BELL GULLY RESPONSE TO MBIE 'REVIEW OF SECTION 36 OF THE COMMERCE ACT AND OTHER MATTERS – DISCUSSION PAPER'

1. Introduction

1.1 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, and competition studies. We welcome the opportunity to make submissions to the Ministry of Business, Innovation and Employment (**MBIE**) on the issues outlined in the 'Review of Section 36 of the Commerce Act and other matters: Discussion paper' (**Discussion Paper**).

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

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2. MBIE's proposal and stated rationale in relation to section 36 reform

2.1 MBIE considers that section 36, in its current form, does not fully meet the purpose of the Commerce Act (the **Act**), which is to promote competition in markets for the long-term benefit of New Zealand consumers. Accordingly, it advocates changing the law to mirror Australia's equivalent provision (section 46 of Australia's Competition and Consumer Act), to read as follows:

> *A person that has a substantial degree of power in a market must not engage in conduct that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.*

2.2 MBIE favours replacing the current section 36 with this provision because this provision would:

(a) address a perceived under-reach by the current law;

(b) remove the need to construct a hypothetical market (counterfactual), which it claims leads to increased enforcement costs and lacks predictability;

(c) fit most closely with the general scheme of the Act, which is based on the Australian legislation;

(d) allow New Zealand courts to align decisions with Australian case law. This enhances the body of case law available to New Zealand market participants and helps to improve certainty; and

(e) assist businesses operating with a substantial degree of market power in both Australia and New Zealand.

2.3 MBIE states that the initial impact analysis suggests that the proposed change to section 36 is "substantially better" than the status quo. It assesses the costs of introducing the new provision to be "very low", at around $2.7 million. It concedes that the benefits are hard to quantify but are likely to outweigh the costs, and materialise in improved competitiveness of markets.

3. Assessment

MBIE's preferred option will result in 'over-reach'

3.1 We have previously submitted on why we consider it is important to retain the causal nexus between market power and conduct. Such a connection 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.

3.2 We have also previously submitted on why we believe replacing the 'take advantage' test with an "effects test" would be inappropriate. Our primary concern remains that an effects test could 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 (large and small). This could ultimately lead to fewer competitors in a market, with a perception that this conduct "lessened competition".

3.3 While an effects test would not be aimed at such vigorous competition, there is a real risk of overreach either through the interpretation of 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 has previously acknowledged, section 36 does not exist to protect small businesses.[1] It should continue to protect the competitive *process*.

3.4 An effects test is therefore likely to introduce uncertainty and ambiguity to everyday business decisions, and may result in deferred investment decisions. In larger jurisdictions (for example in the EU where the "special responsibility" exists) dominant firms may be large enough that they have sufficient resources to test each new business decision in detail for compliance. This could include detailed economic and legal review. However, this could result in substantial costs for New Zealand businesses and slow down decision-making (potentially to the detriment of competition).

3.5 Clearly any rule which has the effect of restricting competition or innovation in New Zealand markets is undesirable. Accordingly, we consider that changing to an effects test at this stage would not be a desirable development. MBIE does not assess the costs of these chilling effects in the Discussion Paper, but they are likely to be substantial.

3.6 As Bell Gully has previously submitted, 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. How any adjustment might take place would no doubt be subject to much further debate and discussion. However, the need for business certainty should be paramount in such a review.

The Discussion Paper does not make the case for 'under-reach'

3.7 MBIE favours an effects test because, inter alia, it addresses the "under-reach" of the current law and removes the need to construct a counterfactual market.

3.8 MBIE rightly points out that false negatives can have harmful consequences for competition. However, the Discussion Paper presents little evidence that, in fact, under-reach is a significant problem. As it concedes, "it has… proved difficult to find evidence of actual harm occurring" and MBIE has "no data on the prevalence of anti-competitive unilateral conduct".

3.9 Notably, the Commerce Commission (**Commission**) has been unable to point to investigations that it has foregone where it believed that unilateral conduct had given rise to a substantial

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

lessening of competition (**SLC**) but where the relevant firm with substantial market power had not taken advantage of this power. We are obviously not privy to the Commission's internal processes, but the assertion that it would be "difficult" to identify such cases is surprising to us given:

(a) such investigations involved a firm with substantial market power engaging in conduct that the Commission considered resulted in an SLC. To the extent that this conduct involved an arrangement, presumably the Commission took some form of action under section 27;

(b) to the extent that the conduct did not involve an arrangement, e.g. a refusal to supply, then given the presence of substantial market power *and* a substantial lessening of competition, presumably the Commission would have undertaken a considerable degree of investigation to determine whether or not the conduct amounted to a 'taking advantage'. Such instances (particularly recent ones) would likely be 'front of mind' for the Commission.

3.10 The Discussion Paper cites a 2013 example as evidence of under-reach (where a firm with substantial market power in Australia contracted all available supply of an input in a market). However the Court in that case found that the conduct breached the section 27 equivalent of Australia's Competition and Consumer Act in any event.

3.11 While we agree that section 27 is not the answer to the perceived problems with section 36, much of the conduct with which MBIE is concerned involves the presence of a contract (e.g. exclusive dealing, predatory pricing etc.). To the extent that such conduct is occurring, this section already provides the Commission (and third parties) with a means to address it via the SLC test.

3.12 In light of the above, we consider that the proposition that the current section has led to "under reach" is significantly over-stated. We also consider that the benefits of MBIE's preferred provision, as set out in the Discussion Paper, are likely to be significantly over-stated, given that much of the conduct that MBIE is concerned with is already subject to the SLC test.

Replacing the counterfactual test with an effects test will increase, not reduce, uncertainty

3.13 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 so that section 36 proceedings will always be overly defendant friendly. However, as noted above, 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.

3.14 Further, the current law is reasonably certain in its application. The certainty brought, in particular by the counterfactual test, is of significant benefit to businesses when making decisions. Whereas firms today can self-assess by asking 'what would I do if I did not have substantial market power?', under MBIE's preferred provision firms must undertake a far more difficult analysis.

3.15 To illustrate, consider the following example: a vertically integrated company with substantial market power (Company A) manufactures and distributes its own products. Company A has invested significantly in its supply chain to ensure high levels of quality and customer service. Company A receives a request from a new entrant (Company B) to be a distributor of Company A's products.

3.16 Under the current law, Company A would need to ask itself a fairly straightforward question: would it allow other companies to distribute its product if it did not have market power? Under the proposed amendment favoured by MBIE, Company A would need to undertake a detailed economic analysis comparing competition in the market 'with' supply to Company B, to competition 'without' it, to determine whether it was required to grant Company B's request – a different counterfactual test, and one that is arguably more difficult to apply.

3.17 Indeed, in the merger context, the Commission itself can take up to 3 or 4 months, or longer, 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 based on far less information than the Commission would have access to. Often a very fast decision will be required – for example, where a firm with market power must quickly decide how to react to new entry or discounting by a competitor. A detailed SLC analysis simply might not be possible within such a short period.

3.18 While MBIE rightly recognises that firms already need to assess contracts against SLC standards (which, as noted, are already subject to an SLC test under section 27), they are not required to conduct such an analysis on *not* entering a contract. In addition, the entering into of a contact is often done within a timeframe that is more conducive to undertaking an SLC analysis.

3.19 The certainty of the current provision benefits the competitive process (costs otherwise incurred are avoided) and ultimately benefits consumers. The Discussion Paper fails to take into account this benefit.

The importance of alignment with Australia, a "global standard" and other provisions of the Act is over-stated

3.20 We agree that there are benefits to harmonising with the Australian provision. However, it remains important to ensure that any amendments are tailored to New Zealand's particular circumstances (particularly its small size), as outlined above. Indeed, New Zealand departed from the Australian approach when the New Zealand government introduced the "collaborative activities" and "vertical supply" exemptions alongside the new cartel prohibition. However, these were regarded by many commentators in Australia and New Zealand as being superior to the Australian approach to such exemptions.

3.21 While alignment with Australia is beneficial, to the extent that the case for change has been made out (which we do not think it has) there is no need to achieve alignment immediately. Australia's equivalent provision has been in effect for less than 18 months. The ACCC has yet to test the new provisions before the courts. 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.

3.22 MBIE also questions whether it is right that New Zealand continues to vary from a "global standard" of an effects based test (see paragraph 80). However, reference to a "global standard" gives the impression that there is a high degree of uniformity in overseas jurisdictions as to how misuse of market power is assessed and that New Zealand departs substantially from this. In fact, there is a wide degree of variation between overseas jurisdictions. For example, the approaches of the US and EU are often seen as quite distinct, with the EU's "special responsibility" rule for firms with market power seen as more "interventionist" than the US approach. The application of New Zealand's misuse of market power law already uses many of the tools developed in the US and EU. Accordingly, we do not see departure from a "global standard" as a compelling reason to depart from New Zealand's current approach.

3.23 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.

The Discussion Paper under-estimates the costs, and over-estimates the benefits, of change

3.24 In our view, the Discussion Paper significantly under-estimates the costs of introducing an effects-based test, compared with the status quo.

(a) One-off transition costs are likely to be significantly greater than $20,000 for a firm with substantial market power. As noted above, applying the SLC test can be a complex

process, which can take teams of people at the Commission months to perform. These assessments will be required not infrequently.

(b) Moreover, the *ongoing* costs of compliance on firms with substantial market power are also likely to be higher under the new test, given the increased complexity. MBIE has not taken account of these costs.

(c) The Discussion Paper does not consider that there will be any costs of significance from moving from the status quo to an effects based test. This ignores the negative impact that the effects test is likely to have on aggressive competitive conduct that benefits consumers, as well as the uncertainty caused by change.

3.25 Similarly, the Discussion Paper over-estimates the benefits of its preferred proposal versus the status quo:

(a) There is no benefit for businesses with a substantial degree of market power. As noted above, the current test is well-understood and provides certainty to businesses both with and without substantial market power.

(b) The Discussion Paper does not present any real life examples to support the contention that changing to an effects test is likely to significantly increase the prospects of new entry, nor that it would make New Zealand a more attractive investment destination.

4. Proposed repeal of IP exemptions

4.1 MBIE proposes an option of repealing each of the IP-related exemptions set out in the Act.

4.2 A key issue that MBIE notes in relation to the current IP-related exemptions is the degree of uncertainty in respect of what conduct they actually exempt from the Act. This is compounded by a lack of case law. MBIE also questions whether it is right that IP rights should be treated any differently under competition law than any other form of property.

4.3 Bell Gully considers that these are valid questions. In particular, the lack of coherence and clarity in the current set of exemptions does indicate that a review would be beneficial. However, the IP and competition law interface is very complex, as shown by the amount of litigation in other jurisdictions involving IP and competition law (including "pay for delay" cases). Such cases demonstrate that there may indeed cause for treating IP rights differently to other types of property. Furthermore, the nature of any amendments to section 36 could well affect the desirability of IP-related exemptions (for example, a section 36 based on the effects test may create a need for a broad IP-related exemption to avoid undue uncertainty for firms when seeking to enforce IP rights).

4.4 Accordingly, Bell Gully does not support repealing the current protections for IP rights. Rather, we consider that this issue would warrant a more detailed review once the outcome of the proposed section 36 changes is known. This review should consider in detail the potential for beneficial amendments to the exemptions in addition to the option of repeal.

Bell Gully