21 July 2016

Targeted Commerce Act Review
Competition and Consumer Policy
Ministry of Business, Innovation and Employment
PO Box 1473
WELLINGTON

By email

Email: commerceact@mbie.govt.nz

Targeted review of the Commerce Act 1986

INTRODUCTION

1. Russell McVeagh supports the Ministry's initiative to invite cross-submissions on the claims made in the original submissions to the Ministry on its targeted review of the Commerce Act and the Commerce Commission's supplementary submission.

2. Russell McVeagh's position remains as set out in our 9 February 2016 submission, namely that:

   (a) There is insufficient evidence that the current formulation of s36 of the Commerce Act is not effective. To that end, we do not support changes to s36.

   (b) We do support further consideration of the Commerce Commission's enforcement tools.

   (c) We do not support the introduction of market studies powers.

3. The purpose of this cross-submission is to:

   (a) respond to specific claims made in the original / supplementary submissions that require further comment;

   (b) comment on the implications of the subsequent (March 2016) announcement of the Australian Government that it intends to implement the so-called "effects test" market power prohibition in Australia; and

   (c) refer to any updating evidence that has emerged since our original 9 February submission.

4. In the interests of brevity, we do not intend to restate points made in our original submission (which we take as read) except to the extent necessary for 3(a) to (c).

Commerce Commission supplementary submission

5. There are a number of comments in the Commerce Commission's 2 June 2016 supplementary submission that we wish to respond to. These comments are as follows:

   (a) "*Perhaps unsurprisingly, those resistant to reform are large businesses and the advisors that represent them*".

   To the extent that this is an observation that large businesses - which would be targeted by the reform - are affected by the removal of the connection between market power and the conduct that is to be prohibited (by removing the "taking advantage" limb), it is not surprising those businesses would voice a concern about that. The proposal means large businesses may be at risk, even if they do not use their (alleged) market power.

   However, to the extent that this is an observation that advisors to large businesses object to the reform to protect those businesses, we strongly disagree. Russell McVeagh, like many large law firms, also acts for parties who wish to complain about misuse of market power, both large and smaller operators. Misuse of market power distorts the proper functioning of markets, so large businesses are as affected by misuse of market power as small businesses are. The Commission's investigation into Sky TV's misuse of market power in its dealings with Vodafone, Telecom, and CallPlus is a public and recent example, where the Commission found market power, and misuse of it, that affected large and small businesses alike.

   To suggest large firms have an interest in 'soft' market power law is wrong. The functioning of the market as a whole, and all participants in it, benefit from a clear law that prohibits <u>abuse</u> of market power (not the attainment of market power, or effective competition by large businesses).

   But the Commission's desired change results in a prohibition that applies to <u>all</u> conduct of a large business, irrespective of whether that conduct is linked to any use of market power or not. Large businesses are the most directly affected and so have a legitimate basis to submit on the proposal. They are concerned that it is unprincipled, and poor policy-making, to have laws that treat different classes of persons/businesses differently, without linking the relevant attributes that are alleged to make the harm more likely to occur. It would also make New Zealand an outlier internationally (the efficiency/business rationale defences overseas guard against this risk of different laws for different businesses - see further at 5(f) below).

   The controversial price signalling prohibitions in Australia provide an example of how problematic it is to have different competition laws apply to different types of businesses, with those prohibitions, although only recent, already in a process of reform.

   Furthermore, we note that Business NZ and Retail NZ, both of which are organisations that represent a range of businesses from large to small, have submitted in opposition to reform, demonstrating that there are not

widespread concerns with the existing s36 in the small business community.

(b) "*Section 36 is not effective*".

This is a mantra that has been repeated by the Commission numerous times over recent years. The Commission's prosecutor, Meredith Connell, in its submission similarly states that the Commission has "*little incentive to take a gamble on a section 36 case compared to, say, section 27 and 30 cases which, in general, have significantly greater prospects of success*."

However, these views are not borne out by the facts. The facts are that in contested substantive s36 cases over the last 16 years,[1] the Commission has had two wins and two losses (a 50% success rate). This includes successfully proving a breach of s36 in its most recent s36 prosecution in 2012, and achieving the largest ever penalty under the Commerce Act in that case.[2]

By contrast, in contested substantive s27[3] cases over the same period, the Commission has had one win and two losses (a 33% success rate). This includes the Commission losing its most recent contested s27 case in 2007.[4]

Even under s30, which is the *per se* prohibition on price fixing, the Commission has had one win and one loss in substantive cases - i.e. those not resolved through settlement - over this period (a 50% success rate). This includes the Commission losing its most recent contested s30 case in 2010.[5]

Looking at Australia, under Australia's similar prohibition to s36 (s46 of the Competition and Consumer Act 2010), the ACCC has been successful in 60% of actions over the last 16 years (including losing only two cases outright).[6]

The Commission seeks to support its arguments that s36 is ineffectual by referencing its own enforcement/prosecution decisions, rather than referencing decisions of the Courts. A more appropriate starting point for identifying whether there is a problem with s36 would be to consider Commission's application of s36, and only after that, then move on to consider s36 itself.

As ice hockey great Wayne Gretzky once said: "You miss 100% of the shots you don't take."

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1 Where the Commerce Commission has established jurisdiction.

2 *Commerce Commission v Telecom Corporation of New Zealand Ltd*, High Court, Auckland, 9/10/2009, CIV-2004-404-133; *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278, (collectively, "***Data Tails***").

3 Being "pure" s27 cases that did not involve a claim of s27 being breached by the deeming provision in s30.

4 *Commerce Commission v Pay of Plenty Electrical Ltd*, High Court, Wellington, 13/12/2007, CIV-2001-485-917.

5 *Commerce Commission v Siemens AG* (2010) 13 TCLR 40.

6 Luke Woodward and Matt Rubinstein "The use and misuse of section 46" (21 May 2016) Competition Law Conference, Sydney.

(c) "*The uncertainty 'should not be unduly significant as the change is to an existing test [equivalent to s 27] with which business are already familiar*".

The change would be significant.

First, we reiterate that the change the Commission is advocating for does not properly reflect the concept of "substantial degree of market power". A market where a participant has a substantial degree of market power is not a workably competitive market:[7]

> A business has substantial market power when it can profitably hold prices above competitive levels for a sustained period of time. Such a price rise will only be profitable if the business does not face effective competition from rivals in the same market.

Therefore, to base the prohibition on conduct that has the purpose or effect of substantially lessening competition in a market where that market already does not have workable competition seems inherently difficult in practice. This would, in effect, involve comparing a Counterfactual where there is already "no workable competition" with a Factual that is alleged to have "substantially less competition than no workable competition".

As set out in our original submission, the jurisdictions, like the US, that have effects tests have "exclusionary effects" tests, with defences for legitimate commercial conduct (which is similar to the test that our s36 has evolved to, with "purpose" being able to be inferred from objective conduct, and "taking advantage" having an overlay of conduct that would be unlikely to occur in a competitive market).

The US and other jurisdictions, such as the EU, do not have tests that start with a prohibition on conduct by a large firm that substantially lessens competition in the market as a whole. We cannot see such a reform being attractive in those jurisdictions because it sets too high a bar - it is more difficult to prove a net effect of substantially lessening competition (which has to look at the conduct of all actual and potential market participants to determine the effect on market of the behaviour) than it is to show market power or to show what a firm would rationally do in a competitive market (which are tests that focus only on one market participant). That is why New Zealand would be an international outlier if the Commission's desired change were made.

Second, there are good policy reasons to apply a different standard to unilateral conduct (s36) vis-à-vis contractual arrangements between third parties (s27 and s47). Businesses make decisions about their own unilateral conduct hundreds (if not thousands) of times per day. It is not possible to perform the same degree of competition analysis as it is for contractual arrangements with third parties, which typically arise in a more structured way, following negotiations, and potentially with the input of legal counsel.

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7 NZCC *Fact sheet: Taking advantage of market power* (June 2012), available at: <http://www.comcom.govt.nz/business-competition/fact-sheets-3/taking-advantage-of-market-power/>.

(d) "*The submitters do not attempt to describe what pro-competitive conduct they could not undertake with a reformed s 36.*"

First, it is inappropriate to criticise businesses for not attempting to describe any specific conduct in their submissions. In the context of a regulator strongly pushing for a new law, no business is going to publicly highlight its own specific conduct that could breach the proposed new law.

Second, the point has been that by removing the link between the conduct and the market power (i.e. by removing the taking advantage limb), even innovative and competitive conduct could be caught by s36 where it has the effect of taking sales from competitors (not just the usual candidates for assessment under s36 such as bundling, predatory discounting, exclusivity, input foreclosure etc). This could include:

(i) meeting the prices of competitors (which is inherently a rational competitive response), if that were to have the effect (even unintended) of driving less efficient competitors out of business;

(ii) introducing a highly innovative / desirable product (which is the type of outcome the Commerce Act is intended to encourage), if that innovation / new product was so successful that it put less innovative competitors out of business.

These are the types of pro-competitive outcomes the Commerce Act is intended to achieve, and these could all potentially be caught by the proposed reform to s36 (in particular in markets with barriers to entry). This would not be in the interests of consumers.

This is the problem with the suggested reform removing the nexus between the market power and impugned conduct. While the Commission may say that it would not prosecute conduct by businesses with market power that is intended to be pro-competitive, those businesses should not be at the mercy of the prosecutorial discretion of the Commission (or the vagaries of subsequent developments in competitive dynamics in the market). The law, not the Commission, should specify the nature of conduct that is intended to be prohibited so that businesses can operate within a sufficiently certain regulatory framework.

(e) "*Submitters say that reform will 'chill' competitive conduct. There is simply no evidence to support that proposition*."

The submissions themselves are evidence of this proposition. The decision makers within the businesses that could be subject to the reformed s36 are saying that their decision making will be slowed and more conservative and that inevitably competitive initiatives will be chilled.

The legal advisors to those businesses have submitted that the reformed s36 will be more difficult to advise on in practice. Again, decision making will be slowed and more conservative and competitive initiatives will be chilled.

Furthermore, the US Department of Justice (as referred to in our first submission) and the International Competition Network consider that an effects-based test is indeed likely to create a chilling effect:[8]

> The effects-based approach tends to lead to a more accurate assessment of a particular case. However, because this approach generates fact-driven outcomes, it tends to lead to greater delays and costs for the agency and those under investigation. The approach also makes it more difficult for business planners and counsel to predict whether specific conduct is likely to result in an infringement decision. **This uncertainty may result in a chilling effect, as firms avoid conduct that may in fact be procompetitive and lawful**. [Emphasised added]

In addition, even setting aside the substance of any reformed s36, the very act of changing settled and well understood law, and discarding 30 years of precedent, with a new and internationally novel prohibition would increase uncertainty for businesses and likely chill competitive initiatives. In those circumstances, there would need to be a strong case for reform before any reform is implemented.

In the ever more competitive and fast-moving world of global commerce, New Zealand needs to be moving to an economy where businesses can make decisions faster, not an economy where large businesses are hamstrung by complex and untested prohibitions.

(f) "*We do not accept that competitive conduct in overseas markets with an 'effects test' has been chilled.*"

The Commission provides no basis for this assertion, based on experience or empirical analysis (as well as confusing what is an "effects test" in those overseas jurisdictions, the point already covered above).

The point we made in our original submission is that in Europe, a more "rules based" approach to misuse of market power is taken (which in our view is further removed from an effects test than the test we have in New Zealand today), including the addition of the "special responsibility" doctrine. In the EU, as a consequence, the threshold for proving misuse of market power is effectively lower. Our lawyers with experience practicing in both New Zealand and the EU can say, based on their experience, that in the EU otherwise competitive conduct, such as loyalty rebates, for example, are not pursued by businesses with market shares in excess of 40%-50% because they are concerned that would be treated as a misuse of market power by the European Commission. That chills discounts that would otherwise be available to loyal purchasers of those businesses' products, removing low pricing from the market, leading to consumers paying more for those products.

Such an outcome would be even more detrimental in a small economy like New Zealand's, where businesses need to have a reasonable market share to gain the efficiencies required to enable them to efficiently compete internationally and where (consequently) many markets can only support one or two competitors.

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8 International Competition Network "Unilateral Conduct Workbook" Presented at the 11th Annual ICN Conference, Rio de Janiero, April 2012.

The statement also appears to be premised on the notion that New Zealand's required "taking advantage" nexus between the firm's market power and the impugned conduct, and its reference to anti-competitive purpose, makes New Zealand an outlier internationally. It does not.

Most jurisdictions have as part of their misuse of market power provision a form of nexus between market power and the conduct or its effect, and a requirement of anti-competitive purpose, which means they should not properly be regarded as having an "effects test" of the nature the Commission is advocating for in New Zealand. For example:

(i) In the US, there is a requirement to obtain or maintain monopoly via "improper means" to distinguish unlawful and lawful conduct. Case law also refers to the requirement of "wilful acquisition or maintenance" of monopoly power, as opposed to natural accumulation and/or growth.[9] Additionally, the defendant has a "pro-competitive justification" defence available to them if their conduct is proven to have an anticompetitive effect.[10]

(ii) The Canadian Competition Act provides for an abuse of dominance through "anti-competitive acts", with the statute including a non-exhaustive list of "anti-competitive acts" (for example margin squeezing and pre-emption of scarce facilities). The Canadian Federal Court of Appeal has stated that an anti−competitive act is defined by reference to its purpose, and the requisite anti−competitive purpose is an intended negative effect on a competitor that is predatory, exclusionary, or disciplinary.

(iii) Singapore's Competition Act uses the concept of "abuse" of a dominant position. This requirement allows legitimately competitive conduct (e.g. dominance arising through efficiencies, or innovation) to remain uncaught.[11] When assessing the alleged abuse, the Competition Commission of Singapore is able to consider whether the conduct is objectively justified, or is proportionately beneficial to the firm.[12]

That nexus between market power and conduct is also implemented in the EU through the concept of "abuse", but with the additional imposition on firms with market power of a "special responsibility" not to impair genuine undistorted competition. Implementing a "special responsibility" on certain New Zealand businesses would be a radical regulatory change, and before implementing such a step careful consideration would need to be given to whether New Zealand wants to aspire to the US model of innovation and competition or the more rules based

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9 *United States v Grinnell Corp* 384 US 563 (1966) at 571.

10 Barry Hawk "International Antitrust Law and Policy: Fordham Competition Law 2014" (1 March 2015, Juris Publishing) at 256.

11 Competition Commission Singapore "CCS Guidelines on the Section 47 Prohibition" at 8. Accessed at https://www.ccs.gov.sg/legislation/~/media/custom/ccs/files/legislation/ccs%20guidelines/s47jul07final.ashx

12 Competition Commission Singapore "CCS Guidelines on the Section 47 Prohibition" at 9. Accessed at https://www.ccs.gov.sg/legislation/~/media/custom/ccs/files/legislation/ccs%20guidelines/s47jul07final.ashx

European model, which has frequently been characterised as focussing more on the protection of competitors than competition.

Furthermore, proper consideration would need to be given to consistency with the National-led Government's Statement on Regulation: [13]

> But regulation also has costs and can have unintended effects. Outdated, poorly conceived and poorly implemented regulation can significantly hinder individual freedom, innovation, and productivity. Reducing the burden imposed by such regulation will help unshackle our economy and give New Zealanders more ability to shape and improve their own lives.
>
> New Zealand needs to offer a better policy environment than can be found elsewhere if we are to overcome the economic disadvantages of our small size and geographical isolation, and attract and retain increasingly mobile talent, skills, capital, technology and entrepreneurship.

(g) "*Winstone Wallboards and Sky Television investigations are good examples of where s36 has effectively provided a safe harbour for conduct by large firms.*"

In relation to Sky TV, we do not see that that s36 provided any such safe harbour. In fact, the Commission found that Sky TV's agreements were likely to breach s36. However, for other reasons the Commission chose not to take any action in respect of Sky TV.

In relation to Winstone Wallboards, the Commission's view (as expressed in its investigation report) was that it could not find a s36 breach arising from Winstone Wallboard's rebate arrangements because rebates are found in competitive markets:[14]

> Given rebates are found in competitive markets, it is difficult on that basis alone to distinguish between rebates that raise competition concerns and those that do not. Therefore, we cannot conclude that there has been a breach of section 36.

With respect, on its face that appears to be overly simplistic application of the Counterfactual test that simply looked at the type of conduct (i.e. rebates) rather than analysing the specific conduct in question (i.e. recognising that not all rebates are created equally). The Courts in Australia have cautioned against taking an overly simplistic approach to Counterfactual analysis. For example, in the *Cement Australia* case,[15] the court "made it clear that the counterfactual analysis must focus on the particular conduct in question, and not on forms or categories of conduct".[16]

Finally, as noted in our first submission, both of those investigations related to agreements, so were examined under s27. The Commission

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13 The Treasury *Government Statement on Regulation: Better Regulation, Less Regulation* (21 September 2015), available at: <http://www.treasury.govt.nz/regulation/informationreleases/statement>.

14 NZCC *Investigation into Winstone Wallboards Limited*(22 December 2014).

15 *ACCC V Cement Australia Pty Ltd* [2013] FCA 909.

16 Luke Woodward and Matt Rubinstein "The use and misuse of section 46" (21 May 2016) Competition Law Conference, Sydney at 16.

also took no enforcement action under s27. Any s36 "safe harbour" is entirely irrelevant to an enforcement decision under s27.

(h) "*In doing so the Commission had to ignore Air New Zealand's commercial realities and the impact on the market of the conduct, and ask a purely hypothetical question.*"

The hypothetical nature of Counterfactual analysis is not unique to the current s36 prohibition. The substantial lessening of competition test in s27 and s47 are also premised on a hypothetical assessment of what would occur in the hypothetical scenario without the contract/merger. The Commission cannot move away from the need to adopt hypothetical counterfactual analysis by achieving its desired reform of s36.

In fact, the hypothetical counterfactual analysis under s27 and s47 is arguably more complex than under s36 where, unlike under s36, the Commission needs to:

(i) consider "multiple Counterfactuals";

(ii) consider the nature and degree of competition in the hypothetical Counterfactual(s) some years into the future;

(iii) compare the degree of competition in the market in the future Factual against the degree of competition in the potentially multiple future Counterfactuals, which requires looking at the likely conduct of all actual and potential market participants and likely market/technological developments (rather than just focusing on what the economic incentives of one firm would be in a competitive environment).

Australian developments

6. We note that in March 2016 the Australian Government announced that it intends to implement the so-called "effects test" market power prohibition in Australia.

7. For the reasons outlined above and in our first submission, we consider there are significant flaws with adopting that model of market power prohibition, and that it will inevitably lead to increased business uncertainty, more conservative decision making, and the chilling of competitive conduct.

8. In that context, alignment with Australia is not of itself sufficient reason for making a change to New Zealand law. Consistent with the National-led Government's statement on the introduction of new regulation, there would need to be conclusive evidence of a problem to justify the introduction of a law change that brings in increased uncertainty and compliance costs, and that the benefits of the new regulation would outweigh the costs.[17]

> We will introduce new regulation only when we are satisfied that it is required, reasonable, and robust.
>
> …

17 The Treasury *Government Statement on Regulation: Better Regulation, Less Regulation* (21 September 2015), available at: <http://www.treasury.govt.nz/regulation/informationreleases/statement>.

> To this end we will:
>
> Resist the temptation or pressure to take a regulatory decision until we have considered the evidence, advice and consultation feedback, and fully satisfied ourselves that … the benefits of the preferred option not only exceed the costs (taking account of all relevant considerations) but will deliver the highest level of net benefit of the practical regulatory options available

9. In our view, the arguments for s36 reform fall well short of this threshold.

Enforcement tools

10. As set out in our earlier submission, we support further consideration of the Commerce Commission's enforcement tools. Such consideration should give weight to options that will reduce the costs and burdens of the Commerce Commission's processes, whilst also protecting the rights of those under investigation.

11. Our view is that reforms facilitating alternative dispute resolution ("**ADR**") options, including arbitration, should be considered, as well as better use of technology in the swift and cost effective resolution of matters before the Commission.

Market studies

12. We reiterate our view that there is no gap in New Zealand's institutional settings for promoting competition. Between the Ministry, Commerce Commission, Productivity Commission, Financial Markets Authority, and Electricity Authority, there are number of Governmental and regulatory agencies that have powers of inquiry that enable them to inquire into whether markets are operating efficiently.

13. The introduction of any additional market studies powers will simply increase the regulatory burden on businesses (as the agency that receives those powers will inevitably feel the need to use them irrespective of need), and those (significant) costs will invariably be passed on to consumers. Consistent with paragraph 8 above, there would need to be conclusive evidence of a problem to justify the introduction of increased compliance costs, and conclusive evidence that the benefits of the new regulation would outweigh the costs. In our view, the arguments for market studies fall well short of this threshold.

14. We also reiterate our concerns that the capabilities of the Commerce Commission to enforce the Commerce Act will be further limited if it is required to also conduct highly resource-intensive market studies. Evidence of this is demonstrated by comments earlier this month from the acting head of the UK Competition and Markets Authority ("**CMA**"), Andrea Coscelli. Mr Coscelli advised that the CMA's enforcement of Competition Act cases is being neglected as a result of the staffing and resource demands of major market studies.[18] Coscelli emphasised the need to balance the benefits of market studies against the cost - noting that market studies are "potentially a very expensive way" of assessing specific industry regulations/policy outcomes.

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18 Tom Madge-Wyld "'We don't have enough people' for cartel and abuse cases, says CMA head" Global Competition Review (5 July 2016). Accessed at http://globalcompetitionreview.com/news/article/41389/we-dont-enough-people-cartel-abuse-cases-says-cma-head.

Other submissions

15. We have reviewed all the submissions provided to the Ministry, and note that several appear to be seeking to re-traverse issues that were properly considered and dealt with in the context of the consultation on the Consumer Law Reform Bill during 2010 - 2013 and, therefore are outside the scope of the Ministry's current consultation process (e.g. the Food & Grocery Council submission). We do not see merit in seeking to re-litigate those matters so soon after they have been considered by the Government / Parliament, and would caution against the current consultation process being side-tracked by issues that are out of scope. In our view, the Ministry should remain focussed on the issues outlined in its Issues Paper.

Concluding comments

16. Thank you again for the opportunity to cross-submit to the Ministry on its targeted review of the Commerce Act. Our comments in this cross-submission are again designed to assist the Ministry to make recommendations that best achieve the purpose of the Commerce Act.

17. Russell McVeagh is available to make an oral presentation to the Ministry and its officials if requested.

18. All enquiries on this submission may be directed to the authors noted below.

Yours faithfully
RUSSELL McVEAGH

Sarah Keene | Troy Pilkington | Christopher Graf
Partner | Senior Associate | Senior Associate