BELL GULLY

Bell Gully cross-submission to MBIE

Targeted Review of the Commerce Act 1986

Introduction

1. This paper sets out Bell Gully's cross submission in response to comments made in submissions on MBIE's targeted review of the Commerce Act as well as the letter from the Commerce Commission (the **Commission**) to the Minister of Commerce and Consumer Affairs. The focus of this cross-submission is on the comments made in respect of section 36 of the Commerce Act (the **Act**).

2. In summary, while we agree with a number of points raised by the Commission in respect of the focus of the review more generally, we do not think that removing the 'take advantage' requirement and introducing an "effects test" is the appropriate response to the perceived problems with the provision. There is a very real risk of overreach and therefore a stifling of innovation and vigorous competition to the detriment of consumers if such amendments were to be made. Any amendment to section 36 has the potential to affect a large number of New Zealand businesses and as a result, getting it "wrong" will be very costly for these businesses, consumers and the economy more generally.

3. In our view, should any changes be made to section 36, this should be by way of clarification to the meaning of the "taking advantage" limb, rather than a wholesale replacement of the test. To echo our earlier comments, New Zealand should take the opportunity to learn from the Australian experience (particularly in respect of the possible introduction of an effects test). New Zealand will benefit from observing the development of the law in Australia which will enable us to make a better assessment as to whether such an approach would be appropriate here (whilst acknowledging New Zealand's unique circumstances).

4. We would be happy to discuss our views further with MBIE. All enquiries on this submission may be directed to:

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Section 36

5. **Suggested reform of section 36**

5.1 The Commission's current preference for reform involves removing the take advantage requirement and adding an effects test (Option 4). Under this approach, firms with market power will be liable if they act in a way that harms competition. The Commission considers that this approach captures anti-competitive unilateral behaviour while enabling firms to compete vigorously on the merits of their products and services.

5.2 As stated in our submission, great care needs to be taken to ensure that, should section 36 be amended, any amendments do not result in overreach. Intervention that is too intrusive will reduce innovation and investment (while a test that is not strong enough reduces competition to the detriment of consumers and the economy more generally). While we appreciate the difficulties with the provision as it currently stands and agree with the Commission in respect of a number of points raised in relation to the scope of the Act more generally, we disagree that Option 4 is preferable.

5.3 The Commission's proposed strengthening of the misuse of market power law has significant implications. The taking advantage requirement creates the necessary causation element.

Without it, there is a risk that a wider range of robust commercial unilateral behaviour will be prohibited (or at the very least, businesses will face significant uncertainty as to the legality of behaviour). Adding an effects test amplifies the problem by essentially placing firms with market power under a "special responsibility", as normal vigorous competition by small or large firms can harm competitors. As the Act makes clear, section 36 does not exist to protect individual competitors but rather the competitive process.[1] The purpose of the Act should be the starting point for the evaluation of the proposed amendments.

5.4 While the Commission makes reference to "large businesses and their advisors" being opposed to change, the misuse of market power provision captures a range of businesses, big and small. Wholesale changes to the legislation could well involve significant compliance costs for those companies that are not commensurate with their size or economic importance. In our view, the better approach is to adjust the current law (should any change be made at all) rather than make dramatic, wholesale changes to the Act. As stated in our submission, we think that there is real benefit in observing the developments of the law in Australia (while acknowledging that New Zealand's unique circumstances should be taken into account).

6. The taking advantage limb

6.1 The "taking advantage" limb of section 36 has been criticised for placing a heavy evidential burden on the plaintiff (which in most cases is likely to be the Commission). In the Commission's view this element should be removed from the provision. We disagree. While we acknowledge that the taking advantage requirement has its difficulties, in our view, a significant portion of this difficulty can be attributed to the often factually complex nature of the inquiry involved in situations where section 36 issues arise. It should not be removed on the basis of a perceived difficulty involved in its application. Clarification is preferable.

6.2 As confirmed by the Supreme Court, the taking advantage limb plays an important role in misuse of market of power analysis, by creating the necessary causal connection between the market power and the conduct at issue.[2] From a policy perspective, the causal connection is important as it is focused on distinguishing competition on the merits with competition that actually harms the competitive process. It prevents large firms from being liable for conduct merely because of their size or power. Critically, there is no taking advantage if firms are competing on their merits.

6.3 In our view, removing this limb would stifle economic activity or otherwise risk deterring businesses with substantial market power from competing effectively. To echo comments made by other submitters, to prohibit firms with market power from engaging in conduct, without requiring proof that such conduct is linked to that market power or would not occur in a competitive market, would result in firms with large market shares being conservative when competing. This creates a real risk that a wider range of competitively robust unilateral behaviour (including discounting, exclusivity etc.) will be prohibited irrespective of the fact that smaller firms may have engaged in such conduct and that is not exclusionary in an economic sense.

6.4 In light of the above, should any changes be made to section 36, this should be by way of clarification to the meaning of the taking advantage limb, rather than wholesale replacement of the test. In our view, this approach is more targeted at what is the real source of concern from the perspective of the Commission (and the courts).

7. Introduction of an effects test

7.1 The Commission sees benefit in the introduction of an effects test to New Zealand's misuse of market power provision. An effects-based test would prohibit a business with substantial market power from engaging in conduct that has the purpose, *effect or likely effect* of substantially lessening competition in a market. While we agree that an effective unilateral conduct provision is especially important for a small economy with concentrated markets, we do not think that

[1] The purpose of the Commerce Act is to "promote competition in markets for the long-term benefit of consumers within New Zealand." Section 1A, Commerce Act 1986.

[2] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111.

introducing an "effects test" is an appropriate response to the perceived problems with the current provision (at least at this stage).

7.2 Such a change would be dramatic for our competition laws. It would mean that dominant firms have to be much more conservative in engaging in conduct which might have an effect on competitors. An effects test, particularly without a nexus to the firm's market power, would likely introduce uncertainty and ambiguity to everyday business decisions. This would create the need for more detailed market competition assessment (that may or may not be feasible). Clearly, more rigorous analysis will be necessary where decisions could have significant market consequences. For example, decisions to cease offering goods or services should be examined more closely to determine their likely effect on competition in any market and whether they can be associated with enhanced efficiency, product quality or price competitiveness over a reasonable time period.

7.3 Analysis of whether conduct could "substantially lessen competition" (**SLC**) can be extraordinarily complex as it is an intensely fact-dependent exercise. In the merger context, the Commission itself can take up to 3 or 4 months to undertake an SLC analysis. However, unlike businesses, the Commission has substantial resources dedicated to such reviews in addition to wide information gathering powers (in particular the ability to gain information from third parties, which is often critical in such reviews). In addition, in the merger context, the structural change to the market (e.g. three competitors to two) is known. In the section 36 context, businesses would first need to make an assessment of the possible effect of their conduct on market structure and then undertake an SLC analysis.

7.4 In larger jurisdictions, like Europe, dominant firms may be sufficiently large that they have sufficient resources to test each new business decision in detail (including the often necessary legal and economic analysis). Many New Zealand businesses with substantial market power do not have such scale. In other words, dominant firms are not necessarily 'big' – small firms may acquire dominance through innovation and this is to be encouraged. As above, section 36 applies to *all conduct* – that is, conduct by small or large businesses. The burden that such an amendment would have is significant and in our view the costs of compliance do not outweigh the intended benefit. Accordingly, we think the case for change is not made out.

7.5 In any event, there is no proper justification to impose a different standard on parties with market power than those who not have market power (i.e. a "special responsibility"). The Commerce Act by nature is intended to protect competition and the competitive process, not individual companies from vigorous competition. Successful businesses should be free to engage in vigorous competition using the legitimate tactics available. In our view, there is a very real risk of regulatory overreach either through the actual provision, or businesses' perception of how the provision is interpreted. This would ultimately be harmful to the long term interests of consumers (contrary to the purpose of the Act).

7.6 An effects test would give section 36 too wide an application bringing within its ambit legitimate business conduct. That is, conduct that was clearly undertaken for legitimate commercial purposes (e.g. discounting) could be prohibited because of its likely competitive effects. This is an undesirable yet very real consequence of such an amendment. In our view, vigorous competition is exactly the type of conduct the Commerce Act is designed to promote. As the Australian Productivity Commission noted in its draft report on the Regulation of Australian Agriculture, shielding firms from competition, including via the introduction of an effects test, would "not be in the interest of consumers."[3]

7.7 Finally, we do not believe that the case examples referred to by the Commission necessarily support the introduction of an effects test. The Sky and Winstone Wallboards examples involved a number of agreements and so the conduct was subject to the existing section 27 test. The Commission considers that it would be an unusual outcome if it found a breach under section 27 and not section 36. However, the Commission states that even where there is an agreement between firms, section 27 can be an inadequate safety net.[4] In our view, where a series of agreements were not found to have breached section 27, it would be an undesirable outcome if a

[3] Productivity Commission 2016, *Regulation of Australian Agriculture,* Draft Report, Canberra.
[4] Paragraph 26.

firm with substantial market power was found to have breached section 36 as a result of having entered those agreements.

8. SLC analysis

8.1 We agree with the Commission that section 27 is not the answer to the perceived problems with section 36. While it is true that allegations of misuse of market power are regularly coupled with allegations that the resulting agreements substantially lessen competition in a market (because an increase in market power is often described as a substantial lessening of competition) section 27 is directed towards agreements between parties, not unilateral conduct which section 36 is specifically designed to address.

8.2 To reiterate our earlier comments, in any event, an endeavour to align section 36 with sections 27 and 47 more generally is less useful given the different concepts that can be involved in assessing unilateral behaviour compared to coordinated conduct.

9. Conclusion in relation to reform of section 36

9.1 Section 36 of the Act is of real importance to New Zealand businesses given the large number of concentrated markets in which one or more companies could well be said to have substantial market power. There is a clear need to ensure that any amendment does not interfere with legitimate, vigorous competitive activity. Getting it "wrong" will be extremely costly not only for the affected businesses but the economy more generally. Removing the taking advantage limb and introducing an effects test amplifies the risk.

9.2 In our view, the most appropriate approach is to adjust the current law (should any changes be made at all) rather than making the wholesale changes suggested by the Commission. As set out above, should Australia enact an effects test and find it to be effective, New Zealand could then consider following its lead should the clarifications to our law not prove effective.

10. Alternative enforcement mechanisms and market studies

10.1 We note that a number of submitters have commented on the merits of reform in respect of the alternative enforcement mechanisms and market studies powers. Our view remains the same as set out in our submission of 9 February 2016. To reiterate, our views are as follows.

(a) Competition litigation is notoriously complex. There may be some advantages to introducing an appropriately drafted enforceable undertakings regime, similar to that set out in sections of the Fair Trading Act 1986 (NZ) or the Competition and Consumer Act 2010 (Cth). Such a regime would obviously not eliminate the need for the parties to reach agreement on settlement terms, but could offer greater certainty to all parties in situations where the private party is to take on continuing obligations. Introducing an undertakings regime would not automatically obviate the need for penalties to be formally imposed by the High Court.

(b) We are not persuaded that it is necessary for New Zealand to make greater use of market studies. Such exercises are likely to be very costly and the outcomes produced could be realised through more traditional policy development mechanisms.

Bell Gully
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