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FROM: Matt Sumpter
Section 9 (2)(a)

REF: 100075046/5049941.5

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By email

Dear Robert,

TARGETED COMMERCE ACT REVIEW – CROSS-SUBMISSION

1 I refer to the Commerce Commission's 2 June 2016 letter to the Minister of Commerce about the Review.

2 In that letter the Commission submits that:

2.1 s36, in its current form, is not fit for purpose; and

2.2 s27 "is not a perfect substitute for a properly functioning unilateral market power section".

3 The Commission backs that perspective with three short case studies, including "the Winstone case" which, the Commission says, "illustrates the complications that can arise relying solely on s27".

4 I was counsel to Winstone Wallboards Limited (*WWB*) throughout the Commission's investigation into its rebating practices. I would like to make some brief remarks about why the matter ended in "no further action". In doing so, I also note why, on balance, I favour the status quo. I think Part 2 of the Commerce Act already contains the legislative tools New Zealand needs to deter and prosecute misuses of market power.

5 That said, may I start with a broader observation. It's fair to say that competition policy debates the world over get dogged by entrenched opinion and extravagant predictions about what will happen if law reformers adopt a rival group's perspective. For instance, for decades we saw the Harvard-versus-Chicago narrative dominate anti-trust discourse. Chicagoans claimed their economically literate analysis was vastly superior to the Harvard school's theory that market structure inevitably dictated performance. Commentators, practitioners, agencies and even courts took sides. The struggle was polemical and seemed even personal at times with rivals laying siege to one another's ideas.

6 Modern competition law, however, involves an amalgam of the best ideas from various schools of thought. In the result, no matter what the rhetoric, informed competition policy debate does not pitch right against wrong. There is no "right

way". Debate involves instead conjecture over different choices with different cost/benefit outcomes. And that is what we face here.

7 The current debate reveals two camps:

7.1 On one side of the s36 Rubicon, there are those that say if it's not broken why fix it? Most submitters so far find themselves in this group.

7.2 Parked on the other bank, further from Rome, are those who worry about false negatives and observe that others like the US have a monopolisation effects test, and they're doing ok. The Commerce Commission is apparently in this camp.

8 The Commission, it must be said, does a world-class job of, inter alia, protecting and enhancing competition in New Zealand markets. It has excellent leadership. It makes good decisions with scarce resources. And in recent years it has taken many successful cases, including its s36 prosecution of Telecom (as it then was) for abuse of market power in the Data-Tails litigation.[1]

9 The Commission still says, though, that the "comparative exercise" inherent in s36 analysis sets the bar too high. It wants a new effects test instead. In its 2 June 2016 letter, the Commission is at pains to say that the current effects test – section 27 – is too small a band-aid for the difficulties it sees with s36 enforcement.

10 I'm not sure I agree. I see sections 27 and 36 as together preventing unilateral and concerted trade practices which damage workable competition.

11 Section 27 confronts commerce which can foreclose rivalry and innovation in markets. That conduct can include behaviour like tying, bundling, rebating, exclusive dealing arrangements and all manner of what will soon be called "collaborative activities".

12 Right from the outset of Commerce Act litigation, the Court of Appeal was clear that s27 is not simply concerned with concerted action or collusion. The section covers unilateral conduct too.[2]

13 For its part, s36 augments s27 – and the other Part 2 provisions – by tackling unilateral action such as refusing to deal, margin squeezing and predatory pricing. I

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[1] *Telecom v Commerce Commission* [2012] NZCA 278. It bears emphasis that the Commission failed in other cases such as *BOPE* and *0867* for litigation-specific reasons: *Commerce Commission v Bay of Plenty Electricity* (CIV-2001-485-917, 13 December 2007, High Court Wellington, Clifford J ("*BOPE*"); *Commerce Commission v Telecom* [2011] 1 NZLR 577 (SC) ("*0867*"). In *BOPE* the Commission lost both its s36 and s27 causes of action because it failed to establish the existence of its pleaded markets: *BOPE* at [421] and [542]. In *0867*, the Commission could have won had it advanced evidence that Telecom deployed its 0867 service to shore up substantial revenues from additional services such as telephone rental, wiring, maintenance, fixing faults, local calls, directory assistance, smart-phone services, "call minder", "call waiting" and so on: *0867* at [47]-[49]. In neither case is it fair to blame the Privy Council and its "counterfactual test" for the fact that the Commission lost on the facts.

[2] *Tui Foods Ltd v New Zealand Milk Corporation Ltd* (1993) 5 TCLR 406 (CA) at p410; *Port Nelson v Commerce Commission* [1996] 3 NZLR 554 at p563.

don't see any difficulty with a provision like s27 covering both anti-competitive action by a single firm and anti-competitive conspiracies.

14 The Commission, however, doesn't seem to accept that view. Which is why, in its 2 June 2016 letter, it offers three case studies designed to show that s36 is broken and s27 doesn't save it.

15 The WWB investigation is front and centre in that approach. The Commission records that it is not suggesting it would have concluded the WWB matter any differently under a different test.

16 But some might not read the Commission's letter that way.

17 For that reason it is worth emphasising why the Commission took no action against WWB. To be sure, WWB had (and still has) high market share. But the company's success was and is a function of:

17.1 the consistent quality of its locally-manufactured product;

17.2 its outstanding service; and

17.3 its investment in intellectual property and product education with, for instance, "an extensive GIB manual available and in wide use".

18 The Commission concluded that WWB's rivals' "lack of success can be attributed to a number of factors unrelated to [WWB's] rebates".[3] The truth was that WWB's rivals could, but were not offering attractive prices to merchants. They could, but were not investing in decent product and efficient distribution and service systems. WWB's rivals were, quite simply, losing on the merits.

19 There is no monopolisation rule in the OECD which would have, or should have, condemned WWB's rebate regime. That regime was part of price competition where downstream merchants held and still hold material countervailing market power.

20 That context brings me to some specific comments on the Commission's 2 June 2016 letter. Again, the Commission highlights its WWB investigation to suggest that s27 doesn't enable it to effectively police the misuse of market power.

21 To that end, at paragraph [19] the Commission observes that:

> …it would have been an odd result [in the WWB investigation] had we concluded there was a substantial lessening of competition under s27… but concluded that we could not have proceeded under s36 even though [the investigation was] about whether there had been a unilateral abuse of market power.

[3] Commerce Commission, *Investigation into Winstone Wallboards Limited*, 22 December 2014, at [116].

22 That doesn't seem odd to me at all. In WWB the Commission investigated two distinct theories of potential harm:[4]

22.1 Did the rebates at issue foreclose access to the merchant channel?

22.2 Did the rebates amount to predatory pricing?

23 The s27 effects test is perfectly suited to the foreclosure enquiry, where concern lies with the overall state of competition in the market at issue. And s36 – as amplified in *Carter Holt Harvey* – responds well to purely unilateral action like predatory pricing designed to take out or discipline a particular rival.[5] Sections 27 and 36 are complementary. Sometimes abusive market conduct will fall foul of both provisions; sometimes it will breach one but not the other.

24 In WWB – had the facts been different – the Commission might well have found a breach of s27, but no breach of s36: there could have been foreclosure, but no predation. And, of course, there have been cases the other way round. In *Union Shipping v Port Nelson*, for example, the High Court held that the port company breached s36 by wanting to eliminate a rival forklift business operating at its facility via a licence containing "commercially unreasonable" wharf user charges. But the Court held that the same licence didn't breach s27, because the s27 inquiry "is directed at competition, not at individual competitors".[6]

25 In other words, s27 analysis concerns the impact of conduct in the relevant market. Section 36 shares the same concern. But s36 also deals with the more focussed and delicate issue of when it's illegal to target a rival firm. To that end, s36 involves what the Supreme Court has called the comparative exercise to distinguish between competition on the merits and nefarious abusive conduct.[7]

26 The s27 and 36 tests are similar but not the same: again it doesn't seem odd if, on the facts, conduct is caught by one but not the other. The important thing is that the conduct doesn't go unpunished.

27 At paragraph [29] of its 2 June 2016 letter the Commission emphasises that:

> …the Winstone case illustrates the complications that can arise relying solely on s27…. Our Winstone investigation concerned Winstone's loyalty rebates with large merchants and whether Winstone was inducing merchants not to use alternative plasterboard suppliers through a lump sum (rather than a per unit) loyalty rebate that the merchants would retain rather than pass through to end consumers… **For a s27 case to succeed, would we have to prove that each merchant had agreed with Winstone to retain the rebate?** (Emphasis added).

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4 Commerce Commission, *Investigation into Winstone Wallboards Limited*, 22 December 2014, at [8].

5 *Carter Holt Harvey v Commerce Commission* [2006] 1 NZLR 145 (PC).

6 *Union Shipping v Port Nelson* [1990] 2 NZLR 662 (HC) at 714.

7 *Carter Holt Harvey v Commerce Commission* [2006] 1 NZLR 145 (PC); *Commerce Commission v Telecom* (0867) [2011] 1 NZLR 577 (SC).

28 The answer to that question is "perhaps". But with respect it's not a relevant question. Pass-through is a matter of evidence which goes to foreclosure. Pass through isn't part of the statutory framework. Nor will it ever be part of the legislative test no matter what s36 might look like in the future.

29 The key point is that the Commission's questions at paragraph [29] of its 2 June 2016 letter shouldn't suggest there is any uncertainty or difficulty with current effects test analysis. It is well-settled and well understood.

30 The Commission ends its 2 June 2016 submission that s27 isn't enough, by noting that:

> This is not to suggest that s27 cannot be useful in some cases. Merely, that for truly unilateral conduct s27 either will not be adequate to capture the conduct, or can create complications because it adds the requirement of needing to show an agreement or set of agreements.

31 Reality is, though, that conduct which forecloses market access almost invariably involves sale and supply arrangements of one sort or another. And s3(5) of the Commerce Act says that the Court can aggregate the effect of those arrangements across a market or throughout a supply chain in assessing anti-competitive effect.

32 In cases involving "truly unilateral conduct" – to use the Commission's phrase – s36 asks the right question: would you rationally refuse access, squeeze margins or price below cost if you faced greater competition? If the answer is no, then the exclusionary conduct is enabled by the defendant firm's market power and appropriately condemned under s36. With "truly unilateral conduct" you need this causation element lest the law force large firms:[8]

> to stand idly by as [they] see [their] market share being eaten into by others who are not dominant. That would be stifling competition – the very thing [s36] is designed to promote for the consumer's benefit.

33 In the result, case law and experience is that alleged abuse of market power can breach s36, s27 or both depending on the facts. The two sections work in tandem. To my mind, the Commission's three cases studies – and WWB in particular – do not demonstrate that there is abusive unilateral conduct falling between a gap in the Part 2 provisions and going unpunished in this country today.

34 There is nothing fundamentally wrong with covering the misuse of market power in two or more provisions in a competition statute. There is no "right way" to do it. The International Competition Network, for example, has found that "there is no universal, all-encompassing approach to identifying exclusionary behaviour".[9]

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8 *Carter Holt Harvery v Commerce Commission* [2006] 1 NZLR 145 (PC) at [23] per Lord Hope.

9 International Competition Network (ICN) "Unilateral Conduct Workbook: Chapter 1 – the objectives and Principles of Unilateral Conduct Laws" (presented at the 11th ICN conference, Rio de Janeiro, Brazil, 2012) at [33]-[34] and [43] available at www.internationalcompetitionnetwork.org/uploads/library/doc827.pdf.

35 In 1986 we made a choice which most say has served us well for the last 30 years. I am not convinced we need to revisit that choice.

Kind regards

Matt Sumpter
PARTNER

Section 9 (2)(a)