Submission template: Review of section 36 of the Commerce Act and other matters

Your details

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Responses to discussion paper questions

Your submission may respond to any or all of the questions from the discussion paper. There is an additional box at the end for any other comments you may wish to make.
Text boxes will expand as you complete them.

Decision-making criteria	
1	Do you agree with the primary objective and the criteria?

Yes we agree with the primary objective and the criteria. However, amongst those criteria we particularly emphasise the importance of predictability. Our primary concern with the proposed change to section 36 is that it doesn't articulate a clear compliance standard and therefore undermines predictability and legal certainty.

Legal certainty and predictability should be fundamental principles for reform in this area. Firms should be able to reliably determine in advance the legal consequences of their actions. This is particularly so given the substantial penalties that can be imposed under the Commerce Act for breach of section 36.

In this submission we address two key issues:

1. Why we don't think the problem definition has been sufficiently explored. While we acknowledge that there is an appetite for change, that change should be informed by a clearer understanding of the perceived deficiencies of section 36 in its current form. (Please see our response to question 2 for more detail.)
2. Why we don't believe the proposed change articulates a compliance standard that can be readily applied. Instead, it simply invites the Commission and courts to explore the concept of "substantial lessening of competition" in the context of single-firm conduct. That's concerning from a compliance standpoint. (We set out more detail on this point in response to question 16.)

While we don't reject the idea of an "effects" test out of hand, for it to be meaningful as a compliance standard, we need a clearer understanding from a policy perspective of what section 36 ought to prohibit and permit. Put another way, our law should clearly state where it would land on highly contested cases, such as Google, and why. These fundamental policy questions need to be addressed before any proposed reform is implemented.

Predictability is important for all industries. However, from our own industry and circumstances, we can illustrate why predictability is key and some of the complexities we face. We are in a transitional period as we move from a contractual pricing framework for fibre to utility style regulation under new Part 6 of the Telecommunications Act. That transition presents a complex set of commercial, regulatory and legal compliance challenges.

Against that background of change, it is important that, as much as possible, the wider legislative framework we operate in is clear and unambiguous. Our objective is to maximise the potential of our UFB network for the benefit of New Zealanders. Uncertainty regarding our obligations under the Commerce Act creates unnecessary costs for our business and chills potentially welfare-enhancing initiatives.

Section 36: Problem Definition	
2	Can you offer any new evidence on the costs and benefits of section 36, as currently worded? If you have previously submitted on this issue, do you have anything new or different to add to your views on the effectiveness of section 36? If you have not previously submitted on this issue, what are your views on the effectiveness of section 36?

In our view, the problems with section 36 remain insufficiently defined and this makes it difficult to properly assess the merits of the proposal for amendment.

MBIE's problem definition has three components:

1. The current formulation of section 36 is said to result in false negatives;
2. The counterfactual analysis under section 36 is costly and complex; and
3. The counterfactual test is unpredictable and therefore undermines legal certainty.

We address each of these three points below.

1. False negatives

The key reason given for abandoning the counterfactual test is that it results in false negatives (i.e. it fails to proscribe certain examples of anticompetitive unilateral conduct). We have three concerns with the way this issue has been approached.

First, there are no concrete examples provided of actual instances of anticompetitive behaviour going unpunished, or types of conduct that are clearly anticompetitive but do not fall within the definition of the existing section 36. The case for change therefore relies on the proposition that the "safe harbour" provided by the counterfactual test has deterred enforcement. That does not provide a compelling case for change.

Second, the history of section 36 enforcement does not suggest that section 36 is ineffectual. Quite the opposite. There have been a number of successful section 36 enforcement actions and, even where the action failed, generally the courts have nonetheless set out principles that have guided future conduct.

Third, the principal categories of anticompetitive single-firm conduct are likely already proscribed by the existing section 36. We note that the Australian Competition and Consumer Commission (**ACCC**) in August 2018 published guidelines on how it intends to interpret the amended section 46 of the Competition and Consumer Act. The ACCC explained, by way of example, how it proposed to address: refusals to deal, restricting access to essential inputs, predatory pricing, loyalty rebates, price squeezes, and tying and bundling. Those are all topics that the courts in New Zealand have addressed in the context of the current law.

2. Cost and complexity

MBIE suggests that the need to construct a counterfactual results in avoidable cost and complexity. However, an "effects" analysis also requires a counterfactual that compares expected outcomes in the market in the presence of the impugned conduct (the factual) with expected outcomes in the absence of the conduct (the counterfactual). The same process is undertaken in relation to sections 27 and 47. That analysis is also complex, particularly because the low threshold for demonstrating a "likely" effect means that the courts may be required to consider multiple counterfactuals in order to assess the conduct.

In any event, the complexity in unilateral conduct cases arises from the need to delineate between anticompetitive conduct (that harms competition) and pro-competitive conduct (that merely harms competitors). So we don't expect any reduction in the cost or complexity of section 36 from either a legal advice or enforcement standpoint.

Finally, adopting a new and untested provision will involve significant cost and complexity as new jurisprudence is developed.

3. Predictability

MBIE's view is that the current test is unpredictable because it is difficult to know how a court will apply a counterfactual test. In our experience the current test can be readily applied to assess conduct because the question it poses is reasonably clear: would a firm rationally undertake the same conduct if it lacked market power? But, more importantly, there appears to be an assumption that an "effects" test will be more predictable. We explain in more detail in our response to question 16 below why that's incorrect.

Section 36: Designing a Unilateral Conduct Prohibition	
3	Do you agree that interconnected bodies corporate should be treated the same as a single firm?
Yes.	
4	Do you agree that "a substantial degree of power in a market" is an appropriate threshold for the prohibition?
Yes.	
5	Do you agree that a new prohibition does not require any equivalents to the Australian section 46(4)-(7)?
Yes.	
6	Should a new prohibition define the types of proscribed conduct? Should a new prohibition describe or list the types of proscribed conduct?
No we don't support the inclusion of a description or list of proscribed conduct. We expect such a list would only include those types of conduct that are sufficiently well understood and accepted as anticompetitive. So specifying them in the Act is unnecessary as they are already contrary to the existing law. In addition, deeming a category of conduct to harm competition risks over-enforcement. That approach is justifiable in the price fixing context on the basis that it is very difficult to imagine a scenario in which price fixing doesn't harm competition and consumers. But price fixing is the only category of conduct to which that presumption fairly applies. We note that the general trend internationally is to move away from *per se* specifications.	
7	Should the prohibition focus on purpose OR effects, purpose AND effects, solely purpose, or solely effects? Please provide reasoning.
If the Australian provisions were adopted, we would recommend removing purpose as an independent limb for the reasons suggested in the paper. Proscribing anticompetitive purpose in the absence of any anticompetitive effect is largely about sanctioning internal communications. In addition, there is no harm to the market from an anticompetitive purpose that has no effect. Purpose is more relevant at the penalty stage once anticompetitive effect is established. The absence of an anticompetitive purpose should be reflected in a lower penalty, recognising that assessing effects is complex and section 36 cases are frequently novel.	
8	Should purpose be defined as per the existing case law or should it explicitly be an objective purpose? Should section 36B and/or an equivalent provision be retained?
An "objective" purpose is essentially just an inference from anticompetitive effects so doesn't add to the analysis. As mentioned above, subjective anticompetitive purpose is more relevant at the penalty stage.	
9	Is a "substantial lessening of competition" the appropriate standard for the prohibition? If not, do you have any alternative suggestions? Does the SLC standard provide enough certainty to assess conduct before it is undertaken?
We don't propose an alternative to the "substantial lessening of competition" standard for the purposes of section 36. It's important though to recognise the difficulties (described below in response to question 16) in delineating between pro-competitive conduct that harms competitors and harm to the competitive process itself.	

10	Can you provide any examples of exclusionary conduct where the anti-competitive effects and the pro-competitive effects occur in different markets? Should the prohibition enable a balancing of pro- and anti-competitive effects that occur in different markets?

The current law extends to anticompetitive effects that arise in markets other than the market in which the defendant has market power. We would expect the same approach to apply under any formulation of section 36. By extension, the balancing of pro- and anti-competitive effects should not be artificially constrained by market definition. We therefore support an approach that looks to the overall effect on competition, regardless of the markets in which the effects occur.

11	Should a "less restrictive alternative" test form part of the analysis when assessing conduct with both pro- and anti-competitive effects?

We don't support a "less restrictive alternative" test. Our concern with a "less restrictive alternative" test is that it tends to be applied with the benefit of hindsight. It also tends to ignore the practical realities that the firm faced at the relevant time: for example imperfect information, limited resources, or time pressure.

Section 36: Providing certainty

12	Are there any forms of anti-competitive unilateral conduct that should be specifically prohibited in the Commerce Act?

No, for the reasons explained in response to question 6. In general we think proscribing those well-understood categories of anticompetitive conduct is unnecessary.

13	Should the Act provide for secondary legislation to provide greater certainty for anti-competitive unilateral conduct? If so, who should hold the power to make secondary legislation?

No, for two reasons. First, as discussed above, specific prohibitions (essentially deeming provisions) are redundant in relation to those categories that are well understood. In relation to less well-understood categories of conduct – or novel instances of allegedly anticompetitive conduct – we think there is a risk of over-enforcement in prescribing per se categories.

As we discussed in response to question 6, *per se* specification is justifiable in the case of conduct such as a price fixing which is very unlikely to ever be welfare enhancing, but not in other cases.

Second, prohibiting categories of single-firm conduct is a significant imposition on commercial freedom and should not, we think, be the province of secondary legislation.

14	Should authorisation be available for unilateral conduct?

Yes, we support the inclusion of an authorisation route, but with an important qualification: declining to seek authorisation, or refusal of authorisation, should not be treated as aggravating features in the context of any subsequent enforcement action.

For firms with substantial market power, section 36 compliance is part of business as usual review of a wide range of actions and initiatives. It is not practical to apply to the Commerce Commission every time a potential section 36 issue is identified. Realistically, firms have to take a view. This is why we emphasise the importance of predictability in the formulation of the test.

For that reason, deciding against pursuing the option of an authorisation should not be viewed as an aggravating feature of allegedly anticompetitive conduct. We would be very concerned if what is intended to be a voluntary process was effectively converted into a mandatory process, as a result of a perception that failing to pursue authorisation is an aggravating feature if the conduct is subsequently found to be anticompetitive.

We would also be concerned if, in the case where an authorisation was applied for and refused, that refusal was construed as an aggravating factor in subsequent proceedings. In practice we expect the Commission to take a conservative stance. If it applies the evidential threshold of "satisfaction" that it does in the merger context, then there will be circumstances in which authorisation is refused but there would still be room to take a view that the conduct is not anticompetitive. Suppliers should not be prevented from taking a view simply because the Commission errs on the side of declining authorisation.

We therefore propose that any authorisation mechanism in the legislation expressly states that: (a) applying for authorisation is voluntary, and (b) refusal of authorisation does not imply that the conduct contravenes section 36, nor can it be treated as an aggravating factor in subsequent enforcement proceedings.

If an authorisation option is included, then it also needs to be workable and timely. That means that: (a) the application requirements have to be proportionate, (b) there must be a clear deadline for a decision from the Commission that is commercially workable (e.g. thirty working days), and (c) the scope of the approval that is provided must be sufficiently flexible that it has practical utility (in other words, the authorisation has to be sufficiently broadly constructed that it permits sensible development or adjustment of the authorised conduct without the need to go back to the Commission).

Section 36A: Misuse of Trans-Tasman Market Power

15	In your view, does section 36A have any practical effect? Should section 36A be retained or repealed? If section 36 is changed, should section 36A be changed to mirror the new section 36?

Section 36: Options Identification and Impact Analysis

16	Do you support our initial proposition? If not, why not?

No we don't support the initial proposition, principally because of our concerns regarding predictability and legal certainty. The proposed change doesn't articulate a compliance standard that can be readily applied.

The challenge for any jurisdiction in formulating a prohibition against anticompetitive unilateral conduct is distinguishing between conduct that harms competition and conduct that merely harms competitors. We disagree with the statement that the counterfactual test is "*particularly unsuited to differentiating competitive conduct from anticompetitive unilateral conduct*". As we have explained above, the evidence of false negatives is not compelling.

But more importantly, the proposed amended formulation of section 36 also does not, in its terms, demarcate the boundary between anticompetitive and pro-competitive conduct. MBIE's assumption appears to be that the phrase "*likely to have the effect of substantially lessening competition*" accomplishes this. However, the experience of equivalent provisions in other jurisdictions suggests that these formulations beg the question because the issue of what types of single-firm conduct constitute a harm to competition (as opposed to competitors) is itself highly contested.

In our submission on MBIE's November 2015 Issues Paper we referred to the European Commission's and US Federal Trade Commission's investigations into Google's search practices. Both agencies investigated Google's prioritisation of its own services in search results. The FTC closed its investigation in January 2013, concluding that Google prioritised its own services in order to improve the quality of its service. The FTC noted that "*while some of Google's rivals may have lost sales… these types of adverse effects on particular competitors from vigorous rivalry are a common by-product of "competition on the merits" and the competitive process that the law encourages*".

In contrast, the European Commission fined Google EUR2.42 billion for abusing its market power. The Commission stated that, by giving priority to its own services, Google "*denied other companies the chance to compete on the merits and to innovate*" and "*denied European consumers a genuine choice of services and the full benefits of innovation.*"

We don't express a view on the merits of the European Commission's and FTC's competing views. Our concern is that the divergence in outcomes did not result from fundamentally different legislative formulations but instead from divergent opinions on the question of whether Google's conduct represented competition on the merits or instead stifled competition on the merits.

To deliver legal certainty, any amended formulation of section 36 needs to answer that question with sufficient specificity to enable firms to assess the lawfulness of their conduct. Essentially, we should be able to look at the words of the Commerce Act and know how the Google case would be decided here. Our concern is that adopting an effects test in the context of single firm conduct doesn't answer that question. Instead, it simply poses the question and invites the Commission and courts to elaborate the answer through *ex post* enforcement action and litigation.

17	Do you agree with the rejection of these options as unfeasible? Are there any other options that should be considered?

Our fundamental concern is that the proposed amendment doesn't articulate a rule with sufficient specificity that it can be used to assess conduct, while acknowledging the challenge of capturing the essence of single-firm anticompetitive conduct in a rule of general application.

We don't reject the idea of an "effects" test out of hand, but in order for it to be meaningful as a compliance standard we need a clearer understanding, from a policy perspective, of what we think section 36 ought to proscribe and what it ought to permit. We need to state clearly where we think our law should land on highly contested cases such as Google, and why. Those fundamental policy questions have not yet been addressed.

18	Do you agree with our assessment of this option against the criteria? If not, why not? Please provide evidence to support your answers.

1. Minimising the risk of false positives

We are less optimistic than MBIE about the effects of this change on risk aversion. Section 36 is a key legal obligation for firms with market power, and so any uncertainty in relation to its scope impacts on decision-making. That uncertainty has to be priced in to every decision.

In contrast, our experience has been that the counterfactual test poses a question that we can readily apply to assess conduct.

2. Minimising the risk of false negatives

As discussed above in response to question 2, we think the evidence of false negatives under the existing law is not compelling.

3. Predictability and costs

As explained in response to question 16, we think the proposal does not provide for predictability or legal certainty.

4. Minimise cost and complexity

As discussed above in response to question 2, we do not expect this amendment to reduce the cost and complexity of section 36, either from an advisory or enforcement perspective.

19	Do you agree with the types of costs and benefits identified? Do you agree with the valuation of the costs and benefits? If not, why not? Please provide evidence to support your answer.

In our view the costs associated with adopting an amended section 36 are significantly underestimated:

- We don't know how the estimate of 30 businesses with substantial market power has been calculated. The number is almost certainly higher. For example, the Commission's regulatory functions (a reasonable starting point for assessing market power) cover 29 electricity distribution businesses, four gas pipeline businesses, three airports, four fibre companies and Fonterra. By focusing only on the regulated sector there are already 41 firms.
- The assumption of an incremental cost of $20,000 grossly underestimates the true cost of section 36 compliance. The assumption appears to be that firms can simply update advice previously received. Given the complexity of the issues the Commission's estimate appears too low. In addition, the incremental cost is ongoing because section 36 compliance is not static. We also expect the costs of assessing future conduct would be higher because of the greater uncertainty resulting from the new test.