



Cross-submission on the Targeted Review of the Commerce Act

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For brevity I have assumed that anyone involved in this cross-submission process already knows their way around the terminology, and I have not included explanations of (eg) *Pink Batts*, 0867, s46 in Australia, or counterfactual analysis.

I have no objection to its publication in its entirety. I have no Privacy Act disclosure issues.

Abuse of market power – s36

The Australian decision on abuse of market power

In mid March the Australian government decided¹ to adopt the Harper Review recommendation on their s46 and to move to an “effects” test, which drops the “take advantage” and “purpose” elements, and also allows for an efficiency defence. The Australian government said that

- “The Harper Review into competition policy...found Australia’s current misuse of market power provision is not reliably enforceable and permits anti-competitive conduct. This slows the entry and expansion of new and innovative firms, delays the entry of new technologies into Australia and impedes economic growth in the long term”
- “The Government is committed to fixing Australia’s competition policy and the amendment of Section 46 to deal with unilateral anti-competitive conduct is an important step to ensure Australia has the best possible competition framework to support innovation and boost economic growth and jobs”
- “Conscious of the needs of business, the change is deliberately designed to reduce the uncertainty associated with amending a law. It uses existing legal concepts from within the competition law – such as ‘substantially lessening competition’ – and ensures the focus of the provision remains only on those firms that have substantial market power”
- “This reform represents a commercially and legally robust law, preventing firms with market power engaging in behaviour that harms the competitive process. It places Australia’s competition law on the right footing to encourage economic growth and innovation”.

1 <https://www.pm.gov.au/media/2016-03-16/joint-media-statement-fixing-competition-policy-drive-economic-growth-and-jobs>

Those decisions and reasons (which I agree with) are highly relevant to New Zealand's path forward, from several perspectives.

- The recommendation came at the end of a very extensive and intensive analytical and consultation process, with the s46 recommendation getting a separate additional consultation process of its own. There has to be a very strong presumption that at the end of that process the Australians have arrived at the 'right' answer, or at least a better solution than our present one.
- It is worth emphasising that the Australian decision was taken from an explicitly pro-growth and pro-innovation perspective.
- When Australia moves to a new s46, there will be a serious anomaly in trans-Tasman business regimes: firms' actions would be subject to different tests of legitimacy. What might be illegal in Australia could be found legal here: alternatively, actions found legal in Australia (because of net consumer benefits on an efficiency test) could be illegal here. These are more than hypothetical possibilities as in many sectors (such as airlines, banking, and supermarkets) the same large firms operate on both sides of the Tasman. This is obviously undesirable and inefficient.
- MBIE's latest *Statement of Intent 2015 – 2019* says (p13) that "Strong international connections enhance competition, innovation and productivity through exposure to other markets" and that "To improve international connectivity in our priority regions of Australia and China and with ASEAN we will...facilitate regulatory cooperation and minimise constraints on trade". From that perspective it would be well nigh indefensible to allow a serious divergence between the competition law treatment of large trans-Tasman businesses.
- It is also worth noting that if amendment is being considered, the New Zealand Law Society's submission supported "alignment with similar provisions in other jurisdictions".
- One straightforward way forward would be to signal an intention in principle to change s36 and to follow Australia's move on s46 as and when they move, which would provide good advance notice to businesses.

The Commerce Commission's letter of June 2

The Commerce Commission's letter was an unusual but significant development — 'unusual' not in any pejorative sense, but simply that it is unusual to see an operational enforcement agency making direct policy representations to a Minister in this manner.

I took this as further evidence of the Commission's assessment that the current regime is unworkable, that the consequences of policy inertia would be significantly adverse, and that the need for reform is urgent. The Commission's citing of real-life examples (Winstone, Sky TV, Air New Zealand²) where potential abuse of market power may have gone unchallenged was particularly telling and was an effective response to (for example) BusinessNZ's submission calling for evidence that there is a significant problem to be addressed.

It is true that representations from enforcement agencies are only part of the picture: citizens and officials can rightly question and overrule (from various perspectives) request for greater or different powers from agencies such as tax or customs authorities, the police, or national statistics organisations. That noted, and read alongside the support for the Commission's position both from the ACCC and the American Bar Association Antitrust and International Sections, the letter makes it clear that the Commission does not have any questionable or overreaching agenda, and that its

² For completeness I should say that I was involved when on the Commission in at least one, and possibly two, of these episodes. I don't recall the third, but wouldn't rule it out.

genuine and legitimate concern is that s36 enforcement will be effectively null and void until s36 is reformulated. A small economy with relatively high levels of market concentration cannot allow a toothless abuse of market power regime to persist.

Further thoughts on the operation of s36

Since my initial submission I have given further thought to s36: the results were presented at this year's New Zealand Association of Economists' annual conference, and are attached as an appendix which forms part of this submission.

One issue that has become clearer to me is the relationship between the current statutory wording and the subsequent jurisprudence. At first I was inclined to regard cases such as *Telecom v Clear* and *Pink Batts* as idiosyncratic judicial interpretation (and still feel that way about 0867's attempt to explain away the New Zealand applicability of Australia's amendments to their s46). On reflection it is clearer that the judges in formulating the counterfactual test in *Telecom v Clear*, and re-emphasising it in *Pink Batts*, were following where the logic of "take advantage" and "purpose" led.

The true problem consequently lies in the wording of s36 itself: the wording leads to the counterfactual jurisprudence. Unfortunately the counterfactual does not address the underlying economic issue which s36 was meant to address, namely that acts undertaken by a firm with market power may differ in their consequence for the competitive process from the same actions undertaken by a firm without market power. Whether a firm without market power would have done the same thing (the counterfactual supposition) is irrelevant. This point is developed in the attached paper at pp11-12. It was also well made by the ABA's submission (p5, footnote omitted):

Although it is clearly the case that in most instances that conduct undertaken by a non-dominant firm will be efficient and procompetitive, and thus in the vast majority of cases also will be efficient and procompetitive if undertaken by a dominant firm, there are cases where an entity has substantial market power and "behavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist." Focusing on the rationality of the conduct for a differently situated market actor will not necessarily protect against the effects of the conduct, and may fall short of the policy objectives of maintaining competitive markets.

Business certainty and 'chilling effects'

Various propositions have been put on the record regarding the potential effects of change on business certainty and investment. At one end, BusinessNZ (p5) says that "An amendment that is neither required nor welcomed will stifle business activities, increase compliance costs and severely restrict commercial flexibility" and "recognition of the potential for chilling effects on competition should mean a very high threshold for regulatory intervention, especially when the intervention is looking to displace market practice". At the other, the Commerce Commission position (p3) is that "Submitters say that reform will 'chill' competitive conduct. There is simply no evidence to support that proposition, and we do not accept that competitive conduct in overseas markets with an 'effects test' has been chilled".

It may be helpful to stand back and consider some wider aspects of 'business certainty':

- Businesses routinely cope with uncertainty and risk: it is one of the core functions of management, and one of the reasons why businesses exist is to enable the coordination of

resources and efforts in an uncertain environment. Large businesses, the ones most likely to be impacted by abuse of market power provisions (of any design), are particularly capable of effective strategic and tactical risk management. That is not to say that government policy can costlessly impose unnecessary uncertainty on managers, but the argument that uncertainty per se must be minimised or even eliminated, for fear that befuddled executives will be overwhelmed, can be (and has been) pushed too far. It is a caricature of modern corporate management

- The search for low (or lower) levels of uncertainty is understandable, but somewhat misplaced when it comes to abuse of market power legislation. As every commentator who has ever looked at the matter has concluded, this is an inherently uncertain area with no ‘magic bullet’ or ‘bright line test’ to call on. The best that can be achieved is ‘better’ rather than ‘worse’
- As the Australian government said, their adoption of the Harper recommendation on s46 in some respects enhanced certainty, particularly in regard to a common “substantial lessening of competition” test across different provisions of their Act
- The reality is that reform of s36 is not an issue that will generate significant levels of economy-wide uncertainty or chilled investment. By definition, the only activities that are affected by s36 (current or reformed) are some borderline activities by some large companies. As Russell McVeagh’s submission noted (p6) (albeit in the context of arguing that the Commerce Commission should not be complaining about the small number of cases it has been able to bring to a successful outcome), the number of instances of s36 style cases being brought before the courts tends to be very low: Russell McVeagh instanced one case in nine years in the US
- Submissions on business uncertainty have not paid enough attention to the availability of the Commerce Commission’s authorisation process, which is an important risk management tool and which enables companies to get approval for activities which may have some anticompetitive effects but which overall have a net public benefit. Australia’s proposed efficiency test if adopted here would also (if an activity is challenged by the authorities) provide an opportunity to make the same arguments, and it is hard to see how a court, presented with evidence that a company had carefully considered an activity from an overall net benefit point of view, would impose significant penalties even if it concluded that the net benefit was not as claimed. One policy option that MBIE might usefully consider, as part of the overall s36 process, would be further streamlining of the Commission’s authorisation processes (beyond the welcome but limited streamlining the Commission has already undertaken)
- The call for greater certainty sits strangely with the support for the “purpose” element and the counterfactual test. “Purpose” is a more subjective element to assess than “effects”, where there is greater scope (eg from economic theory or from market empirics) to adduce concrete evidence. And the counterfactual test is by definition drawn from an imaginary hypothetical world (or series of worlds), which is not what a corporate executive would normally characterise as a high-certainty process
- Business certainty needs to reflect the viewpoint of the entire business sector. As the Australian government noted, “An effective misuse of market power provision is an important and necessary part of competition law, particularly for Australia’s more than two million small businesses which make up more than 97 per cent of all businesses”. It is also worth noting that the victims of market power abuse will often be other large businesses – the biggest victims in *Data Tails*, for example, were any companies who had large volumes of national telecommunications traffic – and they are as much at risk of economic harm as anyone from ineffective policing of abuse (see p6 of the attached paper).

Market studies

I was interested to see the submission by Abbott and Carson supporting the use of market studies. It provided data on how they had been used effectively in Australia, which is always likely to be an important comparator market for competition policy purposes. They cited inter alia this outcome:

This [ACCC market study] report concluded that the grocery market in Australia is workably competitive, however, there were a number of actions that could be taken to improve the level of competition in the Australian groceries market. The report also found that there were a number of impediments to the expansion and entry of new entrants to provide more competition in the Australian retail groceries market, including high barriers to entry and expansion – particularly in relation to planning laws and the attainment of new sites. One result, therefore, has been an increased focus on the part of the ACCC to investigate allegations of abuses in this industry since 2008.

That is exactly the sort of positive outcome we might expect if we did the same.

Matthews Law made a good point in its submission (p2) that “New Zealand has highly concentrated market structures. It may assist policy making and enforcement to have greater scrutiny and the ability to identify markets where workable competition is absent, as is common offshore. It is a gap in the current regime”.

In my previous paper arguing for market studies³ I should have included reference to the positive experience of the then Irish Competition Authority (now the Competition and Consumer Protection Commission). Their reports are available at <http://ccpc.ie/research-advocacy/market-studies>. Ireland is also a useful comparator as a small economy with a large neighbour.

Alternative enforcement mechanisms

This is an area more for lawyers than anyone, and I have no clear preference for one approach as against another, but as an economist (and a former long-serving Commerce Commissioner) I would submit that some form of quick response mechanism is better than none.

While *0867* and *Data Tails* are mostly raised in a s36 context, I think they also have important implications for ‘cease and desist’ style mechanisms. If there had been competitive harm in *0867*, the reality was that by the time it was decided, the technology involved (dial-up Internet) had been superseded by broadband. It would have been impossible to retrospectively rectify the harm. Similarly with *Data Tails*: it impeded the development of competing telco infrastructure for a substantial period, and this at a time when it was becoming increasingly obvious that the country needed a faster, modern telco infrastructure. When the legal process all the way to the Supreme Court can take five to seven years, the risk is that it provides an anti-competitive shield for permanent damage to competition which an eventual judgement will not be able to repair.

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³ Now also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2804410

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Appendix to cross-submission

Abuse of market power: the end of "make-believe" analysis?

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NZ Association of Economists conference, Auckland, June 30 2016

Setting the scene

We have a problem.

To some degree, all economies share it: it is universally recognised that it is difficult to define and detect “abuse of market power”, where a firm with market power engages in conduct which damages the competitive process itself. Broad statements of principle leave much room for ambiguity and alternative interpretation; more detailed shopping-lists (in legislation or as case law accumulates) of proscribed practices (eg predatory pricing, exclusive dealing, tying, refusal to deal, 'loyalty' discounts) fare little better, particularly in a world where new tech-based industries give rise to new forms of behaviour that may not be easily categorised.

But New Zealand has a worse problem than most. The legislation which aims to prevent a significant impediment to effective competition in New Zealand is defective, partly because the statutory formulation is misguided to start with, and partly because the courts' interpretation of the formulation has gone further astray. In Australia, which shares most of these issues, a process is well advanced to fix them (though the ultimate outcome is still unclear). In New Zealand, we have been slower and more hesitant to look at the issue, and the ultimate outcome is even more uncertain.

We need to fix it. Attempts by powerful incumbents to stifle or restrict competition are a serious issue, and arguably one that is growing over time: some of the new IT-based network sectors, for example, are prone to 'tipping' to a dominant incumbent and potentially exposed to new kinds of anti-competitive behaviour (such as the selection and positioning of ads beside the results of internet searches, as in the Google case currently being investigated by the European Commission).

The issues go beyond rorts of the consumer. Less competitive markets weigh on productivity and export competitiveness: as the Productivity Commission found, even such a basic commodity as an export log actually embodies a large proportion of embedded services (about half its value, on the Commission's estimate). If large domestic suppliers of (usually non-tradable) services can suppress competitive threats to their incumbency, exporters wear the cost. In fixing potential issues, that cost needs to be front of mind: while attempts to restrain anti-competitive behaviour by powerful incumbents can easily be portrayed as 'anti business' or 'anti big business', the reality is that it is *other businesses* which typically suffer most, as they do from other anti-competitive practices such

⁴ The author was a member of the Commerce Commission 2001-2013 and was involved in some of the cases and decisions mentioned in this paper: all facts and observations on those cases and decisions are, however, based wholly on material in the public domain. This paper received no funding from anyone (this is a world where the Marsden Fund can find \$600,000 for Professor Jane Kelsey's research “to refine options and strategies for transcending embedded neoliberalism in international economic regulation”) and was an expensive distraction from fee-paying consultancy. There may be some errors, but they are likely the responsibility of sources which misled me. No referees were harmed in the production of this paper. Constructive criticism welcome.

as cartels (often focussed on industrial inputs).

This paper will argue that Australia's proposed way forward looks a good option for us, too. But first we need to traverse how we arrived where we are.

Illustrating the difficulty

Which, if any, of the following looks like problematic anti-competitive behaviour?

An industrial process requires an essential input, which is a waste product from another industrial process. The largest company in the industry buys up more of the input than it needs itself⁵.

An airport company auctions off the right to operate duty-free stores at the airport to a single operator.⁶

The national meteorological office collects weather data, but will not release it to third party commercial weather forecasters⁷.

A sports stadium offers beer only through its own in-stadium outlets⁸.

A pharmaceutical company with the patented leading treatment for an illness pays a producer of a generic substitute not to produce after the patent expires⁹.

A pay-TV broadcaster resells its programmes to internet service providers on terms which prevent them working with other pay-TV operators¹⁰.

A sports body declines third parties permission to stage their own commercial events¹¹.

A heritage steam railway wants to access the national rail network, to take passengers from the big station in town to the start of its own line, but the national rail operator allows access only at a prohibitive price¹².

A large health insurer requires customers to use specified 'affiliated' (but independent)

5 Suggested by the *Cement Australia* case. See

<http://www.australiancompetitionlaw.org/cases/2013cement.html>

6 Based on the real-life example of Auckland International Airport. See <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2008/aucklandinternationalairportdropss> (last accessed June 2 2016)

7 Suggested by <http://www.weatherwatch.co.nz/content/nz-govt-agrees-official-investigation-over-weather-data-access>

8 Suggested by various examples, including the Commerce Commission's only use of a 'cease and desist' order, <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2006/firsteverceaseanddesistorderissued>

9 See <http://economicsnz.blogspot.co.nz/2014/07/smoking-gun-found-as-drug-deals-go-down.html> and the earlier blog posts mentioned there

10 Suggested by the Commerce Commission's warning to Sky TV. See <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2013/commerce-commission-issues-warning-to-sky> and <http://www.comcom.govt.nz/dmsdocument/11161>

11 Suggested by a recent European Union case involving the Greek motorcycle racing authority.

12 We'll hear more of this kind of thing later, when we come to *Data Tails*.

providers for their medical procedures¹³.

The law

How can we tell which of these examples are legally acceptable or not? The piece of legislation that is meant to police anti-competitive behaviour by powerful incumbents, and, when read with the case law, to enable businesses to know what they may or may not safely do, is section 36 of the Commerce Act¹⁴:

36 Taking advantage of market power

...

(2) A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of—

(a) restricting the entry of a person into that or any other market; or

(b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or

(c) eliminating a person from that or any other market.

(3) For the purposes of this section, a person does not take advantage of a substantial degree of power in a market by reason only that the person seeks to enforce a statutory intellectual property right, within the meaning of section 45(2), in New Zealand...

It is not working. The Commerce Commission has effectively given up on trying to make it work:

The Commission's enforcement programme under section 36 of the Commerce Act continues to be constrained by practical difficulties in applying the legal tests set down by the courts. The Commission believes that section 36 is in need of reform¹⁵.

Its Australian equivalent, the Australian Competition and Consumer Commission (ACCC), agrees, saying that the equivalent and very similarly worded provision in Australia is "is not fit for purpose (that is, to prohibit misuse of market power)"¹⁶.

There are a range of reasons for the current situation, but the single biggest issue has been the courts' interpretation of how to read "take advantage" (or, in an earlier, equivalent, formulation, "use").

The story of "taking advantage" and the "counterfactual" test

The history begins in 1995 with a s36 case between private sector litigants¹⁷, which went all the way to the Privy Council, then New Zealand's final court of appeal. It concerned the prices Telecom

13 Not suggested by anything on the record, but a hypothetical example of what could well be pro-consumer and pro-efficiency behaviour that might mistakenly be called anti-competitive under current jurisprudence

14 Readers new to these topics will find the Commerce Commission's plain English explanation of s36, and the accompanying case studies, very helpful. They are available at <http://www.comcom.govt.nz/business-competition/fact-sheets-3/taking-advantage-of-market-power/>

15 Commerce Commission, Briefing for incoming Minister, October 2014, Public Version, p14

16 P1, ACCC's submission to MBIE, February 2016, <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/submissions-received/ACCC.pdf>

17 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC), often called "Telecom Clear".

charged Clear for access to Telecom's network, which Clear alleged were designed to impede its ability to compete in the telco market. The court found that Telecom's prices did not breach s36, and that Telecom was entitled to charge up to the 'Baumol-Willig' or 'Efficient Component Pricing' level, but more importantly directed New Zealand courts on how to interpret 'take advantage':

it cannot be said that a person in a dominant market position “uses” that position for the purposes of s 36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.

In July 2004 the Privy Council (still New Zealand's final court of appeal at that point) heard a case¹⁸ where the Commerce Commission alleged that a unit of Carter Holt had engaged in predatory pricing to drive out the competitive challenge from a new wool-based insulation product to its established 'Pink Batts' product. The New Zealand courts had found for the Commission, but on a penalty shoot-out the Privy Council found 3-2¹⁹ for Carter Holt. The majority noted that “the courts below” - i.e. the New Zealand High Court and Court of Appeal - “showed a marked lack of enthusiasm for what has come to be known as the counterfactual test”. This, they said²⁰, was not on:

It is, as the Board²¹ said in *Telecom Corporation of New Zealand v Clear Communications Ltd...***both legitimate and necessary** when giving effect to section 36 to apply the counterfactual test to determine whether the defendant has used its position of dominance [emphasis added]

In the meantime, however, the Australians were also showing their own “marked lack of enthusiasm”, which they expressed by amending their legislation. The core prohibition, in section 46(1) of their Competition and Consumer Act 2010, remains essentially the same as ours:

(1) A corporation that has a substantial degree of power in a market shall not take advantage of that power in that or any other market for the purpose of:

- (a) eliminating or substantially damaging a competitor ... in that or any other market;
- (b) preventing the entry of a person into that or any other market; or
- (c) deterring or preventing a person from engaging in competitive conduct in that or any other market

but there was a new section 46(6A) which enabled the Australian courts to look at “take advantage” from a number of perspectives:

(6A) In determining for the purposes of this section whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:

- (a) whether the conduct was materially facilitated by the corporation’s substantial degree of power in the market;

18 *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145 (PC), generally known as “Pink Batts” and sometimes as “INZCO”, the name of a Carter Holt operating unit.

19 The minority said at 85 that “This case does not, in our respectful opinion, come within a distance of justifying the Board in setting aside the concurrent findings in the local courts”, which was a very British way of saying that the minority regarded the majority as barking mad.

20 *Pink Batts*, at 60(a)

21 I.e. the Privy Council itself

- (b) whether the corporation engaged in the conduct in reliance on its substantial degree of power in the market;
- (c) whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of power in the market;
- (d) whether the conduct is otherwise related to the corporation's substantial degree of power in the market.

This subsection does not limit the matters to which the court may have regard.

“Materially facilitated”, “in reliance on”, and “otherwise” were clearly seen as acceptable alternatives to the previous sole counterfactual approach (which survived as option (c) in this menu), an interpretation supported by the final words of the section, which says that the courts could look at yet further factors if they wanted to.

There were consequently hopes that when the New Zealand Supreme Court – which would not be bound by rulings of the Privy Council and so would have freedom to take an alternative approach – ended up with a s36 case, it would note the Australian approach and agree that the counterfactual test was not the only way to assess “take advantage”. But when the case finally turned up²², something rather surprising happened. As Mark Berry put it

Regrettably, the Supreme Court's misinterpretation of Australian case law squandered this opportunity. The Supreme Court convinced itself that, when appropriately analysed, all of the Australian tests could be regarded as involving a comparison between actual and hypothetical markets. It also asserted that the predictability of outcome would be harmed by the application of a range of tests. This reading of Australian case law is clearly problematic, given the clear expression that, within the jurisdiction, there are different and alternate tests apart from the counterfactual test

What's wrong with the counterfactual test?

By now there is a substantial body of legal and economics literature pointing out the deficiencies of the counterfactual approach²³. But before looking at it, two more positive points need to be made about the counterfactual test.

The first is that one can understand, at one level, why the judges have taken the approach they have. They have been required to tease out the full meaning of “take advantage”, and have, reasonably, argued that the phrase implies some causal nexus or link to the market power, from which the counterfactual step – would or could a company have done this, without the market power – is a

²² *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111, [2010] 1 NZLR 577, generally known as “0867”

²³ Good examples include Rex Adahr, “Escaping New Zealand's Monopolization Quagmire”, (2006) 34 ABLR 260 and “The Unfulfilled Promise of New Zealand's Monopolisation Law: Sources, Symptoms and Solutions” (2009) 16 CCLJ 291; Paul Scott, “Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act”, *New Zealand Business Law Quarterly* Vol 17, September 2011; Mark Berry (writing in his personal capacity rather than as chair of the Commerce Commission), “New Zealand Antitrust: Some Reflections on the First Twenty-Five Years”, *Loyola University Chicago International Law Review*, Volume 10, Issue 2, Spring/Summer 2013, particularly Part IV, “The Monopoly Problem”; Andrew Gavil, “Imagining a Counterfactual Section 36: Rebalancing New Zealand's Competition Framework”, *New Zealand Commerce Commission's inaugural Competition Matters conference*, 17–18 October 2013; and James Farmer, “Commentary on Paper Delivered by Professor Andrew I Gavil at Commerce Commission Conference”, November 19 2013

logical progression. As argued below, the “take advantage” wording and the associated counterfactual test are the wrong apparatus to use to decide whether there has been anti-competitive behaviour, but given the legislation as it stands, it has been reasonable for judges to take the approach they have.

The second is that, occasionally, even the flawed counterfactual test can ping especially obvious behaviour. The prime example is the “data tails” case²⁴, where Telecom declined to supply the local connection legs (the “data tails”) of a long-distance phone call to the operators of an inter-city trunk line, other than at very high prices (in excess of Baumol-Willig/ECPR levels) which made the complete call (initial local leg, inter-city leg, final local leg) impracticably expensive to provide. The counterfactual in that case was two competing non-monopoly operators of local connection networks, in which case it became obvious that neither would be prepared to forgo the potential value of the long-distance operator's business. There was no possible purpose left, other than the anti-competitive one of deterring investment in long-distance networks that might compete with Telecom's own.

On the downside, however, the counterfactual suffers from two flaws. One is important though not crucial; the other, however, is fatal.

The important but not crucial one is the arbitrariness or artificiality of the counterfactual. As noted by Jim Farmer in his commentary on Gavil's paper, and talking about the “hot tub” process²⁵ in 0867, “The enthusiastic debate between the economists on each side, fuelled by the willing participation of the economist lay member of the Court, led to a focusing on the “correct” counterfactual rather than an analysis of the facts and the application of economic principle to them. Attempts that were made from time to time by counsel for the Commission²⁶ to bring the debate back to “real world reality” failed dismally in the over-heated intellectual climate that had been generated”, which illustrates the degree to which even economic experts may not be able to agree on the make-up of the counterfactual market.

In general, however, this problem with the artificiality or arbitrariness of the counterfactual is less of an issue for economists, who are professionally familiar with comparative statics and various forms of “with” and “without” analysis. But it particularly tends to bother lawyers²⁷, and business people, that important cases are being decided on what might or might not have happened in a contrived counterfactual universe:

“The application of monopoly rules based on hypothetical thought experiments, involving the creation of make-believe market structures and predictions of behaviour in make-believe

24 *Telecom Corporation v Commerce Commission* [2012] NZCA 78

25 A “hot tub” is where, to assist a court, economic (or other) experts are brought together to pool their views and, through debate, identify common ground and outstanding disagreements. The hot tub operates under High Court rules that require participants to bring their best professional judgement to the process and to avoid partisan position-taking.

26 Jim

27 Jim also pointed to a Court of Appeal tax avoidance case, *Alesco New Zealand Ltd & others v Commissioner of Inland Revenue* [2013] NZCA 40. Alesco took a counterfactual approach: if it hadn't set up the tax-minimising arrangements the Inland Revenue challenged, it could just as easily have set up alternatives with exactly the same effect. No dice, said the court at 38-9: “The tax avoidance provisions are concerned with an actual arrangement...[39] The question is whether the particular arrangement had the effect of avoiding or reducing any liability to income tax. It is not whether Alesco NZ would have been equally able to avoid or reduce its liability by implementing an alternative and permissible arrangement”.

worlds, is highly problematic”²⁸

The critical flaw, however, is that the test asks whether a company without market power, but otherwise in the same circumstances as the company with market power, would have engaged in the same behaviour. A company with market power can pass that test – *even if the effect of its behaviour, when carried out by a company with market power, damages the competitive process*. The whole point of the legislation has been bypassed, and the counterfactual test will consequently tend to throw up false negatives²⁹.

Here is Gavil's formulation of the point. He was commenting on a passage in the *0867* judgement where the court had said, restating the counterfactual test, that “The essential point is that if the dominant firm would, as a matter of commercial judgement, have acted in the same way in a hypothetically competitive market, it cannot logically be said that its dominance has given it the advantage that is implied in the concepts of using or taking advantage of dominance or a substantial degree of market power”. Gavil said that the proposition

wrongly infers that if a firm in a competitive market would have adopted the same practice, a firm with market power who adopts it cannot be said to be "taking advantage" of its market power. The proposition ignores the widely accepted fact discussed earlier: the consequences of the same conduct practised by a firm with market power will, especially when competition is at issue, be different when compared to a firm without it. As one commentator recently observed³⁰, it is a mistake to conclude from the fact that a business practice is "prevalent in competitive markets" that a firm "cannot readily use these practices to harm competition, either at all or on balance after accounting for efficiencies" and hence to further conclude that they cannot violate competition laws. Such prevalence "does not preclude the possibility that firms can also use those practices to obtain or maintain market power, and that those practices harm competition on balance when employed by firms exercising market power".

One final oddity of 36

“Take advantage” and its counterfactual lens are the key problem with s36, but “purpose” has also contributed its own difficulties.

As many commentators have pointed out, it is not always easy to distinguish perfectly legitimate actions where the purpose is to damage *competitors* from proscribed actions where the purpose is to damage *competition*, especially when management keen to demonstrate their efforts can send internal e-mails along the lines of “X will never be able to put together a package like this” or “This will crush Y”.

It is also questionable whether a purpose-based test adds anything to the reach or effectiveness of s36. “Purpose” in this context effectively means “intended effect”³¹, and an effects-based

28 Mark Berry, *op cit*, p154, and hence the title of this paper

29 They may be rarer, but the test also has the potential to throw up false positives, which will arise when the entity with market power behaves as a non-powerful company wouldn't in the counterfactual, but has good efficiency reasons for doing so which arise from its market power. An example might be its mandating an industry standard which could increase interoperability, to consumers' benefit. Under our current approach, the company has no opportunity to make that case.

30 Gavil was quoting from Jonathan B Baker "Taking the Error Out of 'Error Cost' Analysis: What's Wrong with Antitrust's Right" (2015) 80 Antitrust LJ 1

31 As it can do in ordinary English. The third main meaning of purpose in the compact edition of the Oxford

redefinition of s36 would serve just as well. The case law on s36 also allows purpose to be inferred from likely effect. It is true that in other (particularly criminal law) contexts “purpose” is sometimes regarded as sufficient in itself to come within the attention of the law: the bank robbers who meet in the warehouse to pore over the maps will be guilty of conspiracy, and the bank robbers whose getaway car breaks down on the way to the bank will be guilty of attempted robbery, even if no robbery has taken place in either case. But in other contexts “strict liability” can apply: the law takes no notice of good or bad intentions, and the directors of a company who sign off on inaccurate financial accounts, for example, even after taking professional advice and with no intention to mislead, can still find themselves in the dock.

A “purpose” to restrain, deter, restrict or eliminate in s36 is also both a strange way of describing the harm that the law attempts to prevent, and at odds with how harm is defined in other parts of the Commerce Act. In s27 (anti-competitive agreements), s30 (price fixing) and s47 (mergers) the harm is (properly) described as a substantial lessening of competition.

In sum it is difficult to argue with where the ACCC got to in its submission to MBIE on MBIE's targeted review of the Commerce Act:

- i. The current section 46³² fails to capture a range of anti-competitive conduct by firms with substantial market power. The Australian Courts have found that conduct by a firm with a substantial degree of market power does not involve a taking advantage of that power if a firm without substantial market power could engage in the same conduct. This ignores the very different consequences that can flow from the same conduct undertaken by a large firm versus a small firm in the same market.
- ii. The current purpose test in section 46 of the CCA is focussed on the impact of the conduct on individual competitors, not on the impact to the competitive process generally. This is inconsistent with the other sections of the CCA and the rationale for having competition laws, which is to protect the competitive process, not individual competitors.

The path to reform

As is evident, there have been ongoing difficulties on both sides of the Tasman with the legislation and jurisprudence around abuse of market power, and it has prompted some action towards reform.

In Australia, they opted for a wide-ranging review of competition law, including of their s46. The review, formally the Competition Policy Review³³ but often called the 'Harper review' after its chair, Professor Ian Harper, got on the case with commendable despatch and efficiency. The review was announced in December 2013, and got an issues paper out in April 2014, a draft report in September 2014, and a final report³⁴ in March 2015, dealing along the way with 350 submissions on the issues paper and 600 on the draft report.

It concluded³⁵ that

English Dictionary is “3. The object for which anything is done or made, or for which it exists; **the result or effect intended** or sought; end, aim”. [emphasis added]

32 The ACCC framed its submission by commenting on the equivalently worded s46 in the Australian legislation. Footnote omitted and typo corrected in para i.

33 <http://competitionpolicyreview.gov.au/>

34 <http://competitionpolicyreview.gov.au/final-report/>

35 Harper review, p340

the current form of section 46, prohibiting conduct if it has the purpose of harming competitors, is misdirected as a matter of policy and out of step with equivalent international approaches. The prohibition ought to be directed to conduct that has the purpose or effect of harming the competitive process.

It recommended³⁶ that

the primary prohibition in section 46 be re-framed to prohibit a corporation with a substantial degree of market power from engaging in conduct if the conduct has the purpose, effect or likely effect of substantially lessening competition in that or any other market. The prohibition would make two significant amendments to the current law. First, it would remove the 'take advantage' element from the prohibition. Second, it would alter the 'purpose' test to the standard test in Australia's competition law: purpose, effect or likely effect of substantially lessening competition. The test of 'substantially lessening competition' would enable the courts to assess whether the conduct is harmful to the competitive process.

The review recognised³⁷ that behaviour by a firm with market power can be a mixed bag:

conduct undertaken by a firm with substantial market power can have both pro-competitive and anti-competitive effects. For example, a firm with substantial market power may compete vigorously in a market through lower prices. If that is sustained through cross-subsidisation from another aspect of the firm's operation, it may limit the ability of other firms in that market to compete. The issue for the court, and for firms assessing their own conduct, is to weigh the pro-competitive and anti-competitive factors to decide if the cross-subsidisation involves a substantial lessening of competition³⁸.

The review's original draft idea on a pro-competitive defence got few takers³⁹, however, and in the end the review opted⁴⁰ for a different way to accommodate pro-consumer, pro-efficiency aspects of behaviour that would otherwise be suspect, namely a balancing exercise that would require a court to look at both pluses and minuses. Apart from being the conceptually correct thing to do, the balancing exercise ought (in my view) to go some way to alleviating the concern felt by some businesses that they might be exposed to unfairly prescriptive or uncertain law:

the preferable approach is to include in section 46 legislative guidance with respect to the section's intended operation. Specifically, the legislation should direct the court, when determining whether conduct has the purpose, effect or likely effect of substantially lessening competition in a market, to have regard to:

36 Harper review, pp340-1

37 Harper review, p344

38 A recent example was the ACCC's opposition to what the Aussies call 'shopper dockets', the petrol discount vouchers you get from supermarkets. The ACCC was of the view that very large discounts (of the order of 24-30 Aussie cents a litre) represented cross-subsidisation of the supermarkets' petrol outlets to the detriment of other petrol station chains' ability to compete. More detail at <http://www.accc.gov.au/media-release/coles-and-woolworths-undertake-to-cessupermarket-subsidised-fuel-discounts>. Personally I think the balance of pro-consumer and anti-competitive effects was misjudged, as I said here:

<http://economicsnz.blogspot.co.nz/2013/12/a-win-for-accc-petrol-will-be-dearer.html>

39 Among other things it included a 'counterfactual' element

40 Harper review, p344

- the extent to which the conduct has the purpose, effect or likely effect of increasing competition in the market, including by enhancing efficiency, innovation, product quality or price competitiveness; and
- the extent to which the conduct has the purpose, effect or likely effect of lessening competition in the market, including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market

The Australian government responded to the Harper review in November 2015, accepting many of its recommendations, but opting to have a further round of consultation on s46: “Given the importance of the misuse of market power provision, the Government will consult further on options for reform and release a discussion paper on this topic”⁴¹. The discussion paper duly arrived in December 2015⁴², there were 86 submissions, and the consultation period closed in February 2016.

As in other jurisdictions, reform of abuse of market power ends to be a difficult process, partly because of the inherent complexity of the issues but also because it can become highly politicised with some groups (typically larger businesses) seeing it as potentially threatening, while others (typically organisations representing smaller businesses) seeing a potential opportunity for rent-seeking. It was not surprising to see the Australian initial reaction, to send the s46 recommendations through a second consultation process of its own.

In mid March, however, the Australian government came to a decision. It backed the proposed Harper approach to reform of s46⁴³, saying that “Australia’s current misuse of market power provision is not reliably enforceable and permits anti-competitive conduct”, that “the amendment of Section 46 to deal with unilateral anti-competitive conduct is an important step to ensure Australia has the best possible competition framework to support innovation and boost economic growth and jobs”, and that “Conscious of the needs of business, the change is deliberately designed to reduce the uncertainty associated with amending a law. It uses existing legal concepts from within the competition law – such as ‘substantially lessening competition’ – and ensures the focus of the provision remains only on those firms that have substantial market power. This reform represents a commercially and legally robust law”.

It is currently not clear when the Australian government will make a decision, or whether the new post-election government will have enough backing from minor parties to get it through the legislative process, but the intent is clear, as are the implications for New Zealand being left as the sole jurisdiction with a “take advantage”/“purpose” regime.

In New Zealand, the initial running was made by the Productivity Commission. In March 2013 it was asked to undertake a study on 'Boosting services sector productivity', and it too moved along briskly: an issues paper in April 2013, an interim report in January 2014 and a final report in June 2014. It had not set out to be a principally competition-focused inquiry, but as it went along it

41 http://treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Competition%20Policy%20Review/Downloads/PDF/Govt_response_comp-policy_factsheet.ashx

42 http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Options%20to%20strengthen%20the%20misuse%20of%20market%20power%20law/Key%20Documents/PDF/doptions_marketpowerlaw.ashx

43 <https://www.pm.gov.au/media/2016-03-16/joint-media-statement-fixing-competition-policy-drive-economic-growth-and-jobs>

found⁴⁴ that

Competition laws and the institutions that implement them – competition agencies and the courts – have an important influence on the behaviour of firms and on competition outcomes.

New Zealand’s small market size, geographic isolation and the characteristics of many services make it important that competition law strongly supports competition in the services sector.

A key component of a competition regime is preventing firms from misusing market power to damage competition and dynamic efficiency...

Section 36 of the Commerce Act 1986 aims to prevent firms misusing their market power. It was drafted to be similar to the parallel section in Australian law, but New Zealand courts have diverged from Australian courts in interpreting it. New Zealand’s highest court has come to rely solely on a “counterfactual test”.

Sole reliance on the counterfactual test is problematic because it increases the risk that dominant firms escape sanction for conduct that suppresses competition and innovation. But any reform should still allow large firms to compete vigorously as part of the competitive process, and realise efficiencies beyond those possible for firms without market power.

The Commission believes there is a strong case to review s36 despite some opposition to change because of loss of certainty and the risk of unintended consequences.

The 2015 review of the Business Growth Agenda picked up on this, and MBIE were asked to “review the misuse of market power prohibition and related matters”. The related matters in MBIE's subsequent “Targeted review of the Commerce Act 1986”⁴⁵ were use of alternatives to Commerce Act litigation, such as settlements and 'cease and desist' orders, and the desirability or otherwise of 'market studies', proactive inquiries into the state of competition in markets).

MBIE produced an issues paper⁴⁶ in November 2015. As it was an issues paper, it did not come to any firm conclusion about s36, but noted that New Zealand's current approach is internationally rare among a range of comparator countries (and would be unique⁴⁷ if Australia changes as recommended by Harper and accepted by the Australian government).

It also listed a menu of potential options for change:

44 On p25 of the report summary, http://www.productivity.govt.nz/sites/default/files/services-inquiry-final-report-summary_0.pdf

45 <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act>

46 <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/targeted-commerce-act-review/issues-paper.pdf-1>

47 Gavil also found (op cit, p1068) that “Although a comprehensive canvassing of the world's competition laws is beyond the scope of this article, those laws are reflected in the policy statements and guidelines adopted by a variety of enforcement agencies around the world, including the European Commission (EC), the Canadian Competition Bureau (CCB), and the United Kingdom's Competition and Markets Authority (CMA), each of which has issued formal guidance documents in connection with their prohibitions of unilateral conduct by dominant firms. None appear to use an analytical approach like the counterfactual as it is applied in New Zealand” (footnotes omitted)

Table 2: Conduct that breaches the rule

	NZ	Australia	Australia (Harper)	EU	USA		Canada
Purpose versus effect	The purpose of their conduct is to exclude competitors from the market	The purpose of their conduct is to exclude competitors from the market	The purpose, effect or likely effect of their conduct is to substantially lessen competition	The effect of their conduct is to hinder the maintenance or development of the level of competition in the market ¹⁵	The effect of their conduct is to impair the opportunities of rivals ¹⁶		They undertake an 'anti-competitive act', ¹⁷ and the effect of their conduct is to prevent or substantially lessen competition ¹⁸
Causal connection	They take advantage of their market power	They take advantage of their market power	n/a	Not settled	The conduct contributes to the maintenance or enhancement of the monopoly power	The conduct contributes to the acquisition of the monopoly power	n/a

Table 3: Summary of potential options

Option	1		2	3		4	
Description	Status quo		Remove taking advantage requirement	Add an effects test		Remove taking advantage requirement and add effects test	
Variants	Current test 'as is'	Current test with added guidance	Powerful firm will be liable whenever it acts with exclusionary purpose	Powerful firm will be liable if it takes advantage of market power to act in a way that harms competition	Powerful firm will be liable if it takes advantage of market power (i) to act in a way that harms competition and/or (ii) with an anti-competitive purpose	Powerful firm will be liable if it acts in a way that harms competition	Powerful firm will be liable if it acts (i) in a way that harms competition and/or (ii) with an anti-competitive purpose

Thirty-nine submissions⁴⁸ were made before the consultation period closed in February. And there matters rested until, in a surprise move, the Commerce Commission wrote⁴⁹ on June 2 to its Minister, Paul Goldsmith. It noted that submitters were split - “Some, like us, support reform of section 36 of the Commerce Act (s36) or at least further consideration of the issues (there are 13 submissions in this category); others are resistant to reform (18 fall in this category)” - and also that “Perhaps unsurprisingly, those resistant to reform are large businesses and the advisors that represent them”.

48 Including mine, <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/submissions-received/Donal-Curtin-Redacted.pdf>. The full set of submissions is at <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/submissions-received-on-the-issues-paper-1>. Incidentally, submissions from other economic consultancies were noticeable by their absence: draw from that what you will.

49 <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/commerce-commission-letter-to%20Minister.pdf>

At a complete surmise, the Commission may have been spooked by the Minister's decision on the criminalisation of cartels. In December 2015, the Minister had said⁵⁰ that “In the current version of the [Commerce (Cartels and Other Matters) Amendment] Bill, criminal sanctions are also introduced to accompany civil sanctions for cartel behaviour”, a move that (like reform of s36) would have brought New Zealand in line with the usual comparators (Australia, the UK, the Eurozone, the US). The Minister noted that “The criminalisation of cartels has remained an issue of major contention with the Bill”, as has s36 for large companies. He decided that “on balance I have recommended that the criminalisation provisions be removed...In weighing up the benefits of criminalising cartel activity, the Government had to consider the significant risk that cartel criminalisation would have a chilling effect on pro-competitive behaviour between companies”.

Exactly the same argument can be made against changes to s36. BusinessNZ, for example, in its submission on the targeted review said this (and similar comments were made by a range of large companies):

BusinessNZ is particularly concerned that potential amendments would have a chilling effect on the legitimate commercial activities of New Zealand companies, or would prop up inefficient new market entrants. Competition law should not unduly impede legitimate business decision making but instead recognise the commercial dynamics and constraints at work in markets. An amendment that is neither required nor welcomed will stifle business activities, increase compliance costs and severely restrict commercial flexibility.

It is a fair point, though not the only or most important one, and it is possible that the Commission was concerned that it would carry the day unless contested, given the Minister's previous receptiveness to “chilling effect” lines of argument. Hence or otherwise, the Commission's letter consequently reiterated the arguments laid out in its submission⁵¹ to MBIE's review, added some extra case studies, specifically confronted the 'chilling' argument - “Submitters say that reform will 'chill' competitive conduct. There is simply no evidence to support that proposition, and we do not accept that competitive conduct in overseas markets with an 'effects test' has been chilled” - and finished by urging the Minister not to rush to judgement: “We therefore encourage you to continue to examine these important issues whether through an Options Paper, or via a cross submission stage”. The Minister agreed: in June he called⁵² for cross-submissions, due by July 21.

Conclusion

This is a difficult and vexed area of economics and law. As the Minister rightly said in calling for cross-submissions, “Section 36 is widely recognised as one of the most complex areas in competition law”, and there are good arguments for and against the status quo, and for and against alternative approaches.

From my perspective, I start from a reasonably pro-business standpoint. I am sympathetic to arguments that businesses with market power must be allowed (even required) to compete vigorously, and that the law and jurisprudence must be clear enough (as much as it can be in this difficult context) to avoid dynamic or other “chilling” inefficiencies.

50 <https://www.beehive.govt.nz/release/amendments-cartels-bill>

51 <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act/submissions-received/NZCC-Redacted.pdf>

52 <https://www.beehive.govt.nz/release/further-views-invited-competition-law>

But even from where I stand, I think it is reasonably clear that the status quo has failed. The test for anti-competitive behaviour is too weak: its design allows anti-competitive behaviour to slip through. It also risks misidentifying potentially pro-consumer behaviour. A switch to Australia's proposed approach – an “effects” test rather than a “purpose” test, a focus on a substantial lessening of competition, and an opportunity for companies to plead an efficiency defence – would serve us better.

If you agree, or even if you don't, I would suggest that you might like to take part in the cross-submission process. To date, there has been some input from Australian academics, and I'm pleased they have made the effort: now it's time for more of our own academic and consultancy communities to contribute their expertise to an important policy debate.