BELL GULLY

Bell Gully submission to MBIE – Targeted Review of the Commerce Act 1986: Issues Paper

Introduction

1. Bell Gully is a leading competition law practice, advising major New Zealand and overseas companies. Our competition law team advises on all aspects of competition law including, mergers and acquisitions, misuse of market power and access issues, cartel investigations and leniency issues. We welcome the opportunity to make submissions to the Ministry of Business, Innovation and Employment (**MBIE**) on the issues outlined in the Targeted Review of the Commerce Act 1986: Issues Paper (**Issues Paper**).

2. We would be happy to discuss our views further with MBIE. Please contact:

Section 36

3. **Comment on the current section**

3.1 Section 36 of the Commerce Act (the **Act**) aims to deter and prevent dominant firms misusing their market power to damage the competitive process. Ultimately, achieving market power is what encourages innovation, and firms should not be punished when they achieve it. As MBIE acknowledges, the overriding goal of the Act is to promote competition in markets for the long-term benefit of consumers in New Zealand. In our view, when firms are motivated to innovate and be as efficient as possible – whether market power is ultimately obtained or not – the Act is achieving this purpose.

3.2 It is true that few cases have been brought by the Commerce Commission (the **Commission**) in recent times. That measure alone might suggest that the section is not working well. However, the current law is reasonably certain in its application (particularly by comparison to this area of law in other jurisdictions). The certainty brought, in particular by the counterfactual test, is of significant benefit to businesses when making investment decisions. This in turn benefits the competitive process (costs otherwise incurred are avoided) and so ultimately benefits consumers. This benefit should not be underestimated when considering amendments to section 36.

3.3 More generally, misuse of market power is a notoriously complex area and getting it "wrong" can be extremely costly for businesses, consumers and ultimately detrimental to the economy as a whole. Accordingly, great care needs to be taken to ensure that, should section 36 be amended, any amendments do not overreach.

4. **Response to the matters raised by MBIE**

Taking advantage

4.1 The debate around the effectiveness of section 36 generally centres on the "taking advantage" limb, with questions over its effectiveness in light of its interpretation by the courts through a

number of cases. Accordingly, we agree with MBIE that the review should focus on this element in particular.

4.2 However, the "taking advantage" limb plays an important role in misuse of market power analysis, by creating a nexus between the market power and the impugned conduct. From a policy perspective, a causal connection between the market power and the impugned conduct is important as it assists in distinguishing pro-competitive from anti-competitive exclusionary behaviour. Firms with market power must not be prevented from engaging in competitive conduct that firms without market power would engage in.

Improving the taking advantage limb

4.3 The key concern around the taking advantage limb is the perception that (as a result of interpretation of the limb by the courts) the "counterfactual test" sets too high a threshold such that section 36 proceedings will always be overly defendant friendly. The counterfactual test says that if conduct could rationally be taken by a firm in a competitive market, then a firm with market power cannot be "taking advantage" of that market power by engaging in that conduct.

4.4 However, this does not require elimination of the taking advantage limb altogether. In our view, maintaining the nexus between market power and the impugned conduct is critical. Without any nexus, there is a risk of imposing a "special responsibility" on a firm with market power. As described in the European Commission's *Michelin I* case[1], "[a] finding that an undertaking has a dominant position is not in itself a recrimination but simply means that, irrespective of the reasons for which it has such a position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market". Such a special responsibility may not be in the long term best interests of consumers in the New Zealand context, if it causes firms to compete less aggressively.

4.5 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. One option is to list factors that can be taken into account when assessing the "taking advantage" test, along the lines of section 46(6A) of Australia's Competition and Consumer Act 2010 (Cth).

4.6 How any adjustment takes place would no doubt be subject to much further debate and discussion. However, for the reasons set out above, the need for business certainty should be paramount in such a review. Any amendment must be drafted carefully to ensure that conduct that forms part of a normal competitive process falls clearly outside the scope of the section 36 prohibition.

4.7 Finally, there is a significant body of case law and economic literature from around the world that grapples with the distinction between normal competitive behaviour and misuse of market power. Subject to the overriding need for certainty, any changes to the law should allow the courts to have full regard to the concepts developed in the case law and economic literature, rather than focussing on the specific meaning of the words of the relevant provision.

Introduction of an effects test

4.8 We do not think that introducing an "effects test" would be an appropriate response to the perceived problems around section 36. We acknowledge that the rationale behind introducing such a test is an attempt to overcome the perceived difficulty faced by regulators and the courts in potential section 36 cases. However, in our view, there is a very real risk of regulatory overreach and a consequent adverse impact on competition. This would ultimately be harmful to the long-term interests of consumers.

[1] *Michelin I, EC case n° 322/81.*

4.9 Our primary concern with an effects test is that it could operate to place large firms under an obligation or "special responsibility" to ensure that their conduct does not adversely impact smaller (and possibly less efficient) competitors. Normal, vigorous competition by small or large firms can harm competitors. This could ultimately lead to fewer competitors in a market, with a perception that this conduct "lessened competition".

4.10 While an effects test would not be aimed at such vigorous competition, there is a real risk of overreach either through the actual provision, or businesses' perception of how the provision is interpreted. This risks going beyond protecting the competitive process and, instead, seeking to protect smaller competitors. As MBIE acknowledges, section 36 does not exist to protect small businesses.[2] It should continue to protect the competitive *process*.

4.11 An effects test would likely introduce uncertainty and ambiguity to everyday business decisions, and may result in deferred investment decisions. The effects test risks calling into question every business decision made by a firm with market power. In larger jurisdictions (for example in the EU where the "special responsibility" exists) dominant firms may be sufficiently large that they have sufficient resources to test each new business decision in detail for compliance. This could include detailed economic and legal review. However, given New Zealand's smaller scale, such a level of review would not be feasible in most circumstances. Hence the greater need for certainty surrounding the scope of this prohibition.

4.12 Clearly any rule which has the effect of restricting competition or innovation in New Zealand's small markets is undesirable. Accordingly, we consider that changing to an effects test at this stage would not be a desirable development. Rather, the better approach, as set out above, is to adjust the current law (should any changes be made at all) rather than making wholesale changes. As set out below, should Australia enact an effects test and find it to be effective, New Zealand could then consider following its lead should the adjustments to our law not prove so effective.

Small and remote economy

4.13 The size of New Zealand's economy is an important factor to when considering our misuse of market power provision. As set out above, the smaller scale of New Zealand's firms makes ensuring compliance with the law relatively more burdensome.

4.14 In addition, as a small economy, there is often room only for a small number of firms in a given market, where such markets require scale to produce efficiently. As a result, it is especially important in the New Zealand context to guard against overreach when considering legislative amendments. For the reasons set out above, introduction of an effects test and/or removal of the taking advantage limb both risk such overreach.

Alignment with other provisions

4.15 We agree with MBIE that any review of section 36 should take account of developments in Australia as a result of its 'root and branch' review of the Competition and Consumer Act 2010. However, while there are benefits to harmonising with the Australian provision, it remains important to ensure that any amendments are tailored to New Zealand's particular circumstances (particularly its small size).

4.16 Further, while alignment with Australia is beneficial, there is no need to achieve alignment immediately. Rather, should Australia adopt an effects test, New Zealand will benefit from observing the development of the law in Australia and enable us to make a better assessment as to whether such a test would benefit New Zealand. In any event, the Australian Government in its response to the Harper Review recommendations has taken account of feedback provided in

[2] Ministry of Business, Innovation & Employment, "*Targeted Review of the Commerce Act 1986 – Issues Paper",* November 2015 at page 15.

relation to the effects test and determined to consult further on any amendments to its misuse of market power test and release a further discussion paper.[3]

4.17 More generally, provided that the New Zealand' unique circumstances are taken into account, we do see benefit in aligning New Zealand's law with commonly understood concepts of misuse of market power law from overseas. As set out above, there is a large body of case law and economic literature which aims to distinguish between genuinely competitive behaviour and behaviour aimed at interfering with the competitive process. Subject to the overriding need for certainty and ensuring that no "special responsibility" is imposed, our legislation should allow for courts to have regard to overseas case law and economic literature when deciding misuse of market power questions.

4.18 In our view, an endeavour to align section 36 with sections 27 and 47 is less useful given the different concepts that can be involved in assessing unilateral behaviour compared to coordinated conduct.

Alternative enforcement mechanisms

5. Views on improving alternative enforcement mechanisms

5.1 Competition litigation is notoriously complex. Substantive trials almost always involve High Court costs and significant delays. Those factors, combined with the very substantial penalties which can now be imposed for even minor or unintentional breaches, mean that the majority of claims brought by the Commission under the Act are now resolved by agreement rather than substantive trial – private parties simply cannot take on the risk of defending proceedings, even where the core allegations are weak.

5.2 That is not to say that litigation of urgent or interim issues suffers from the same disadvantages. In the unusual cases where urgent action is necessary to prevent an apprehended or on-going breach of the Act, the Commission is in a good position to seek interlocutory orders from the High Court. Such applications have considerable advantages over 'cease and desist' regimes. They make use of existing, well-established, widely-accepted procedures which are also available to private parties. Those procedures offer extensive protections to both parties to ensure that the Court reaches a decision that is just in the circumstances. They do not require the maintenance and funding of a competition-specific institution with idiosyncratic procedures, whose decisions may in any event be susceptible to court challenge by way of judicial review. In the relatively few cases which do require urgent intervention, interlocutory applications to the Court do not involve undue cost or delay. Especially in light of the infrequency with which it has been utilised, the 'cease and desist' regime set out in the Act should simply be repealed.

5.3 As already noted, it is becoming increasingly common for proceedings brought by the Commission under the Act in non-urgent cases to be settled rather than litigated to finality. As the Issues Paper notes, some complexity can arise where such proceedings are resolved by settlement agreement. There may be some advantages in introducing an appropriately drafted enforceable undertakings regime, similar to that set out in sections 46A-46B of the Fair Trading Act 1986 (NZ) or section 87B of 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.

[3] See: http://www.treasury.gov.au/~/media/Treasury/Publications and Media/Publications/2015/Government response to the Competition Policy Review/Downloads/RTF/Govtresponse_CPR.ashx at page 25

Market studies

6. **Comment on the need for a market studies power**

6.1 As set out in our submission to the Productivity Commission in March 2014, 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 for Government and for business and the outcomes produced could be realised through traditional policy development mechanisms.

6.2 Market studies are characterised as not focussing on the actions of a specific company, but rather on the structure and behaviour of the market itself.[4] Nevertheless, market studies can involve significant expense for businesses involved in market studies through the need to provide information and make submissions. This can result in a significant diversion of financial and human resources form the core activity of the business in question.

6.3 If it is thought that such market studies should be used more frequently, we consider that they should be conducted as required by MBIE rather than the Commission. To impose a further research function upon the Commission could distract it from its other roles, and would present obvious difficulties with reference to its separate enforcement roles, as referenced by MBIE in its Issues Paper.[5] MBIE has the requisite skillset and experience in conducting such studies, which have not in the past been detrimentally affected by any lack of 'independence'.

Bell Gully
9 February 2016

[4] Ministry of Business, Innovation & Employment, "*Targeted Review of the Commerce Act 1986 – Issues Paper",* November 2015 at 4.2.

[5] See 4.5.3.