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Public

Cross-submission for Chorus in response to

Targeted Review of the Commerce Act 1986 – Issues Paper 2015

Chorus

EXECUTIVE SUMMARY

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

We agree with the Commerce Commission on the importance of decision-makers having the information necessary to make well informed decisions that promote the long term interests of New Zealand consumers when considering potential changes to section 36. We also agree that it's important to get this right. This is a complex area of the law – the task is to strike the appropriate balance between vigorous competition that is beneficial to consumers and abuse of market power. This is the challenge facing MBIE.

We agree with a number of other submissions that the case for change to section 36 hasn't been made out. To justify any changes there needs to be:

- a clear articulation of the current problems with section 36 and what behaviour should be caught and isn't today. Simply proposing an effects test is not an answer to that question. Even those jurisdictions that have an effects test often treat identical conduct differently. For example, in our November 2015 submission we pointed to the divergent approaches in the US and EU to Google's prioritisation of its own services in search results;

- evidence that the proposed change will in fact better promote the long term interests of New Zealanders than the status quo; and

- defined benefits that clearly outweigh the costs of the changes.

We also think, as the Supreme Court has said, that section 36 should be approached in a way that "gives firms and their advisers a reasonable basis for predicting in advance whether their proposed conduct falls afoul of section 36 and risks a substantial financial penalty".[1] As we said previously, market participants need to understand the law to comply with it. If any changes are made to section 36, there should be a legislated requirement that the Commission provides guidance to encourage compliance in the market.

On our reading of the Issues Paper and other parties' submissions there is no clear case for change. Submissions were split and the evidence presented by submitters advocating change didn't demonstrate that an effects based test would lead to better outcomes for consumers.

This is a hard area of the law to get right. The current test may not be perfect but it's unlikely that we would ever achieve a perfect test for all circumstances. We think in most cases the current test strikes the right balance and there should be a cautious approach to changing it.

After reading submissions we haven't changed our view that section 36:

[1] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2011] 1 NZLR 577, at [30].

- appropriately distinguishes between competitive and anticompetitive conduct;
- provides the necessary commercial predictability that companies with market power can reasonably apply (i.e. it poses a reasonably straightforward compliance standard: "would we do this, as a matter of rational commercial judgment, in a competitive market"); and
- has the benefit of extensive elaboration and development through the courts, something which is continually referred to as of value by regulators in other settings and is important to business when no up-front guidance is provided.

EXAMPLES OF HARM

We agree with submissions that there isn't any evidence of anti-competitive conduct not being adequately addressed by section 36 as it stands.

The Commission supports its case for a change to an effects based test by referring to cases it may have taken but couldn't under the current section 36. We don't find the Commission's examples justify changes to section 36 for the following reasons:

- in two of the Commission's three examples (Winstone and Sky TV), the Commission acknowledges that it also investigated the conduct under section 27 and concluded that it didn't have an anticompetitive effect under section 27;
- in the third example (Air NZ) the Commission doesn't appear to express any view as to whether it thought the conduct was likely to substantially lessen competition; and
- the Commission also acknowledges that these cases wouldn't necessarily have been decided differently under a different formulation of section 36.

It is worth noting that the Commission, while it expressed dissatisfaction with the current section 36, hasn't identified any cases that would have been decided differently. So it's not clear to us what the impetus is for change.

ALL MARKET PLAYERS SHOULD BE ABLE TO COMPETE FOR THE BENEFIT OF CONSUMERS

We agree with other submitters too that firms with market power should be able to engage in the same competitive conduct that others would. Such competition can be pro-competitive and benefit consumers.

Changes to section 36 to apply an effects test could discourage firms with market power from engaging in competitive conduct. It wouldn't be in the interests of consumers if a different section 36 test meant that suppliers with market power had to hold back in offering consumers compelling services at compelling prices.

The challenge in amending section 36 is finding the appropriate boundary between competitive and anti-competitive conduct. The boundary isn't obvious. When a firm competes successfully, that often comes at the expense of other competitors. When consumers prefer product A that will be to the detriment of product B. That means we can't assess the legitimacy of single firm conduct simply by looking to see whether competitors are disadvantaged. If that was the limit of inquiry then we would not be distinguishing between firms that maintain a leading position in the market because they compete hard and offer the best products and services and those that achieve the same by abusing their market power. Google, for example, came to dominate internet searches at the expense of competing search engines such as AltaVista. But that was because it offered a superior product that consumers preferred to the alternatives. No one would suggest that the decline of Google's competitors was the result of abusive conduct.

Something more is required – a principle that clearly distinguishes between harm to competitors that reflects the process of competition and harm to competitors that reflects abusive conduct. That principle needs to be equally applicable to firms with market power. If it isn't, then the consequence is that the largest firms in the market are required to refrain from competing in order to "hold an umbrella over inefficient competitors".[2]

In New Zealand law the delineation principle is the counterfactual test. It is the result of years of policy discussion, academic analysis and detailed consideration by the courts. It reflects the best efforts of many people – on all sides of the policy debate – to identify the point at which vigorous competition strays into abusive conduct. It does so by identifying conduct that is inconsistent with how a firm would operate under competitive conditions. It also ensures that firms with market power are not penalised or deterred from competing hard in the interests of consumers.

And it is effective. Section 36 in its current form addresses all of the principal categories of anticompetitive single-firm conduct recognised in most other jurisdictions. So it's not as if competition law in New Zealand fails to recognise as unlawful conduct that would be unlawful elsewhere. In fact, New Zealand internationally sits somewhere in the middle of the enforcement spectrum. Also, the Commission and private litigants have had significant success in proceedings under the current section 36. Even where the Commission hasn't been successful in court, the court's decision has often articulated a compliance standard that has subsequently guided the conduct of firms with market power.

The Commission shouldn't be solely measured by success in court but also by the robustness and fairness of its investigations, its influence in the market in deterring anti-competitive activity, and its thinking in applying the law as it stands for the long term benefit of consumers, recognising the significant and disruptive pace of change.

The Commission in its letter to the Minister has criticised submitters for failing to describe what pro-competitive conduct could not be undertaken with a reformed section 36. But we think it's the opposite question that should inform the policy and legislative reform process. The focus should be on perceived deficiencies with the current section 36, rather

[2] Privy Council in *Telecom Corporation of New Zealand v Clear Communications Ltd* [1995] 1 NZLR 385 at 402, citing *Olympia Equipment Leasing Co v Western Union Telegraph Co* 797 F 2d 370 (1986).

than on the possible deficiencies of an – as yet – unknown alternative formulation that has not had the benefit of judicial examination.

Nonetheless, we think there are obvious examples of competitive conduct that might be deterred under an effects test. For example, discounting may harm competitors when one firm is able to pass on its significantly greater efficiencies to customers in the form of lower prices. As the Privy Council has said:[3]

> *The public interest lies in preserving the ability of firms to compete with each other in a competitive market, on price as well as on quality. It is not well served if a firm which has a dominant position in the market is penalised for cutting prices, when that same conduct if undertaken in the same circumstances by a firm which was not dominant would not be.*

If section 36 simply said that conduct that has the effect of lessening competition is prohibited, then firms with market power might be deterred from discounting if the result would be that less efficient competitors would struggle to compete. This is the issue that the Privy Council in *Telecom v Clear* was highlighting when it said that section 36 should not require firms to hold an umbrella over inefficient competitors.

The Commission may say that we are being alarmist. But the concern is a real one, and it arises for two reasons. First, because a reformulated section 36 may on its face prohibit conduct that most people would consider consumer-focused. Second, because uncertainty as to how it will be interpreted and applied – by the Commission and by the courts – forces businesses to adopt an overly conservative compliance standard.

ROLE OF REGULATION

Section 36 should not be analysed in isolation. It is part of an integrated package of regulatory interventions that includes Part 4 of the Commerce Act and the Telecommunications Act. These regulatory regimes constrain the exercise of market power in the energy, telecommunications and airports markets and require consumer-focused outcomes consistent with competitive markets. The regulatory regimes are deliberately flexible and responsive to changing market conditions, and are the subject of considerable and ongoing policy work (as MBIE obviously knows). This isn't to say that there is no role for section 36, but simply that section 36 is not the only way that we address issues of market power.

DISRUPTION HAPPENS AND BRINGS INNOVATION

It's important also to bear in mind that even apparently entrenched market power is vulnerable to technology change and disruptive innovation. By its very nature, disruptive innovation is difficult to identify in advance, even though it may seem obvious in hindsight. The lesson from the history of competition law enforcement in technology markets is that litigation has seldom been as successful as technology change in undermining dominant positions and driving consumer welfare. For example:

[3] *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145 at [66].

- Kodak was for much of the 20th century the focus of US Government antitrust litigation, given its dominant position in the camera, film and copier business. As recently as the early 2000s Kodak was the leading global supplier of camera and film equipment. By 2007, Kodak's share of the camera market had dwindled to less than 10%. By the late 2000s, dedicated digital cameras started to be displaced by smartphones, further exacerbating Kodak's decline.

- Microsoft, similarly, was the target of multiple antitrust suits in the US and EU in the 1990s and 2000s. The basis was Microsoft's market power derived ultimately from its dominant position in personal computer operating systems, which it leveraged into adjacent markets for internet browsers, media players and middleware. Again, Microsoft's dominance of the personal computing market was not undermined by antitrust litigation, but by a succession of technology disruptions, beginning with the resurgence of Apple in the early 2000s, and culminating most recently in the rise of smartphones and the Android operating system.

There are many other examples of disruptive innovation disturbing apparently entrenched business models. Before Uber, passenger transport was dominated by taxi companies. Before Air BnB, large hotel chains controlled the markets for leisure accommodation. No one saw these changes coming. The lesson is that market power in the modern economy is never as entrenched as it seems. New technology and business models have the potential to undermine market power almost overnight, regardless of how powerful the incumbents may appear.

TRANS-TASMAN ALIGNMENT

We briefly touch on trans-Tasman alignment in response to others' submissions. It's uncertain whether Australia will in fact change its equivalent legislation despite acceptance of the Harper Review recommendation before the recent election. We agree with other submitters that, if trans-Tasman alignment is viewed as important (although we don't think there is great value in alignment in this case), we should wait and see when and what changes are made.