Review of Section 36 of the Commerce Act and other matters

Submission to the Ministry of Business, Innovation and Employment

1 April 2019

Preliminary

1 My name is Dr Edward Willis. I am an academic at the University of Auckland's Faculty of Law where may research includes competition and regulatory law issues. I also provide consulting services to government and private sector clients specialising in advice on regulation, micro-economic policy and non-market strategy. Until 2017 I was a practising lawyer and have previously worked as a staff solicitor at the Commerce Commission.

2 I make this submission in a personal capacity. My submission focuses only on the headline issue of reform of the market power prohibition currently set out in section 36(2) of the Commerce Act 1986. I do not offer comment on the treatment of intellectual property or covenants also raised in the Ministry's consultation document.

3 I am very happy to make myself available to discuss the themes of this submission further with Ministry staff at a convenient time. I can be contacted on [redacted] or by email at edward.willis@auckland.ac.nz.

Previous submission

4 I note that I have previously submitted to the Ministry's 'Targeted Review of the Commerce Act Issues Paper' under the letterhead of Tompkins Wake.[1] In brief, that submission contended that:

(a) the current law prohibiting abuse of market power is acutely uncertain because of a legal (rather than a policy) defect that leaves it to the discretion of the court to apply a superficial legal test of 'but for' causation rather than engage in substantive economic analysis;[2]

(b) developing a shared understanding of the appropriate role of the courts to engage with economic analysis as part of the application of the law to the circumstances of specific cases is essential to effective reform; and

(c) an effects based test is likely to address these points.

5 I reiterate the contentions and analysis set out in that previous submission as remaining highly relevant to the Ministry's current consultation document. The conclusions reached in that previous submission ought to inform any reform proposal.

Substantive comments

6 Rather than address each of the Ministry's specific questions, I wish to highlight two conceptual issues that must be addressed to ensure that any reform of section 36(2) is coherent. These conceptual issues arise directly from the preference in the Ministry's consultation document for an effects based test based on a 'substantial lessening of competition' standard.

7 The first conceptual issue arises from the fact that the current unilateral conduct prohibition is primarily concerned with market foreclosure issues rather than a substantial lessening of competition *per se*. The introduction of an effects based test calibrated to a 'substantial lessening of competition' standard therefore represents a significant realignment of the underlying policy objectives for the anti-competitive unilateral conduct prohibition.

8 I do not hold a strong view on whether this policy realignment is desirable. However, assessment of this proposed reform must proceed on the express basis that it would do considerably more than simply make the existing prohibition more effective. It goes further by changing the fundamental nature of the test to be applied at a policy level.

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1 Tompkins Wake 'Cross-submission on the Targeted Review of the Commerce Act' (21 July 2016), available here.

2 It is perhaps worth augmenting this point to note that 'but for' causation is a test developed in the private law context to determine the cause of harm or loss to a private individual or firm, and as such is conceptually ill-suited to the competition law context where the primary concern is harm to the competitive process rather than harm to individual competitors.

9 This is a concern because the Ministry's consultation document does not clearly set out either a theory of harm or evaluation criteria that can sensibly be used to assess the merits of this kind of substantive policy change. In particular:

(a) the error cost analysis-based decision-making criteria presupposes that particular policy position (presumably either a focus on prohibiting exclusionary conduct or a generic prohibition on all potential competitive harm) has already been adopted, as that framework must be applied in light of a commitment to a particular policy position;[3] and

(b) the "three main problems" of the current statutory prohibition can be fully addressed through redrafting section 36(2) to better align with its original policy intent (a focus on prohibiting exclusionary conduct) rather than requiring a change to the substantive policy position (such as a move to a generic prohibition on all potential competitive harm).[4]

10 Addressing this issue requires a clear conception of the type of conduct that is intended to be prohibited under the unilateral conduct prohibition. This clear statement of the intended substantive policy objective, and a coherent justification for that objective, is currently absent from the Ministry's consultation document. As a result, there is a risk that application of a substantial lessening of competition standard (at least in the context of the Ministry's proposed drafting) will be either over- or under-inclusive:

(a) the standard may be over-inclusive because it extends beyond recognised harms of market foreclosure, such as:

(i) restricting the entry of a person into any market;

(ii) preventing or deterring a person from engaging in competitive conduct in any market; or

(iii) eliminating a person from any market; and

(b) the standard may be under-inclusive because:

(i) conventional "with and without" analysis under the substantial lessening of competition standard does not easily capture harmful conduct in a low-competition environment (which necessarily accompanies a finding of substantial market power);[5] and

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3 Ministry of Business, Innovation and Employment 'Discussion Paper: Review of section 36 of the Commerce Act and other matters' (January 2019) at paragraphs [9]-[11]. Error-cost analysis assumes that there is a shared understanding of what constitutes an error, which critically depends on the substantive policy position adopted.

4 Ministry of Business, Innovation and Employment 'Discussion Paper: Review of section 36 of the Commerce Act and other matters' (January 2019) at paragraph [47].

5 See further Tompkins Wake 'Cross-submission on the Targeted Review of the Commerce Act' (21 July 2016) at paragraph [6.2].

(ii) recognised harms of market foreclosure are not specifically prohibited.

11 I emphasise that I do not have a strong personal preference as to which substantive policy position ought to be adopted. However, the Ministry's consultation document clearly favours a move away from the *status quo* to a policy of prohibiting all potential competitive harm. Given this clear intention the policy justification for the change ought to be made express, especially as it goes beyond addressing the key defect in the current provision (being a matter of legal drafting and application rather than an obvious defect of substantive policy).

12 Further, the intended substantive policy change gives rise to a second conceptual issue relating to the proposed "substantial market power" threshold for the provision to take effect.

13 The rationale for this threshold in the current law is that *market foreclosure* is only a risk where a dominant firm exercises its substantial market power. If the substantive policy objective is that all unilateral conduct that harms competition is captured by the reform, then there is no coherent reason to limit the effect the prohibition to firms with substantial market power. Doing so would have the effect of increasing the risk of anti-competitive behaviour occurring that should be prohibited because it inhibits the promotion of the competitive process for long-term consumer benefit.

14 The Ministry's consultation document suggests that firms "without much market power cannot have any significant effects on competition when they act alone".[6] If this assertion is accepted as true, then:

(a) it renders the 'substantial market power' threshold redundant, and so inclusion of the threshold cannot materially add to the certainty of the provision; or

(b) it presupposes that the harms arising from unilateral conduct are limited to market foreclosure issues, which is inconsistent with the motivating assumption that a broader spectrum of anti-competitive harm is a genuine policy concern.

15 In either case, conceptual confusion is introduced as to the underlying policy rationale and the basis for court intervention.

16 These two conceptual points go directly to the coherency of any reform, and so will materially affect the predictability, cost and complexity of the new provision's application. Unless these points are addressed through refined policy analysis or in the drafting of the proposed new provision, a material risk remains of a court committing significant type I and type II errors.

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6 Ministry of Business, Innovation and Employment 'Discussion Paper: Review of section 36 of the Commerce Act and other matters' (January 2019) at paragraph [98].