zealand claimed that it "has found that the current section 36, and in particular the 'taking advantage' limb, relatively simple to apply to its own conduct and the conduct of its competitors."

Other stakeholders disagreed. The Commission argued that the hypothetical nature of the competitive market a court must construct means there is an inherent uncertainty in the counterfactual test. A firm cannot know for certain in advance what the hypothetical market the court will adopt will look like.

As the Commission noted in its supplementary submission on the Issues Paper, "business is… exposed to significant risks around how the Commission and the courts will undertake the hypothetical analysis required by the taking advantage test… The Commission's conclusion on this hypothetical analysis [in an investigation of Air New Zealand] turned on a single adjustment to an assumption about seating capacity in this hypothetical scenario. This change was made late in the investigation. That this change was made so late and was so significant to the outcome tends to belie the purported certainty of the counterfactual test."[19]

Further, in its cross-submission on the Issues Paper, Tompkins Wake[20] considered that, even if the counterfactual test itself is predictable, there can be uncertainty in what approach an individual judge would take to the test.

Predictability is not solely the concern of the incumbent firm, as new entrants also require a degree of certainty that they will be able to compete on their merits and not be subject to anti-competitive behaviour by the incumbent.

At present, the dominant form of predictability may be knowing that the Commission or other plaintiff may find it difficult to take any enforcement action if there is a breach of section 36. This is not a desirable form of predictability.

In summary, MBIE is of the view that the status quo makes it difficult for businesses to predict whether their conduct is likely to breach section 36. However, MBIE does not consider this to be as significant an issue as the other problems with section 36, given that a number of the firms which this most affects believe that the status quo provides sufficient predictability.

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18 Orion. (2016). *Submission on the Targeted Review of the Commerce Act 1986.* Retrieved from: https://www.mbie.govt.nz/dmsdocument/2334-orion-redacted-targeted-review-commerce-act-phase-one-submission-pdf

19 Commerce Commission. (2016). Letter to Minister of Commerce and Consumer Affairs regarding Targeted Commerce Act Review. Retrieved from: https://www.mbie.govt.nz/assets/d14295e4f8/commerce-commission-letter-to-Minister.pdf

20 Tompkins Wake. (2016). Cross-submission on the review of section 36. Retrieved from: https://www.mbie.govt.nz/dmsdocument/2308-tompkins-wake-targeted-review-commerce-act-phase-one-cross-submission-pdf

Conclusion

MBIE concludes that there are the following issues with the status quo:

- Certain types of undesirable conduct are unlikely to be prohibited under the current test.
- The counterfactual test adopted by the courts increases the cost and complexity of enforcement, raising questions around the regulator's ability to enforce the law, thus reducing the incentive on businesses to comply with the law.
- There is some evidence that the current test lacks predictability.

Overall, the current interpretation of the prohibition presents risks that some anti-competitive conduct will not be illegal, that – even if conduct is illegal – no enforcement action will be taken, and that – even if enforcement action is taken – that such action will not be successful.

However, the magnitude of these issues is not clear and they are difficult to quantify.

MBIE officials are conscious that it can be difficult to quantify the benefits of a law change in a complex area of competition law like this. We have no data on the prevalence of anti-competitive unilateral conduct and even in individual cases, assessments of the magnitude of harm is difficult when competition has been foreclosed. The benefits of change would come from improved static and dynamic efficiency across the economy, and this is all but impossible to isolate and measure.

It is also useful to consider the extent to which there is a bias towards the status quo. As we understand it, New Zealand is the only country (with a modern competition law) without any direct consideration of the effects of unilateral conduct. In theory, given New Zealand's size and remoteness, any variation from the global standard of an effects-based test should require a very high level of proof of superior outcomes from an alternative approach. If the status quo were an effects-based test, it would be very difficult to show any benefit from changing to a test that relied on a strict causal connection between market power and conduct. It would likely never be considered as a plausible alternative to an effects-based test as it has so many obvious theoretical difficulties.

Although there is a lack of empirical evidence about the scale of the problem, it is our judgement that maintaining the status quo does not promote the long term benefit of consumers. As such, it is no longer appropriate to wait for certainty about the costs and benefits of reform before recommending change.

Issue 2: Commerce Act's IP provisions

Introduction

In the early-mid 20th century, IP and competition law were generally seen as being incompatible with each other. In particular, because IP rights in effect grant a limited monopoly to the rights holder, it was thought that there was little point in granting IP rights if these would immediately breach competition law. Partial exemptions from competition law for IP rights were consequently introduced in some jurisdictions, including New Zealand, as a way to address this conflict.

However, academic thinking has changed, and IP and competition laws are now generally seen as being complementary to each other, as both seek to increase productivity and innovation. While IP rights may confer exclusivity, they generally do not confer 'monopoly' power in the competition law sense. This is because the scope of an IP right is generally much narrower than the market used to assess the competition impacts.[21] As such, the availability of substitutes and competitive pressures generally ensures that IP rights holders do not have enduring market power. However, where IP rights do create competition concerns, we consider that these arrangements should be able to be

[21] For example, in the case of *Tru Tone Ltd v Festival Records Retail Marketing Ltd [1988] 2 NZLR 352 (CA)* the Court of Appeal held that each music album was not a separate market in itself, rather the relevant market was the New Zealand album market.

assessed under competition law.

There have been few cases involving the intersection between competition law and IP rights. However, the Commerce Commission has investigated several cases involving IP in the past. For example, in 2010, the Commission investigated royalty agreements between owners of music copyright and Photographic Performance NZ Ltd in respect of a potential breach of section 27.[22] Similarly, the Commission's investigation report into a patent dispute regarding metal roof flashings stated that a breach of the Act was likely to have occurred.[23] This indicates that not all IP-related conduct is exempt from the Act.

High-level issues

IP-related conduct is unlikely to be anti-competitive in most instances. However, there are cases where the use of, licensing of, or refusal to license IP rights could lead to a lessening of competition.

For example:

- Tying or bundling IP with another product (which might also be protected IP), so as to extend a firm's market power in one market to another.
- Firms agreeing not to challenge the validity of each other's IP.
- 'Pay for delay', where, upon expiry of a patent, a firm pays a potential competitor to not introduce a generic version of a product.
- 'Patent pooling', in which a group of patent owners with collective market power form a patent pool where they agree to license their patents to everyone else in the pool, but not to outsiders.
- Grant-back obligations, in which licensees are required to license any improvements made to the technology back to the licensor, can reduce a licensee's incentives to engage in research and development.
- 'Hold-up', where patent holders license a patented technology to a licensee, then increase the license fees to the licensee after they have made up-front investments that rely on the patented technology. Potential licensees may anticipate this tactic, discouraging them from making the initial investment in the first place (and thus holding up the adoption of new inventions).

Many of these examples may fall outside of the three IP-related provisions in the Act (although the boundaries of the provisions are unclear) and therefore could be challenged as unlawful at present.

However, conduct which may fall within the section 45 exemption at present includes:[24]

- granting exclusive licences;
- limiting licensees to particular territories or for a specified period of time;
- imposing production quotas (i.e. restricting output);
- refusals to license (although this may be caught by section 36); and
- placing bans on resale to unauthorised distributors.

To the extent that IP-related conduct falls *outside* of the Act's IP provisions, it can be assessed on a case-by-case basis. Under the Act's provisions relating to anti-competitive agreements, an IP-related agreement is only prohibited if it is anti-competitive. Under the Act's provisions relating to cartels, IP-

[22] Commerce Commission. (2010). *Commerce Commission closes investigation into music copyright holders.* Retrieved from: https://comcom.govt.nz/news-and-media/media-releases/archive/commerce-commission-closes-investigation-into-music-copyright-holders

[23] Commerce Commission. (2015) *Metal Roof Flashing: Investigation Report.* Retrieved from: https://comcom.govt.nz/__data/assets/pdf_file/0024/94371/Investigation-report-Metal-roof-flashing-5-October-2015.PDF

[24] Noonan, C. (2017). *Competition Law in New Zealand.* Wellington: Thompson Reuters, p. 698.

related conduct may fall within the generic exemptions for collaborative activities, vertical supply contracts, or joint buying and promotion agreements. These reflect the understanding that many forms of conduct (including in relation to IP rights) can be pro-competitive.

However, our key concern is that that some anti-competitive IP-related conduct may be exempt from the Act and will therefore not be subject to the same competition analysis as any other form of conduct. This means that anti-competitive conduct may go undeterred, with corresponding negative implications for consumers and New Zealand's economic performance.

It is worth reiterating our view that the vast majority of IP-related conduct is unlikely to be anti-competitive. For example, as noted by the Harper Panel, granting an exclusive licence would be unlikely to lead to a lessening of competition. Without an exclusive licence, a licensee would have been unable to commercialise the IP right. Therefore, a licence does not generally restrict the level of competition that would have existed but for the licence. Similarly, recent guidance produced by the Australian Competition and Consumer Commission in response to the repeal of Australia's equivalent provision has recognised the important role that IP rights play in incentivising innovation.[25]

Nevertheless, in cases where IP-related conduct does impact on competition, our view is that it should be prohibited. Put another way, we consider that there is no strong rationale for treating IP differently under competition law to any other form of property.

MBIE officials have been made aware of several examples of conduct relating to IP that may be anti-competitive, or where the Commission has declined to investigate further on the basis that it is unable to because of the exemptions. There are likely to be other examples that we are not aware of, due to cases not being taken by private litigants, or complaints not being made to the Commission, because the complainants considered that the current provisions meant that their complaint was unlikely to succeed. Potential complainants may also be deterred from complaining because it could damage their relationship with rights holders and restrict their access to material protected by IP rights.

Specific issues

In addition to what MBIE considers to be the general lack of rationale for the Commerce Act's IP provisions, there are more specific issues with the provisions.[26]

In particular, the provisions are very unclear as to their scope. For example, there are different views on whether section 36(3) is an actual carve-out from the Act for the enforcement of IP rights, or whether it simply clarifies that enforcing an IP right should not automatically be assumed to be a misuse of market power. The only case law on this point is that the High Court has ruled that IP rights holders can file proceedings to enforce their rights.[27] It is also unclear whether a refusal to license IP is captured within the scope of this provision. If the provision does exempt enforcement of an IP right but not refusal to license, the economic justification for doing so is unclear. Taking action to prevent unauthorised use of IP can essentially have the same effect as not licensing the IP in the first place.

Another issue is that section 45 focuses on form rather substance, meaning that licensors and licenses may be able to structure their dealings relatively easily to fall within the scope of the exemption. For example, an agreement in which two firms agree to exclusively cross-license their IP rights to each other might fall outside the exemption (because it restricts the licensee beyond the restriction imposed by the IP right itself). However, two separate agreements in which each firm licenses their IP rights to the other may fall inside the exemption (because it enables something that

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25 Australian Competition and Consumer Commission. (2019). *Guidelines on the repeal of subsection 51(3) of the Competition and Consumer Act 2010.* Retrieved from :https://www.accc.gov.au/publications/guidelines-on-the-repeal-of-subsection-513-of-the-competition-and-consumer-act-2010-cth

26 For an elaboration on these issues, see Eagles, I. (2007). Regulating the Interface Between Competition Law and Intellectual Property in New Zealand. *New Zealand Business Law Quarterly (13).*

27 *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* [1992] 3 NZLR 247 (HC).

would otherwise be restricted by the IP right). This is the case despite both approaches having the same effect.

Other issues include:

- Sections 45 and 36(3) apply solely to statutory IP rights, thus treating them differently to rights created in common law (such as the tort of passing off).
- The rationale behind section 7(2) is unclear. The provisions appear to have been lifted from Australia's Trade Practices Act 1974, which also contained consumer protection provisions. It has been suggested that the section may have had more relevance in the context of those provisions.
- By defining statutory IP rights to include any 'entitlement that is conferred or acknowledged as valid, by or under' one of the IP statutes, the provisions may extend to a range of secret information and expertise that has only a loose connection to the statutory IP right. Under a broad interpretation of the wording, restrictions on the use and transfer of such information could potentially be included as part of licenses of IP rights. This could impede the ability of firms to undertake innovations that 'piggy-back' or build upon previous ones.

2.4 Are there any constraints on the scope for decision making?

There are no specific constraints on the scope for decision-making. However, the options considered in this RIS are focused on generic interventions to address anti-competitive unilateral conduct in a way that harms competition, and of the treatment of IP under competition law. This means that the RIS does not consider options for sector- or conduct-specific regulation, or for addressing conduct that does not harm competition, but is nevertheless considered to be 'unfair'. In terms of the latter, such conduct is likely to be addressed to an extent by the Government's proposals relating to unfair commercial practices.[28] Similarly, this RIS does not consider interventions in respect of one area of IP (for example patents), as the issue spans all types of statutory IP rights.

2.5 What do stakeholders think?

Issue 1: Anti-competitive unilateral conduct

Overview

The design of section 36 has the potential to impact a wide range of stakeholder across the economy, both directly (in terms of the firms with market power whose conduct is governed by section 36) and indirectly (in terms of other firms and consumers who are affected by the conduct of powerful firms).

As noted above, there have been three rounds of consultation on the issue of section 36 since 2015. Many – but not all – stakeholders have participated in more than one of the consultation rounds.

- Around two-thirds of submitters on the 2015 Issues Paper supported retaining the current test contained in section 36 of the Act. However, a number of submitters supported reform of section 36.
- Of those who participated in the 2016 cross-submissions process, six stakeholders broadly favoured reform, 16 broadly favoured the status quo, and three were broadly neutral.
- Of the submitters on the 2019 Discussion Paper, eight broadly favoured the status quo, seven were broadly in favour of reform, and eight were broadly neutral.

Those opposed to reform include a number of large businesses, and the law firms and industry

[28] See https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-law/protecting-businesses-and-consumers-from-unfair-commercial-practices/

associations that represent them. Those supportive of reform include organisations such as the Commerce Commission, Consumer NZ, some independent lawyers, economists, and academics, and a small number of 'challenger' businesses.

Arguments in favour of reform

Those in favour of reform, including the Commerce Commission, largely shared MBIE's definition of the problem (see section 2.3). Submitters considered that section 36 is likely to under-capture in respect of some forms of anti-competitive conduct, that it is costly and complex to enforce, and that New Zealand is an outlier internationally in terms of the design of our prohibition.

Submitters provided few examples of anti-competitive conduct that is currently going undeterred, although, as noted above, the Commerce Commission did outline some historical cases that section 36 was not well-equipped to deal with. The lack of examples provided by submitters is not unexpected; anti-competitive conduct can be difficult and resource-intensive to detect and analyse. It is also not necessarily realistic to expect the Commerce Commission (or other parties) to assess current or historical conduct against a potential future strengthened section 36 to determine whether the current prohibition is under-reaching.

Some businesses in favour of reform highlighted concerns that would not necessarily be addressed by a strengthened section 36. For example, the Food and Grocery Council highlighted concerns around the bargaining power of supermarkets and the impact on suppliers. Some of these concerns may, however, be addressed through the Fair Trading Amendment Bill currently before Parliament.

Arguments against reform

Stakeholders opposed to reform raised a number of arguments in favour of the status quo. Some of the more frequently-raised arguments are presented below, alongside MBIE's response.

Stakeholder concern	MBIE response
There is little evidence of anti-competitive conduct that is going undeterred at present, or that reform would improve competition.	As noted above, the lack of evidence of a problem is not unexpected. There are good theoretical and practical reasons to believe that the current prohibition is not fit-for-purpose.
The current prohibition is predictable and easy for businesses to apply in their day-to-day decision-making.	As outlined above, we do not necessarily agree that the current prohibition promotes predictability. To the extent that it does, this arguably just reflects the high probability under the current prohibition that conduct will not breach the Act. We do not consider this to be a desirable form of predictability.
Many forms of anti-competitive conduct by firms with market power can already be caught under the Act's provisions relating to anti-competitive agreements (section 27).	While many forms of conduct that are intended to be captured under section 36 can also involve agreements, the Commerce Act's prohibitions relating to agreements are often not well suited to addressing this conduct. For example, taking a case against a business accused of predatory pricing might require the Commission to argue that the predatory pricing was an 'agreement' between a business and each of its (potentially thousands of) customers.
The 'take advantage' test is an appropriate way of distinguishing between conduct that should and should not be prohibited.	We disagree. We think that the current test is poorly targeted, and the fact that a firm would have engaged in the same conduct if it did not have market power is not a good reason to permit conduct that has an anti-competitive effect.

Any reform would chill competition and investment by slowing down decision-making, increasing compliance costs, and introducing uncertainty and ambiguity. In particular, an Australian-style effects test would require firms with substantial market power to conduct detailed up-front analysis of the effects of a wide range of day-to-day conduct.	We agree that firms would need to conduct a self-assessment as to the possible effects (and purpose) of a range of conduct. However, the proposal shares a number of similarities to the existing prohibition against anti-competitive agreements. Given this, many businesses and their legal advisors are already familiar with the concepts in the proposed prohibition (although section 36 would apply to a wider range of situations). There will still unquestionably be scope for uncertainty, particularly for novel or borderline cases. However, existing New Zealand and international case law should provide sufficient guidance as to whether many forms of conduct are pro- or anti-competitive. A Canadian-style prohibition (see below) would be a way of reducing the situations in which firms would have to assess the effects of their conduct.
Reform could result in pro-competitive conduct (such as price decreases as a result of efficiencies that lead to competitors exiting the market) being treated as breaches of the law.	Courts and the Commerce Commission are very unlikely to treat pro-competitive conduct (such as price reductions resulting from efficiencies, or new innovations) as anti-competitive, even if they result in competitors exiting the market. The prohibition would be focused on the competitive process, not the number of competitors in a market, and courts have recognised that (non predatory) price reductions and quality improvements are an important part of competition.
By nature of the conduct that section 36 seeks to address, any prohibition will be costly and complex to enforce, regardless of the wording.	We agree that any unilateral conduct prohibition will involve complexity. However, the current section 36 is particularly challenging to enforce in a way that is unlikely to be replicated under other potential tests.
There has not been enough time for the Australian reforms to bed in, and that the importance of consistency with Australia is overstated in any case.	It may take a significant amount of time for case law to build up in Australia. We think that the case for waiting is outweighed by the risks that anti-competitive behaviour is currently going undeterred in New Zealand. We agree that consistency is not critical, however alignment with international tests will promote certainty by allowing New Zealand to draw on international case law, and reduce compliance costs for firms operating in multiple markets.

Issue 2: Commerce Act's IP provisions

Overview

The Commerce Act's IP provisions have the potential to impact on a range of creators and users of IP, although, given that most IP-related conduct is unlikely to be anti-competitive, this impact should not be overstated.

In January 2019, we consulted on whether to remove the IP exemptions in the discussion paper *Review of section 36 of the Commerce Act and other matters*.

We received 14 submissions on this issue from the Commerce Commission, IP rights holders, and the legal community. Of these, two stakeholders broadly supported reform, seven were broadly opposed, and five were broadly neutral.

Arguments in favour of reform

The Commerce Commission and Buddle Findlay generally agreed with MBIE's description of the issue (see above) and that IP should be treated the same as other types of property or assets under competition law. In addition, four other submitters[29] agreed that the current IP exemptions were unclear as to their scope. For example, both academics and businesses had different views on whether section 36(3) is an actual exception for IP rights, or whether it simply reinforces the rights contained in the various IP statutes.

Arguments against reform

Those opposed to reform advanced a number of concerns about the proposal, and provided arguments in support of retaining the IP exemptions. The table below sets out the key concerns raised by stakeholders, and our comments in response.

Stakeholder concern	MBIE response
There is no evidence of a problem at present.	We note that a lack of cases involving IP exemptions may be because private litigants are choosing not to take cases, or are not referring complaints to the Commerce Commission, because the current wording of the Act means that their case is unlikely to succeed. MBIE knows of at least one example where this has been the case.
IP and competition law remain in fundamental conflict. IP rights should be treated differently to other types of property for the purposes of competition law.	We disagree. Both regimes seek to promote innovation to enhance economic welfare. We think that IP rights are essentially comparable to other forms of property. The exclusivity or limited monopoly granted by an IP right is generally unlikely to raise concerns in the competition law sense because the right is typically much narrower than the market for the product or service. The availability of substitutes and competitive pressure ensures that IP rights holders, including inventors, typically do not have enduring market power.
The current exemptions are clear and it is easy to understand whether particular conduct falls within their scope at present.	We disagree. We think it is likely that a number of businesses engage in conduct that they think is protected by the IP exemptions but actually is not – i.e. businesses think the exemptions are broader than they actually are. Further, as stated above, we note that several other submitters considered that the exemptions lack clarity.
The IP provisions should be reviewed separately and more intensively once the outcome of the section 36 review is known.	Conducting the reviews together allows us to consider both issues holistically.

[29] These submitters were Grasslanz, New Zealand Institute of Patent Attorneys, Alan Lear (a barrister specialising in IP law) and Bell Gully.

Repealing the exemptions would reduce incentives to innovate if businesses felt they had to license their IP to other parties.	We disagree. Refusals to license IP do not tend to raise competition concerns because any temporary market power or advantage provided by an IP right provides other businesses with an incentive to engage in the competitive process and invest in developing their own IP. Where a refusal to license did attract the Commerce Commission and/or the courts' interest, we would expect them to conduct analysis of the market with and without the licensing arrangement, and judge the agreement accordingly. Additionally, the Patents Act and the Plant Variety Rights Act already contain compulsory licensing regimes for those who seek to access these types of IP but are refused by the rights holder.
Repeal of provisions would result in costly litigation.	The majority of IP conduct is not likely to raise competition concerns. While some IP rights-seekers may try to test the new laws initially, we think the risk of frivolous litigation from any law change is relatively low. A transition period and guidance material provided from the Commerce Commission would help businesses to assess whether their IP arrangements are likely to raise competition concerns. This is discussed further below.
If MBIE repeals section 45, there will need to be some defences for IP licensing to the cartel provisions in the Act.	We do not think that any additional defences are needed. The Act's cartel provisions already contain a number of defences and exceptions that mean that most IP-related arrangements would not breach the provisions. Where a licence did seek to extinguish competition, this should be examined under general competition law.

Section 3: Options identification

3.1 What options are available to address the problem?

Issue 1: Anti-competitive unilateral conduct

In addition to the status quo, we have considered two main options to address the issues with section 36 of the Commerce Act:

- **Option 1:** Prohibit firms with a substantial degree of market power from engaging in conduct that has the purpose, effect, or likely effect of substantially lessening competition (preferred).
- **Option 2:** Prohibit firms with a substantial degree of market power from engaging in conduct that:
  - is for an exclusionary purpose; and
  - has, or is likely to have, the effect of substantially lessening competition.

Option 1: Prohibit conduct with the purpose, effect, or likely effect of substantially lessening competition (preferred)

Description

This option would involve prohibiting firms with a substantial degree of market power from engaging in conduct that has the purpose, effect, or likely effect of substantially lessening competition. This is effectively the approach adopted by Australia in 2017, and was the initial proposition set out in the 2019 discussion paper.

The key differences from the status quo are that:

- the 'take advantage' test – the source of (in MBIE's view) most of the issues with the status quo – would be removed; and
- the current focus on the purpose of a firm's conduct in relation to individual competitors would be replaced by a focus on the purpose or effect of the firm's conduct on the competitive process as a whole.

As at present, breach of this prohibition would be subject to pecuniary penalties of up to $500,000 for individuals, and in any other case, the greater of $10 million, 3 times the value of any commercial gain from the contravention, or 10 per cent of turnover of the business in question. Other remedies, such as injunctions and damages, would also be available, as at present.

As part of this option, parties would be allowed to seek authorisation from the Commerce Commission for conduct that may contravene section 36, but which is in the public interest. The current authorisation process does not extend to conduct captured under section 36.

This approach would also involve amending section 36A, relating to misuse of trans-Tasman market power, in line with the amended section 36, subject to consultation with the Australian government.

Discussion

Compared to the status quo, this option would focus the prohibition directly on the anti-competitive nature of the conduct (as opposed to whether a firm without market power would have engaged in the conduct). Fundamentally, it would mean that firms would not be able to engage in conduct with the purpose or effect of substantially lessening competition, regardless of whether they would have engaged in the same conduct if they did not have substantial market power. In considering whether conduct substantially lessened competition, courts would be able to take into account pro-competitive effects of conduct, such as efficiency gains (i.e. it is the *net* impact on competition that would be assessed).

This option would likely significantly decrease the cost and complexity of enforcement. It would be consistent with the Australian prohibition, and New Zealand's provisions relating to anti-competitive agreements, which would promote predictability by allowing domestic and Australian case law to be drawn on.

Despite the benefits of the Australian approach, one arguable limitation of this option is that there is nothing in the wording of the prohibition that would clarify that it is targeted at exclusionary conduct. This means that there are some forms of conduct that could, on the face of it, appear to breach this test, despite not having an exclusionary purpose.

Some examples of this are outlined in the table below, largely based on concerns raised by stakeholders. We consider that these examples are unlikely to breach the Commerce Act, or be a problem in practice, for the reasons set out in the table below.

Example of how Option 1 might, on the face of it, over-capture	Why this is unlikely to be a breach / is not a problem in practice
Firm with substantial market power withdraws from a market	A substantial lessening of competition is generally understood to mean something that results in the creation, maintenance or enhancement of market power for a sustained period. A firm withdrawing from a market should not represent a substantial lessening of competition (and therefore should not breach the prohibition) because it does not preserve or extend any firm's market power. A firm exiting a market does not prevent a new firm from entering, and may in fact provide an opportunity for new competition to emerge.
Online marketplace that facilitates the sale of a high proportion of a particular good on its platform bans the sale of that good on its platform on 'public good' considerations	If the ban means that the marketplace no longer has any connection to the sale or production of the goods in question, then the ban would be unlikely to extend the marketplace's market power, and therefore would be unlikely to lead to a substantial lessening of competition.
Firm engages in conduct that substantially lessens competition as a direct result of compliance with government regulations	If the relevant conduct of the firm is a direct result of a government regulation, then it may be exempted from the Act under section 43, which provides for statutorily authorised conduct.
Government agency (in trade) procures all supplies from one provider, resulting in the exit of another provider from the market	The provider's decision to exit the market is separate to (albeit influenced by) the government's procurement decision and so the government's procurement decision is unlikely to 'cause' a substantial lessening of competition. In addition, if the government has secured favourable terms from the supplier in question, then such conduct may be pro-competitive. In any case, procurement agreements are already subject to provisions of the Act relating to anti-competitive agreements.

Even if any of the above examples were breaches of the Act, we consider it highly unlikely that the Commerce Commission would ever take a case in relation to these sorts of conduct.

While we think that such examples are unlikely to be a breach, it is not entirely certain that a court would take the same view in such situations, in response to private litigation. We think it is likely that it would, and that a court would also view conduct such as innovation and (non-predatory) reductions in price as pro-competitive (and thus not a breach of the Act), even if it results in other firms exiting the market.

However, there is a genuine risk that some businesses may act overly conservatively and compliance-focused to avoid any risk of contravening the prohibition. This would impose some costs, and could lead to some firms not engaging in conduct that is ultimately pro-competitive. This risk would lessen once case law has developed. However, it could be a number of years before there are court judgments relating to a reformed section 36.

Option 2: Prohibit conduct with an exclusionary purpose and the effect, or likely effect of substantially lessening competition

Description

An alternative approach would be to adopt what is, in effect, a simplified version of Canada's anti-competitive unilateral conduct prohibition. It would effectively provide that a person that has a substantial degree of power in a market must not engage in conduct that:

- is for an exclusionary purpose; and
- has, or is likely to have, the effect of substantially lessening competition.

Penalties and other remedies would be the same as under Option 1 (and the status quo). Like Option 1, parties would be able to apply for authorisation from the Commerce Commission. Section 36A would be amended in line with the revised section 36, subject to consultation with the Australian government.

Discussion

The intent of this option would be to reduce any risk of inadvertently capturing legitimate, non-exclusionary conduct, or of businesses acting overly conservatively. Requiring proof of exclusionary purpose *and* effects would likely reduce the costs for businesses of complying with the prohibition. In theory, businesses would be able to reassure themselves relatively simply that, if their conduct has a legitimate business rationale, they would be unlikely to be at risk of breaching the prohibition. They would only need to undertake internal analysis as to the likely effects of their conduct if their conduct did have an exclusionary purpose (although some stakeholders have suggested that many firms would want to conduct an effects analysis regardless).

Compared to Option 1, this option would also reduce any risk of firms being penalised for conduct that had anti-competitive effects that were not reasonably foreseeable. However, it may also reduce the incentives on dominant firms to manage the incidental effects of their commercial strategies on competition and consumers.

A key trade-off associated with Option 2 is that it would be harder to enforce than Option 1 (although likely still much easier than the status quo), as the Commission or private parties would have to prove both purpose *and* effect (or likely effect), rather than just one or other. However, the evidential burden for proving purpose should, in theory, be relatively low in most instances. Section 36B of the Act already provides that purpose may be inferred from a person's conduct and any other relevant circumstances (rather than, for example, needing to provide evidence of the internal thought processes of management). The intent would be for the purpose element to essentially 'filter out' conduct that is not exclusionary in nature, but otherwise not act as a substantial barrier to taking a case.

Issue 2: Commerce Act's IP provisions

In addition to the status quo, we have considered one option in respect of the Commerce Act's IP provisions:

Option: Repeal each of the Commerce Act's IP provisions (preferred)

Description

Under this option, each of the Act's IP exemptions would be repealed. There would be an appropriate transition period to help businesses adjust to the changes. In the event of repeal, the Commerce Commission is likely to produce guidelines about its approach to enforcing the Act in respect of IP-related conflict. This is the approach that the Australian Competition and Consumer Commission has taken in Australia following the repeal of s 51(3) of the Australian Competition and Consumer Act.

Discussion

As explained above, it is now generally accepted that IP rights and competition law are complementary. IP rights do not usually create substantial market power in the competition law sense, and licensing or assigning IP rights usually encourages competition and future innovation.

However, some IP arrangements can be anti-competitive and some arrangements are potentially sheltered from New Zealand's competition law at present. We have become aware of several situations in relation to potential anti-competitive IP-related conduct in the fields of patents, copyright and plant variety rights where this may currently be the case.

We consider that IP arrangements should be scrutinised under the Act like any other form of arrangement. Other comparable jurisdictions like Canada, the United Kingdom, the United States and Australia have reduced or completely removed the IP exemptions in their competition legislation.

MBIE has considered a variety of examples of IP rights conduct provided by submitters, academics and the legal community. We consider that, due to the fact that most IP-related conduct is pro-competitive, and because of New Zealand's broad exceptions to the cartel provisions in the Commerce Act, the majority of IP-related conduct is unlikely to breach the Act. Where IP-related conduct does not fall within such an exception, we considered that it should be scrutinised under the Act like any other form of conduct.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The purpose of the Act is "to promote competition in markets for the long-term benefit of consumers within New Zealand." This is the primary objective for any reform of the Act. The criteria below should all be read in the light of furthering this objective.

We have used four main criteria to assess options for reforming section 36 and the Act's IP provisions to determine their likely contribution to the objective:

- **Criterion 1:** Minimise the risk of wrong answers that stop pro-competitive behaviour (false positives).
- **Criterion 2:** Minimise the risk of wrong answers that allow anti-competitive behaviour (false negatives).
- **Criterion 3:** Provide businesses with predictability for pro-competitive decision making and reasonable compliance costs.
- **Criterion 4:** Minimise the cost and complexity of enforcing cases in order to penalise and deter anti-competitive behaviour.

These criteria are based upon the 'error cost' analysis framework commonly used in competition law and policy.[30]

The extent of any trade-offs between these criteria is not straightforward, and is contested. Some stakeholders effectively argue that there is a trade-off between Criterion 1 and Criterion 3 on one hand, and Criterion 2 and Criterion 4 on the other. It can also be argued that, with appropriate options design, all of these objectives can be achieved without any substantial trade-offs.

3.3 What other options have been ruled out of scope, or not considered, and why?

Issue 1: Anti-competitive unilateral conduct

No options have been explicitly ruled out of scope. However, as noted above, the options considered in this section of the RIS are focused on generic interventions to address anti-competitive unilateral conduct in a way that harms competition.

There are a number of alternative (or in some cases, complimentary) options that we have not fully considered as part of this RIS. These include:

- **Minor modifications to the current section 36.** A few submitters suggested that, if section 36 is to be amended, the 'take advantage' test should be retained, but altered to provide the court with more flexibility as to how this should be interpreted. In short, we do not support this option. A number of attempts have already been made to encourage New Zealand courts to move away from the use of a complex hypothetical counterfactual as part of this test, with little success. Similarly, Australia amended its 'take advantage' test to provide for greater flexibility, but ultimately concluded that more fundamental reform was required.
- **Requiring proof of effects or likely effects, with defence if the conduct did not have an exclusionary purpose.** This would be similar to Option 2, in that the Commerce Commission (or private plaintiff) would not have the option of only focusing on the purpose of conduct, and would need to prove the effects or likely effects. However, unlike Option 2, the burden would be on the defendant to prove that it did not have an exclusionary purpose, rather than on the Commission to prove that it did. While we think that this option has some merit, it is not sufficiently different to Option 2 to justify full analysis.
- **Provide a defence for conduct that had an anti-competitive effect that was not reasonably foreseeable at the time of engaging in the conduct.** This option could reduce the risk of businesses acting risk-aversely. However, it could also make enforcement of section 36 more difficult, as it could lead to disagreements about whether or not conduct was reasonably foreseeable. It could also reduce the incentive for firms to appropriately consider the effects of their conduct up front. Even without this option, we expect that courts would take the culpability of the defendant into account when setting penalties and making other orders.
- **Repealing section 36A of the Commerce Act.** We considered repealing the provisions relating to misuse of trans-Tasman market power, given their lack of use to date and limited likely future use. However, there is little cost associated with retaining and updating the provision, and section 36A arguably has an important symbolic value in that it contributes towards the integration of the New Zealand and Australian economies. Retaining section 36A also avoids arguments that anti-dumping remedies should be reintroduced in relation to Australia and New Zealand.
- **Providing detailed rules for specific types of conduct in secondary legislation.** Prescribing certain rules for certain types of conduct could provide additional upfront clarity. However, this

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[30] For a discussion of error cost analysis see Kemp, K. (2017). *The Big Chill? A Comparative Analysis of Effects-Based Tests for Misuse of Market Power*. *40*(2) University of New South Wales Law Journal.

could add complexity by leading to a 'laundry list' of conduct. There are a very large number of ways in which a monopolist can engage in exclusionary conduct and it is almost impossible to come up with a complete list. It would also require 'characterisation' of the conduct in question, and could lead to different standards applying for different forms of conduct. Our preference is to rely on Commission guidance and domestic and international case law as means of promoting certainty, rather than prescribing conduct-specific rules.

Issue 2: Commerce Act's IP provisions

We have not seriously considered amendments to the IP provisions to clarify or reduce their scope because we consider that there would be significant difficulty in defining new provisions that made economic and legal sense. In addition, we think that any benefits that might result from the redefined provisions could be outweighed by the costs faced by firms in interpreting the new provisions. Even if amendment did aid with clarity, amendment rather than repeal will likely result in some anti-competitive IP-related conduct remaining shielded from the Act.

While some submitters did offer suggestions such as reframing the provisions, providing that the provisions only apply in relation to a narrower range of IP statutes, or retaining some, but not all of the provisions, we do not consider these to be viable options. The Commerce Commission's submission supports MBIE's position.

Section 4: Impact Analysis

	No action	Options relating to anti-competitive unilateral conduct		Option relating to IP provisions
		Option 1 – Prohibit conduct with the purpose, effect, or likely effect of substantially lessening competition (Preferred)	**Option 2 – Prohibit conduct with an exclusionary purpose and the effect or likely effect of substantially lessening competition**	**Option – Repeal each of the Commerce Act's IP provisions (Preferred)**
Minimise the risk of wrong answers that stop pro-competitive behaviour (false positives)	0	0 Reduces theoretical risk of the current prohibition over-capturing, but there is a low chance that it could lead to some non-exclusionary conduct being prohibited.	+ Reduces theoretical risk of the current prohibition over capturing.	0 Unlikely to result in any false positives.
Minimise the risk of wrong answers that allow anti-competitive behaviour (false negatives)	0	+++ Significantly reduces the risk of anti-competitive conduct going undeterred.	++ Significantly reduces the risk of anti-competitive conduct going undeterred, although the need to demonstrate purpose could lead to some anti-competitive conduct going undeterred.	+ Addresses the risk that the status quo is leading to false negatives as some anti-competitive conduct is shielded from the Act.
Provide businesses with predictability and reasonable compliance costs	0	- We do not consider the existing section 36 offers significant predictability. However, many businesses may consider that this option will reduce predictability. It may also increase compliance costs as businesses will need to conduct an assessment of the likely effects of their conduct.	0 We do not consider the existing section 36 offers significant predictability. However, many businesses may consider that this option will reduce predictability. Compliance costs would likely be lower than Option 1 as businesses without an exclusionary purpose would not need to assess the likely effects of their conduct.	0 Repeal may lead to a drop in predictability in the short term for conduct that was previously exempt from the Act. But for conduct where it is currently unclear as to whether or not the exemption applied, the removal of the exemption could increase clarity.
Minimise the cost and complexity of enforcing cases in order to penalise and deter anti-competitive behaviour	0	+++ Likely to significantly reduce the cost and complexity associated with enforcement.	++ Likely to reduce the cost and complexity associated with enforcement, although less than Option 1, due to the need to demonstrate purpose *and* effect.	+ Will allow parties to focus on whether the conduct is anti-competitive, rather than also first arguing over whether the conduct is exempt from the Act.
Overall assessment		++	++	+

Key:

+++ much better than doing nothing/the status quo ++ better than doing nothing/the status quo + slightly better than doing nothing/the status quo

0 about the same as doing nothing/the status quo

- slightly worse than doing nothing/the status quo - - worse than doing nothing/the status quo - - - much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Issue 1: Anti-competitive unilateral conduct

Preferred option

As outlined in section 4, we think that both options are likely to represent a material improvement on the status quo in terms of ease of enforcement and the range of anti-competitive conduct captured.

As noted in section 3.2, the extent of any trade-offs between our criteria is contested. However, at a basic level, if more weight is placed on Criterion 2 and Criterion 4 (and on other potential objectives, such as alignment with Australia), Option 1 is preferable. If more weight is placed on Criterion 1 and Criterion 3, then Option 2 is preferable.

We place a slightly higher weighting on Criterion 2 and Criterion 4, and therefore have a slight preference for Option 1.

Stakeholder views on the options

As noted above, of the 23 submitters who submitted on the issue of section 36 in response to our 2019 Discussion Paper, seven were broadly in favour of reform in line with the proposals outlined in the discussion paper (i.e. Option 1), eight were broadly opposed, and eight were broadly neutral.

Three of the stakeholders that we categorised as neutral were broadly supportive of an option in line with Option 2. Other stakeholders favoured other variations, some of which are outlined in section 3.3.

More information on stakeholder views is presented in sections 2.5 and 3.1.

Issue 2: Commerce Act's IP provisions

Preferred option

Our preferred option is to repeal each of the Commerce Act's IP provisions. We consider that this is the option that best solves the problems set out in the problem definition section. Repealing the exemption will reduce the risk of false negatives (Criterion 2), and lead to easier enforcement and greater deterrence of anti-competitive conduct (Criterion 4). We do not consider that it will have any meaningful impact on the risk of false positives (Criterion 1) or on predictability and compliance costs for businesses (Criterion 4). It should also not have any impact on the outcomes sought by IP policy in respect of innovation and creativity, as these are complementary to the goals of competition policy.

Stakeholder views on the options

In their submissions on the discussion document, two stakeholders (out of 14) supported this option. These stakeholders were the Commerce Commission and Buddle Findley. The Ministry for Primary Industries also supports this option, as its staff are aware of potential competition issues relating to IP in the agriculture sector.

It is not surprising that stakeholders who create and licence IP (and the law firms that represent them) favour retaining the status quo. These stakeholders raised a number of concerns about repealing the exemptions (described earlier). However, we consider these to be overstated. In addition, they arguably have a vested interest in ensuring that their conduct stays exempt from scrutiny under competition law. Furthermore, as noted above, some of the existing 'certainty' that stakeholders consider exists at present may be false certainty. That is, given that the existing IP exemptions are potentially quite narrow, some conduct that is perceived to be exempt, may actually not be.

5.2 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Affected parties	Comment: nature of cost or benefit	Impact
Additional costs of proposed approach, compared to taking no action		
Businesses with a substantial degree of market power	One-off transition costs as businesses become acquainted with the new law and may have greater uncertainty about the law in the initial stages. May also result in higher ongoing compliance costs than the status quo, partly reflecting the under-capture of the existing prohibition.	Low-Medium[31]
Businesses with rights to significant or critical IP	IP rights-holders and users of IP will have one-off transition costs as they become acquainted with the impact of the removal of the provisions and face some uncertainty about the impact in the early stages. IP rights holders who are engaging in anti-competitive practices will face reduced profits as these practices become illegal.	Low
Commerce Commission	One-off transition costs for the Commission to produce rules and guidelines. Ongoing costs from authorisation applications. Additional enforcement costs for conduct that is currently exempt from the Act.	$0.17m[32] per annum for authorisation – NPV $1.95m[33] $0.3m one-off transition costs[34] Low additional enforcement costs
Wider government	None of significance	None
Other parties	None of significance	None
Total Monetised Cost		$2.1 million
Non-monetised costs		Low

[31] This was estimated as $0.6 million in the discussion paper. A number of submitters argued that this estimate was too low, without providing alternative figures.

[32] Assumes 1 complex application (around $500,000) every 3 years.

[33] 6% discount rate for costs continuing over 20 years.

[34] Based on preparation costs for cartel criminalisation multiplied by two sets of rules and guidelines.

Expected benefits of proposed approach, compared to taking no action		
Businesses with a substantial degree of market power	May benefit over time from greater certainty of rules around specific types of conduct.	Low
Businesses with rights to significant or critical IP	None of significance.	None
Commerce Commission	Less complex enforcement produces cost savings for the Commission. Greater certainty of outcomes enables the Commission to be a more effective regulator.	Low
Wider government	None of significance	None
Other parties	If more anti-competitive unilateral conduct is deterred, other businesses, including new entrants, may find it easier to grow and develop. Easier for businesses to access, utilise, and build upon existing IP. Some could benefit from greater likelihood of success of private litigation.	Low-Medium
Wider economy	Gains to broader economy from improved static and dynamic gains from improved competition.	Low-Medium
Non-monetised benefits		Low-Medium

5.3 What other impacts is this approach likely to have?

As outlined in section 3.1, there are risks that Option 1 in respect of section 36 could result in non-exclusionary conduct being prohibited, and in businesses being too risk-averse and not engaging in conduct that is ultimately pro-competitive. We think that the risk of the former is low. The risk of the latter is potentially higher, but should be able to be reduced through Commerce Commission guidance, and through reference to domestic and international case law. Risk aversion is also likely to be constrained by commercial incentives that are likely to encourage businesses to continue to compete aggressively within the limits of the law.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

Broadly, yes.

Some parties will argue that the preferred options will not produce predictable outcomes for regulated parties. While the changes may result in some uncertainty, this is, to an extent, inherent in principles-based regulation. The uncertainty will be able to be addressed through Commerce Commission guidance, reference to existing relevant New Zealand and overseas case law, and the development of specific case law in New Zealand relating to New Zealand's new anti-competitive unilateral conduct law and IP-related conduct over time.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

These proposals will be given effect through a Commerce Amendment Bill. We expect that this Amendment Bill will be introduced in 2020. It is anticipated that the changes will come into force 12 months after the legislation receives Royal Assent.

Public enforcement will be carried out by the Commerce Commission. Businesses will also be able to self-enforce the Act by taking cases through the courts.

Stakeholders will be informed about the Government's policy decisions and the progress of legislation via ministerial announcements, the MBIE website, and through direct contact with interested parties.

It is expected that the Commerce Commission will undertake initiatives to raise business awareness of the law changes prior to them taking effect. For example, it is likely that the Commission will publish guidance on its website – typically such guidance outlines the Commission's approach to enforcing the legislation and provides examples of conduct that is, and is not, likely to be in breach. Commission guidance is often informed by relevant domestic and international case law.

6.2 What are the implementation risks?

The benefits associated with intervention will depend on the extent to which the legislative amendments drive changes in behaviour and are enforced. While businesses can and do take private action to enforce the Commerce Act, due to financial or other reasons (such as licensees of IP not wanting to affect their relationship with licensors), private parties will not always be in a position to enforce the strengthened laws. Given this, enforcement by the Commerce Commission will play an important role in the success of the proposals.

As a result, the main implementation risk is if the Commission is not adequately resourced to enforce the changes. The Commerce Commission's funding already takes into account its role in enforcing section 36. However, it is possible that extending authorisation to conduct captured under section 36 could result in increased costs for the Commission, although it is difficult to predict with any degree of certainty the number of authorisation applications (if any) that the Commission is likely to receive. The only other change with potential financial implications is the increase in the cap on the number of Commissioners (see the Annex). However, this will not have any financial implications unless/until additional appointments are made. These implications will be considered at that time. In any case, the Commerce Commission's baseline funding has recently been reviewed, and a bid for addition funding is being considered as part of Budget 2020.

In addition, as discussed above, there are risks that the proposals create uncertainty for businesses, or lead to them being too risk-averse. However, these risks should be able to be managed through proactive communication with stakeholders, guidance from the Commission, and an appropriate transition period to enable businesses to adjust to the reforms.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

As the enforcement agency for the Commerce Act, the Commerce Commission will play a key role in monitoring the proposed changes. In particular, complaints to the Commission, and subsequent investigations and enforcement action, will provide a valuable evidence about the effectiveness – or otherwise – of the proposals. There will be an opportunity for MBIE to receive this information on an ongoing basis as part of our regular engagements with the Commission, as well as through more formal Commission reporting, such as through its annual reports.

MBIE will also continue to monitor data and reports that provided indications of the levels of competition in the economy, although the impacts of the particular proposals contained in this RIS are likely to be difficult to isolate.

More generally, officials regularly engage with businesses, law firms, and consumer organisations. These engagements provide an opportunity to test the impacts of the proposed reforms.

7.2 When and how will the new arrangements be reviewed?

While there are currently no plans for a formal review of these proposals, MBIE regularly evaluates and reviews amendments to the laws it administers. The changes could, for example, be evaluated three to five years after coming into force (subject to resource constraints). An evaluation or review at this time should allow for the changes to have bedded in and any anticipated and desired impacts to emerge.

Stakeholders with concerns about the policy proposals will have the opportunity to raise these through the Parliamentary Select Committee process, and through engagement with MBIE. Any issues or concerns that stakeholders have in relation to implementation or enforcement of the changes can be directed to the relevant enforcement body, the Commerce Commission.

Annex: Additional minor proposals

In addition to the issues of anti-competitive unilateral conduct and the Commerce Act's IP provisions, we propose to make a number of more minor changes to the Commerce Act.

The Regulatory Quality team at the Treasury has determined that the below issues do not require full impact analysis, but they are included for completeness.

Minor proposal 1: Clarify the treatment of covenants in the Commerce Act

Issue

The Commerce Act defines covenants as relating to land. A covenant on land generally restricts the way in which that land can be used. For example, a supermarket may place a covenant on the sale of its surplus land to prevent that land from being used for a competing supermarket. Depending on the specific circumstances, such as the availability of other suitable land, such a covenant might impede competition.

In 2017, when the Act's price fixing prohibitions were repealed and replaced with new cartel prohibitions, covenants were inadvertently excluded from the new prohibitions. This was an oversight, rather than any change in the policy position. The impact of this is that covenants which create or implement a cartel will not 'automatically' be prohibited in the same way that standard cartel agreements are, making the prohibition harder to enforce and meaning that the criminal penalties for cartel conduct that will come into force in 2021 will not apply.

Proposal

We propose to close this loophole and restore the pre-2017 position of covenants being treated equivalently to contracts under the Act. The exact mechanism for doing so will be determined by the Parliamentary Counsel Office during drafting of the Commerce Amendment Bill.

Minor proposal 2: Clarify the treatment of anti-competitive conduct in relation to land

Issue

As currently drafted, different provisions of the Act treat issues relating to land inconsistently and somewhat ambiguously. Anti-competitive conduct is only prohibited in relation to the supply or acquisition of goods or services; land is not specifically mentioned. However, the definition of services includes "rights in relation to, and interests in, real or personal property". In other parts of the Act, land is mentioned separately to goods and services, which has led to some disagreement about the scope of the Act in relation to land. The courts have recently stated that the Act's definition of services does include land, but we nevertheless consider that there may be merit in some drafting amendments to the Act.

Proposal

We propose to make drafting amendments to the Act, to provide for a more consistent treatment of land. In particular, the Act should be clear that collusion or exclusionary conduct in relation to interests in land is unlawful in the same way as other property. The exact amendments will be determined during drafting, but our intent is to clarify the treatment of land under the Act, rather than to substantively extend the Act's scope.

Minor proposal 3: Align penalties for anti-competitive mergers with other anti-competitive conduct

Issue

The Commerce Act prohibits business mergers and acquisitions that would substantially lessen competition. It provides for a voluntary clearance (for mergers that would not substantially lessen competition) and authorisation (for mergers that would substantially lessen competition, but are justified on other public interest grounds) regime, under which mergers that are cleared or authorised by the Commission cannot be challenged as a breach of the Act.

The maximum penalty for an anti-competitive merger or acquisition is currently $500,000 for individuals and $5 million for anyone else (e.g. companies). This maximum penalty has been unchanged since 1990. It compares to a maximum penalty for other forms of anti-competitive conduct of up to $500,000 for individuals, and for anyone else, the greater of $10 million, three times the value of any commercial gain from the contravention, or, if the commercial gain is unknown, ten per cent of turnover of the business in question.

Since the beginning of 2018, the Commerce Commission has undertaken investigations into eight possibly anti-competitive mergers for which clearance or authorisation was not sought. This suggests that the current penalties for anti-competitive mergers are not acting as a sufficient deterrent.

Proposal

We propose to increase the maximum penalties for anti-competitive mergers and acquisitions, to align them with the maximum penalties for other breaches, as set out above.

Minor proposal 4: Increase the cap on the number of members of the Commerce Commission board

Issue

The Commerce Act provides that the Commerce Commission must have between four and six 'full' Commissioners (i.e. board members) at any one time. There may also be any number of Associate Commissioners. Given the steady increase in the Commission's functions over time, and the significant role Commissioners have as statutory decision-makers, constraints on the number of Commissioners can lead to delays in decision-making and high workloads for the incumbents.

To date, we have sought to address these issues by appointing additional Associate Commissioners. However, we think it would be useful for there to be flexibility to appoint additional full Commissioners to manage the workload and bring a wider mix of skills and experience to the Commission's decision-making. For example, full Commissioners have governance responsibilities under the Crown Entities Act, whereas Associate Commissioners do not. Flexibility to appoint an increased number of full Commissioners could therefore provide greater depth to the Commission board's governance role. The maximum number of board members is also lower than that for other Crown entities such as the Financial Markets Authority, which has a statutory maximum of nine members.

Proposal

We propose to increase the maximum number of Commissioners from six to eight (while retaining the minimum number at four). The decision regarding whether to actually appoint additional Commissioners would be a separate one.

Minor proposal 5: Provide for information sharing between the Commerce Commission and other regulators and agencies

Issue

Given the Commerce Commission's broad, cross-economy remit, its activities can overlap with those of other government agencies or regulators, or it may unearth information in the course of an investigation that may be of relevance to another regulator. Currently, the Commission's ability to share information that it obtains – particularly information of a confidential nature – is uncertain. Where information is not able to be shared, it can result in duplication of effort, impede regulatory cooperation and coordination, and lead to under-enforcement of the law.

The Privacy Act 1993 and the Official Information Act 1982 do provide mechanisms that allow for information to be shared between agencies. However, the Privacy Act is concerned with personal, rather than commercial, information. In any case, the information sharing agreements that it provides for are not well-suited to the Commission, given the wide range of agencies that it may need to deal with from time to time. We do not consider the Official Information Act to be an appropriate mechanism for facilitating cooperation between government agencies and regulators.

It is common for other regulators to have specific provisions in their governing Acts that provide that they can share information with other government agencies. This includes legislation such as the Financial Markets Authority Act 2011 and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. While the Commerce Commission has the ability to share information with the Financial Markets Authority and the Takeovers Panel in relation to its activities under the Fair Trading Act, this does not extend to its Commerce Act functions.

Proposal

We propose to amend the Commerce Act to provide that the Commission may share information that it holds in relation to its functions under the Commerce Act, or any other Act that it enforces, with other government agencies or regulators. This would be subject to safeguards relating to the use and storage of the information. Existing information sharing provisions that overlap with this provision (such as the one contained in the Fair Trading Act) would be repealed.