February 2016

Public

Submission for Chorus in response to

Targeted Review of the Commerce Act 1986 – Issues Paper (November 2015)

Chorus

SUMMARY

1 This submission is made in response to the Ministry's "Targeted Review of the Commerce Act 1986 – Issues Paper 2015" (**Issues Paper**).

2 We support MBIE's review of the three areas set out in the Issues Paper. It is important to have competition law that is fit for purpose. We do not intend to submit on all the questions in the Issues Paper. Instead we have focused our response on where we believe we have some practical experience.

Regulatory framework

3 We agree that competition is a process.[1] As MBIE notes, competition is simply a means to an end – not an end in itself to be pursued at all costs. What is key is efficient competition – not protection of, or giving a competitive advantage to, inefficient market participants.

4 As MBIE points out, there may be some markets (such as natural monopolies) where competition can constitute wasteful duplication or may discourage socially beneficial collaboration and cooperation.[2]

5 The role of regulation is relevant when assessing the policy and tools required in a particular context. An important distinction lies between:

5.1 Ex ante regulation – where there is unlikely to be competition and the focus is about setting up fair, facilitative and cost-efficient processes and rules;

5.2 Ex post regulation – where, as in the Commerce Act context, there is an enforcement lens and flexible and cost-efficient remedies are relevant.

6 A clear understanding of the regulator's purpose and functions is essential when designing legislative policy.

Anti-competitive exclusionary conduct

7 At this stage, we do not think that the case for making changes to section 36 of the Commerce Act has been made. The current test has the advantages of being relatively simple to apply; relatively predictable due to the well-established body of case law; proportionate; and appropriate for the size of our economy where concentrated markets are more likely. There is little evidence that any change will lead to a better outcome for the long-term benefit of consumers – in fact we believe the contrary is likely.

8 The line between permissible vigorous competition and anti-competitive conduct is widely acknowledged as being a difficult area of the law. Having a clear, predictable

[1] Maureen Brunt, 'Market definition Issues in Australian and New Zealand Trade Practices Litigation', in Ahdar (ed), 'Competition Law and Policy in New Zealand', 1991, page 115.

[2] MBIE Issues Paper, page 14, footnote 4.

test in this environment is all the more important given the consequences of erring on the wrong side of the law. The current section 36 has well established case law that parties have been able to understand, take advice on, implement and rely on.

9 In order to make any substantive change to the legislation and sweep away the extensive body of developed case law there needs to be a clear articulation of the purpose for the change with clear evidence to establish that there is a real risk of harm. While there is mention of section 36 failing to maximise the long-term benefit of consumers by failing to punish anti-competitive conduct, we are not aware of any actual instances of allegedly anti-competitive conduct that section 36 has failed to address. It must also be clear that the proposed solution will result in a more appropriate outcome. We don't believe that threshold has been reached. Any change would mean there was a considerable period of unpredictability and changes, with consequential costs, would need to be made to try to assess compliance.

10 Market participants need to understand the law in order to comply with it. The regulator needs to be transparent in its thinking about what it considers is compliant or non-compliant behaviour. It is good practice for regulators to provide guidelines and there are many examples of it occurring in New Zealand and overseas.[3] However, guidance on section 36 is currently lacking. Guidance on section 36 is already important for transparency and becomes even more so if any changes to its interpretation or the legislative policy are made going forward.

Enforcement

11 Ex post enforcement and ex ante intervention may lend themselves to different tools. However, effective, flexible and cost efficient tools are relevant for both – and are even more important in ex ante intervention given the absence of fault.

12 We agree that a mechanism like the enforceable undertakings regime under the Telecommunications Act could be an efficient and effective alternative to administrative settlements and the cease and desist regime. We support an option that allows an affected party to agree a proposal and have this accepted by the Commerce Commission.

Market studies

13 In thinking about market studies, it is important to keep in mind the distinction between a process that ensures authorities are properly informed before setting policy or making ex ante regulatory interventions; and one that serves as a precursor to enforcement or review of the regulators own enforcement operations.

14 We currently operate subject to a specific market review function[4] that can be used for dual purposes. Therefore there might be some merit in considering further a more general function to ensure policy makers are properly informed before setting

[3] The body of guidance produced by the Financial Markets Authority is a good example.

[4] Section 9A Telecommunications Act 2001.

policy or making ex ante regulatory interventions into markets. This is similar to the function of the Productivity Commission. This function should not:

14.1 include compulsory information gathering powers (the Productivity Commission, for example, operates effectively without such powers); and

14.2 be granted to the competition enforcement agency as this inevitably leads to a loss of the distinction of purpose we describe above.

ANTI-COMPETITIVE EXCLUSIONARY CONDUCT

Framework for assessment

15 We believe that the relevant criteria for assessing any options under the Issues Paper should include the following:

15.1 the long-term benefit of consumers;

15.2 simplicity;

15.3 predictability; and

15.4 proportionality.

16 The assessment of options should also include consideration of New Zealand's small and remote economy.

17 Another important distinction to consider as part of this review is whether the policy design concerns ex ante regulatory intervention or ex post enforcement; and the desirability of separation. Ex post enforcement action is appropriate where a market participant has done something that needs to be rectified and potentially punished. Ex ante intervention is more appropriate where there is a structural feature of a market that means it may not be functioning in the long-term interests of consumers.

18 While broader questions about the regulatory framework are beyond the scope of the Issues Paper it may be worthwhile giving further consideration to the purpose and role of any proposed policy change (and the subsequent implementation of legislation) in this context. In our view economic regulation is likely to operate best where there is a clear distinction between policy setting and deciding on ex ante regulatory intervention on the one hand; and ex post enforcement on the other.

Long-term benefit of consumers

19 We agree that criteria for assessing any options for change should include the section 1A purpose statement in the Commerce Act. As MBIE has stated in the Issues Paper the critical point is to assure the long-term benefit of consumers and this means maximising economic efficiencies.[5]

20 Competition is just one way of maximising the long-term benefits of consumers. In the Issues Paper, MBIE correctly notes there may be some markets, such as natural monopolies, where competition can constitute wasteful duplication.[6] The idea that competition is not an end in itself should be kept front of mind when assessing any options for change.

[5] Issues Paper, page 25.

[6] MBIE Issues Paper, page 14, footnote 4.

Simplicity and predictability

21 It is important that the law is clear to the market and enforceable by regulators and courts. Simplicity should not come at the expense of predictability. Accordingly, we believe that predictability should be a separate criterion and be given greater weight than simplicity.

22 By predictability, we mean that the law must be capable of delivering a compliance standard against which commercial proposals can be assessed with a degree of certainty as to their legal treatment. Ex post enforcement is appropriate where an organisation has acted in a blameworthy manner. An organisation cannot be blameworthy if it is incapable of reasonably assessing whether its conduct is prohibited.

Proportionality

23 We agree with the Harper Report that a relevant principle is that regulation should not over or under reach.[7] The Commerce Act has a significant impact on market behaviour and must strike the right balance between deterring anti-competitive conduct while not impeding beneficial activity in the market. There are significant costs and time in implementing any changes to the law and different tests may place different regulatory costs on the affected industry, which will eventually flow through to consumers. Any regulatory intervention needs to be demonstrably proportionate to the problem.

Other criteria

24 We don't believe that alignment with other provisions in the Commerce Act and overseas jurisdictions is as important as the other assessment criteria MBIE proposes. It is more important that assessment take into account the size and remoteness of New Zealand's economy. In thinking about alignment, rather than pursue alignment per se, it is useful to consider the purpose of alignment (to facilitate cross-border trade) and whether alignment would achieve that or might actually inhibit it. There is little merit in aligning economic regulation in fundamentally different economic environments.

Assessment of New Zealand regime

25 We think that the existing section 36 test should be maintained. Section 36:

25.1 is likely to help assure the long-term benefit of consumers by facilitating efficient investment and innovation;

25.2 is relatively simple to apply given the complexities inherent in economic regulation;

25.3 has a level of predictability thanks to a developed body of case law;

[7] Above, fn1.

25.4 strikes the appropriate balance in preventing harm to consumers while not preventing vigorous competition; and

25.5 is appropriate for New Zealand where our size results in more concentrated markets.

26 We are not aware of any evidence that suggests any alternative test would better meet these objectives.

Long-term benefit to consumers

27 Consideration of benefits in the long-term is intended to ensure the focus is on preventing harm to competition (as a means of promoting economic efficiency) rather than competitors. The advantage of the status quo is that it ensures that firms with market power are nonetheless permitted to compete strongly in the market. A competition framework that ensures that competitive conduct by firms with market power is not chilled is most likely to promote long-term economic efficiency ultimately benefiting consumers through lower prices, higher quality and more innovation.

28 It has been widely acknowledged that section 36 concerns a difficult area of the law. Given New Zealand's size, there is naturally greater concentration in many of our markets. However, as MBIE points out, the fact that there are larger firms in markets in New Zealand is not bad per se. The balance in the law and its implementation that needs to be struck is preventing dominant firms in a market from harming competition to the detriment of consumers and yet still allowing vigorous competition ensuring efficiency, innovation and higher productivity.

29 We think the status quo strikes the right balance and moving to an effects based test would be likely to have a chilling effect on market activity to the detriment of consumers. For example, larger market players may be unable to meet competition even if they were to undertake exactly the same action as smaller players given the potential impact of their actions. Alternatively, firms with market power might be deterred from commercial proposals that are demonstrably favourable to consumers; for example competitive pricing offers (resulting in lower prices for consumers) that less efficient competitors are unable to match by virtue of their limited scale or cost structures.

30 Encouraging vigorous competition by firms with market power is more likely to maximise the long term benefit of consumers than requiring firms with market power to "hold an umbrella over inefficient competitors".[8] Abandoning the "taking advantage" test would mean that, in future, firms with market power would be subject to a special responsibility to shelter smaller (potentially inefficient) competitors. Such a requirement would be inconsistent with the purpose of the Commerce Act as set out in section 1A.

[8] *Telecom v Clear* [1995] 1 NZLR 385, 402 (PC).

31 We note that MBIE has provisionally concluded that the current form of section 36 likely does not maximise long-term benefit to consumers. While there have been references to conduct which is anti-competitive and harmful that cannot be prosecuted, MBIE has not identified any instances of allegedly anticompetitive conduct that section 36 has failed to address. It is therefore difficult to conclude that section 36 is negatively affecting consumers without this information. And it might be that the law is in fact simply working to avoid wasteful duplication.

32 In our view, more work should be done to validate the perception that section 36 is not adequately addressing anticompetitive conduct that adversely impacts consumers.

Simplicity and predictability

33 Consideration of simplicity needs to take into account simplicity for market participants as well as the courts and enforcers. While the law is tested in the courts occasionally, responsible large businesses are applying the test regularly to ensure their market activity remains within the bounds of the law. We believe that the current section 36 test relatively practical to apply in a cost-effective and timely manner while also being predictable enough for businesses. Any new test will not necessarily be simpler to apply and change will bring less predictability, which may remain for considerable time before there is guidance from the Commission and the courts.

34 The Issues Paper states that a system that perfectly assured the long-term benefit of consumers – even if possible – would likely be highly complex bringing with it undesirable expense and delays and it would be difficult for firms to know in advance whether their proposed course of action was likely to be punishable. For those reasons the complexity of the system may need to be reduced to allow it to be cost-efficient, timely and predictable. We agree that cost, timeliness and predictability are relevant considerations but we believe predictability is key.

Simple

35 The Issues Paper indicates that there is a concern that the requirement of "taking advantage" of market power has led to complex and lengthy argument, particularly as a result of the counter-factual test. The counter-factual test originated in case law and subsequent judgments have not raised any concerns with the current test. Simply because actions under section 36 have not always been successful does not mean the law or the test applied by the courts is flawed. The application of any new law would also develop through court judgments and there is no certainty that any other test will in fact be easier to apply, more cost efficient or timely.

36 It is a key strength of the current law that the test for compliance with the law accords with whether the action is commercially reasonable. Businesses are likely to know whether the rationale underlying any proposal makes commercial sense and would be undertaken by a player in the market without market power. If an effects based test was established it would likely require greater expert economic support in

defining the market which is key to determining the impact of the proposed action within that market.

37 It is not clear to us that an effects based test, if it adopted the "substantial lessening of competition" test used in section 47 and 27 of the Commerce Act, would be simpler than the status quo. A counterfactual test ("with" and "without" analysis) is still used under those provisions.

38 What constitutes an anticompetitive effect in terms of single-firm conduct is a highly contested matter. For example, while the EU and US regimes both broadly use an effects test to assess single-firm conduct, they understand that test to mean very different things. In the European context, the prohibition against abuse of a dominant position is understood to impose a special responsibility on the dominant firm to refrain from conduct that would distort the competitive landscape. Dominant firms may therefore be prohibited from engaging in conduct that non-dominant firms are permitted to engage in. Courts in the United States, by contrast, would resist such a conclusion. In the United States the courts impose on complainants stricter requirements to demonstrate that the allegedly anticompetitive conduct has an actual effect on prices or output – i.e. that the conduct does not merely disturb the competitive process – or actually leads to inefficient outcomes.

39 What is common to both jurisdictions is that they have developed their approach incrementally over the course of decades, building up a critical body of case law and economic analysis that informs the superficially straightforward question of "effects". It is unlikely that New Zealand could simply legislate its way to a comparably nuanced position.

Predictable

40 We do not agree that the problem "is not so much one of predictability for powerful firms". Given the penalties and reputational damage for businesses of getting it wrong a predictable test is key. So far as is possible, there needs to be clarity between breach and legitimate competition.

41 The Privy Council's statement continues to be valid today[9]:

> In their Lordships' view, s 36 must be construed in such a way as to enable the monopolist, before he enters upon a line of conduct, to know with some certainty whether or not it is lawful.

42 We agree with the courts' concern that this rule should provide firms with certainty as to whether their actions are lawful before they take them to minimise the risk of a chilling effect on large businesses competing.

43 We acknowledge that predictability of any new test will improve over time as the Commerce Commission and courts interpret and apply any new test. But as discussed above, effects based tests overseas have been developed incrementally

[9] *Telecom v Clear* 1994 6 TCLR 138 at 154.

over the course of decades. Even so, there is still a high degree of disagreement as to the appropriate approach.

44 While the EU and US both have adopted effects based tests their implementation diverges, with the EU focusing more on the maintenance of the competitive process of rivalry, and the US focused more on ensuring that the presumptively efficient conduct of successful firms is not chilled. As a consequence, cases tried in both jurisdictions often lead to different results. A recent example is 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".[10]

45 In contrast, the European Commission investigation is ongoing (having formally commenced in November 2010). In April 2015, commitments discussions having broken down, the Commission sent Google a Statement of Objections outlining the Commission's preliminary view that Google's "systematic favouring" of its own services was "to the detriment" of rival services. The Commission's view is that Google's conduct has a "negative impact on consumers and innovation" because users do not necessarily see the most relevant results, and incentives for rivals to innovate are lowered as they know that "however good their product, they will not benefit from the same prominence".[11]

46 The different treatment of Google's search practices in the US and EU serves to illustrate the point that what constitutes an anticompetitive effect in the context of single firm conduct is extremely complex, and subject to ongoing disagreement. Accordingly, while we are familiar with the substantial lessening of competition test as used elsewhere in the Commerce Act, it would be wrong to assume that it could be extended from sections 27 and 47 to section 36 in a straightforward manner.

47 Given the importance of predictability, guidance from the regulator is also important. The regulator needs to be transparent in its thinking in how it views what is compliant or non-compliant behaviour. It is good practice for regulators to provide guidelines Guidance on section 36 is however currently lacking.

48 If there is any change to section 36, and the developed body of case law is swept away, then guidance becomes even more important as there would likely be an

[10] Statement of the Federal Trade Commission Regarding Google's Search Practices, *In the Matter of Google Inc.* FTC File Number 111-0163, 3 January 2013, available at: www.ftc.gov.

[11] European Commission – Fact Sheet, *Antitrust – Commission Sends Statement of Objections to Google on comparison shopping service*, 15 April 2015 (MEMO/15/4781), available at: http://ec.europa.eu/competition/.

absence of precedent for a considerable time. Therefore, if there is any change to section 36, a statutory requirement to provide guidance should be included. There is overseas precedent for requiring regulators to issue guidance on compliance and enforcement when new competition regulation is introduced.[12]

Proportionality

49 We believe the right balance has been struck by section 36 in terms of under reach and over reach for the reasons set out above.

50 The Commerce Commission or courts have the relevant experts and expertise and powers to gather information. It is also a civil standard of the balance of probabilities only and purpose can be inferred from conduct. Accordingly the threshold for prohibited conduct should not be reduced.

51 We also think that moving to penalise market activity in the absence of blameworthy conduct (i.e. if an organisation has not taken advantage of its market power for an anti-competitive purpose) is inappropriate. Where there is limited competition in a market and increased competition would be desirable it is neither proportionate nor principled to try to achieve that by penalising the reasonable commercial conduct of one market participant. Persistent structural issues in a market are more appropriately addressed through ex ante regulation.

Other criteria

Alignment with other provisions

52 Alignment with other substantial lessening of competition tests may seem appealing but does not necessarily make sense because the effects analysis in sections 27 and 47 has a different role to that in section 36. Sections 27 and 47 are principally concerned with the aggregation of market power via collusion (section 27) or acquisition (section 47). Sections 27 and 47 reflect a policy decision that the aggregation of market power by collusion or acquisition – i.e. not as a result of consumer choice – is unlikely to serve the interests of consumers. The substantial lessening of competition test therefore proceeds with that premise in mind.

53 Section 36, on the other hand, applies in circumstances where a firm already possesses market power (having acquired it lawfully) meaning competition is already structurally limited. An effects analysis under section 36 is therefore not concerned with the process by which market power is acquired or the effects on the market of increasing concentration. Rather, section 36 focuses on the use that is made of market power, and whether that use reflects competition on the merits or is an exclusionary or exploitative abuse of that market power. As a result, when applying a substantial lessening of competition test it is difficult to reason by direct analogy from sections 27 and 47 to section 36.

[12] See for example section 78 of the Health and Social Care Act 2012 (UK) which requires the regulator to issue guidance on compliance with requirements imposed by competition regulations for the health care sector; and how it intends to exercise the enforcement powers conferred by those regulations.

Alignment with other jurisdictions and consideration of New Zealand's economy

54 We don't think there is a great deal of value in alignment of this particular restriction with overseas jurisdictions. The purpose of alignment is to facilitate cross-border trade. This is presumably because aligned regulations increase certainty and reduce compliance costs so it is easier for market participants in one jurisdiction to enter another. The Issues Paper identifies alignment with Australia as a particular issue so investors "feel reassured they face few extra competition law risks if they scale up Australian operations to encompass New Zealand". However, it is quite possible that alignment in this case could have the opposite effect.

55 The Issues Paper correctly acknowledges that in New Zealand's concentrated markets a firm is more likely to find itself having significant market power than in larger overseas jurisdictions. If the acquisition of market power results in what is effectively a prohibition on competing vigorously, uncertainty will increase and investing substantially in New Zealand could become unattractive. Businesses in larger markets might therefore see the competition law risks of entering New Zealand as having increased if our regulation is aligned with overseas jurisdictions.

Defence and authorisation provisions

56 If there is to be any substantive change to section 36 then we believe there should be further consideration of a potential defence and authorisation process. A defence should not be viewed as necessarily balancing the impact of any change to lower the threshold section 36. An authorisation process has the potential to also delay businesses that in today's world need to be flexible and nimble to innovate and adapt to the pace of change in markets.

Potential options for reform

57 Though we don't think any change is desirable, if any significant changes are proposed to section 36 of the Commerce Act involving some kind of effects based test, we think it is important that any reform make clear that a complainant will be required to demonstrate not merely an effect on competitors, but an effect on competition, in the sense that price, output or consumer choice are demonstrably harmed.

58 We believe the logic of the position taken by the courts is sound that coincidence of market power and allegedly anticompetitive conduct is not sufficient. There needs to be a causal link between the firm's market power and conduct. If a requirement that powerful firms "take advantage" of their market power is removed then the test essentially becomes effects based. Since the Act provides that an anti-competitive purpose may be inferred from the conduct of any relevant person or from any other relevant circumstances, there is a real risk conduct that results in harm to competition will have an anti-competitive purpose imputed.

59 Any reversal of the onus of elements of the section 36 test are likely to lead to the same concerns we have raised in respect of an effects based test.

ENFORCEMENT

60 In thinking about regulatory tools we are mindful of the distinction between ex post enforcement and ex ante intervention. The different contexts may lend themselves to different tools but, in principle, we support flexible tools for both enforcement and ex ante regulation. Flexible, collaborative tools are even more important in ex ante intervention given the absence of any fault in that context.

61 We support considering further the option of something like the enforceable undertakings regime under the Telecommunications Act as an alternative to administrative settlements and the cease and desist regime. Such undertakings are a flexible and cost-effective tool and could be enforceable in the High Court and may include a pecuniary penalty. This would remove some of the concerns MBIE identifies that exist today with administrative settlements.

MARKET STUDIES

62 There needs to be some ability to understand whether markets are functioning in the interests of consumers and investigate potentially anti-competitive behaviour. However, it is important to keep in mind the distinction between a process that ensures decision-makers are properly informed before setting policy or making ex ante regulatory interventions; and one that serves as a precursor to enforcement or review of the regulators own enforcement operations. The description in the Issues Paper of "the absence of a formal power for specifically analysing competition across any market" seems to risk conflating the two.

63 As we've noted above, competition is not an end in itself and, where relevant, is simply a means of maximising efficiency in the interests of consumers. Therefore it is not clear that a power specifically aimed at analysing competition is necessary or desirable.

64 Also, it is not clear that there is a gap in New Zealand's institutional settings for promoting competition. Between the Productivity Commission, MBIE and the powers the Commerce Commission has under Part 4 of the Commerce Act, it seems to us New Zealand's public authorities are able to identify and investigate markets that are not functioning in the best interests of consumers.

65 Certain competition issues in overseas markets that have been addressed through market studies have been addressed in New Zealand under existing powers. For example, the UK Competition Commission considered competition for the supply of airport services at airports owned by BAA Limited as a market investigation under the Enterprise Act 2002 (UK).[13] In New Zealand the Commerce Commission considered competition for the supply of airfield activities at Auckland, Wellington and

[13] Competition Commission "BAA airports market investigation: A report on the supply of airport services by BAA in the UK", available at: https://www.gov.uk/cma-cases/baa-airports-market-investigation-cc

Christchurch airports under Part 4 of the Commerce Act.[14] This suggests that New Zealand does not lack the tools necessary to address problems caused by limited competition.

66 We support having processes in place to ensure decision-makers are properly informed before setting policy or making regulatory interventions. If this is the aim of a new market studies function then we are likely to be supportive. However, in that context there are two important points:

66.1 It is unlikely that compulsory information gathering powers are necessary for a function aimed at informing policy. The Productivity Commission is able to produce high quality reviews in the absence of any formal information gathering power. The exercise of such powers has real and significant costs for businesses targeted by these powers which are inevitably passed on to consumers. If MBIE considers information gathering powers are necessary, they should be tightly controlled, subject to detailed guidance and involve consultation with the proposed target(s) prior to service.

66.2 A function of this kind should not be given to the competition enforcement agency. We noted earlier that more role distinction between policy setting and enforcement would be desirable.[15] We support a firmer distinction between policy setting on the one hand and enforcement on the other. We do not support a market studies power that can be used as a precursor to enforcement. We agree with MBIE that any utility gained by instituting such a power would be outweighed by the disadvantages.

67 We operate in telecommunications markets which are subject to monitoring and review by the Commerce Commission under section 9A of the Telecommunications Act 2001. We think this particular provision blurs the important distinction we described earlier (between a process that ensures decision-makers are properly informed before setting policy or making regulatory interventions and one that serves as a precursor to enforcement or review of enforcement operations).

68 We would therefore support replacement of section 9A with a more general review function specifically aimed at properly informing policy setting and ex ante intervention granted to a body independent of the competition enforcement agency. The Productivity Commission would be worth considering further for this function given its expertise and experience to date.

[14] See: http://www.comcom.govt.nz/regulated-industries/airports/

[15] See paragraph 18 above.