Targeted Review of the Commerce Act 1986: Issues Paper

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Contents

1 Introduction 3
2 Anti-competitive conduct: consideration of an effects test 3
3 Enforcement mechanisms 5
4 Market studies 5

1 Introduction

Thank you for opportunity to comment on submissions made to the Ministry of Business, Innovation and Employment Issues Paper, *Targeted Review of the Commerce Act 1986* (the **Issues Paper**) and the further letter from the Commerce Commission to the Minister of Commerce and Consumer Affairs on this issue.

2degrees supports a stable and predictable legal framework to promote investment. However it is clear that the current Commerce Act (**Act**) does not achieve its intended objective of promoting competition in markets for the long term benefit of consumers within New Zealand.

2degrees has reviewed the responses to the Issues Paper and continues to support improvements to address the effectiveness of the regime as set out in its initial submission, including:

- Further consideration of an effects test to more effectively address and deter anti-competitive conduct;
- Potential changes to enforcement mechanisms, including consideration of an enforceable undertakings regime alongside the existing settlements process; and
- Consideration of providing the Commerce Commission with a power to undertake competition-related market studies.

2 Anti-competitive conduct: consideration of an effects test

We continue to support consideration of a section 36 effects test (the Act's misuse of market power provision).

As an investor in competitive services for New Zealand consumers we are concerned that both the competition regulator and Productivity Commission do not consider the current legislation fit for purpose.

Sustained competition is well-recognised as a key driver of economic efficiency and growth. However, the Commerce Commission has repeatedly indicated that it does not believe section 36 is effective in promoting competition in New Zealand markets for the long term interests of New Zealand. The Commerce Commission has identified the Courts' interpretation of the "taking advantage of" limb of the section 36 test as being of particular concern (including in submissions on the Issues Paper).

The Commerce Commission's view is supported by the Productivity Commission. In its final report on boosting productivity in the services sector, the Productivity Commission concluded that "[t]*he current law and jurisprudence under section 36 of the Commerce Act is not working well and risks causing losses of dynamic efficiency through failing to identify some cases where firms use their market power to restrict the ability of other firms to innovate and compete*".[1]

We consider that an effective misuse of market power provision is especially important for a small economy like New Zealand. This is particularly the case given New Zealand's light-handed regulatory approach (which relies on generic competition legislation), its permissive merger regime and highly concentrated markets.

[1] New Zealand Productivity Commission, Boosting productivity in the services sector, May 2014, p133.

An ineffective and narrowly interpreted misuse of market power provision has the potential to undermine substantial competition benefits in the form of long term efficiencies, investment and innovation, and ultimately New Zealand economic growth (as highlighted by the Productivity Commission). We expect the Government, responsible for the legislation the Commerce Commission enforces and ultimately to NZ Inc., will also be concerned with these assessments and in our view will need to address this as part of any Act review.

Having reviewed submissions on the Issues Paper it is no surprise that larger organisations support the status quo. However, in our view the arguments against an effects test are likely to be overstated. We agree with submissions that note:

- The test should not protect competitors but the competitive process. In our view none of the proposals are aiming to protect competitors. Consideration of the impact on the competitive process requires that a longer term view is taken rather than focussing on short term efficiencies.
- Certain conduct can harm the competitive process when undertaken by a firm with substantial market power, but not when undertaken by a firm without market power (for example loss-leader pricing, cross-subsidisation and exclusive dealing). It does not make sense to ignore the commercial impact of an action when there is clear anticompetitive harm. This is well-understood and recognised internationally and makes the current reliance on the counterfactual test/"taking advantage of" purpose inappropriate.
- The introduction of an effects test should not overly chill investment and increase uncertainty: businesses already apply an effects test (in addition to a purpose test), in their daily decisions in respect of contracts, arrangements or understandings with other parties under section 27 of the Act. Section 27 applies to the "entering into" and "giving effect to" contracts, arrangements or understandings. Therefore businesses are already continually assessing the effects of their arrangements with other parties on competition. We appreciate the initial concern that a change could make large firms more cautious in introducing new initiatives however it is unclear what pro-competitive innovation would be prevented (for example, what innovation has been suppressed overseas as a result of implementing an effects test).
- An authorisation process may be an appropriate consideration to address concerns where an action is expected to result in long term net benefits, despite competitive harm. Alternative regulatory mechanisms can be used to address long term structural issues in specific markets (such as certain wholesale telecommunications services) but this is *ex ante* regulation, and not a substitute for *ex post* consideration of services not currently regulated.
- Alignment with overseas jurisdictions is not an end in itself. While we consider legislation should be considered on a country by country basis on its merits, it is notable that the US, EU, Canada, UK and now Australia, have or are shifting to an "effects" based test rather than having a purpose focus, and that if New Zealand does not also shift towards an effects-based approach it would become more of an outlier in this respect. This will have implications for legal precedent going forward.

Conversely, we find it difficult to agree with submitters that state there is no evidence for a change and section 36 is a strong deterrent to misuse of market power conduct when the Commerce Commission itself has indicated it that it is unwilling to take many cases and given the legal precedent to date. Given that many markets in New Zealand are concentrated and dominated by a few participants we query whether the existing test, and its application, is capturing conduct that is harming New Zealand consumers. We have previously indicated our concerns with the length and resources cases under the Act take (over a decade for cases in the telecommunications industry), plus importantly the detrimental impact on competition and consumers as these cases work their way through the legal system.

That said, we acknowledge competition law cases can be factually complex, regardless of the test applied, and that changing to an effects test is not a panacea. Overall we consider the benefits of amending the legislation will outweigh the costs, recognising that there will be some transitional costs of amendments.

3 Enforcement mechanisms

Cease and desist/injunction mechanisms

As set out in our initial submission we see value in the Commerce Commission being able to intervene on an urgent basis where it considers there are breaches of competition law, but recognise that the cease and desist regime has not been used nearly as often as expected.

The Commission has clarified in its responses to the Issues Paper that it considers injunctions provide a more effective and efficient method of stopping harmful conduct, and that it does not consider the lack of use of cease and desist orders has affected the Commission's ability to achieve appropriate enforcement outcomes. Given this is the case, we consider it may then be appropriate to repeal the cease and desist orders and continue to use the injunction mechanism to address cases where urgent intervention is required.

Settlements/Enforceable Undertakings

We continue to support a review of the alternative enforcement mechanisms currently set out in the Act, particularly given the time and costs associated with litigation under the Act.

This includes considering the merits of an enforceable undertakings regime that accepts both structural and behavioural undertakings to address potential competition issues that may arise (with appropriate checks and balances to address natural justice considerations and any future changes in situation). We note the Commerce Commission considers this to be a useful additional to their toolkit and consistent with recent amendments to the Fair Trading and Credit Contracts and Consumer Finance Acts.

We consider that there also continues to be a role for other enforcement mechanisms such as out-of-court settlements and compliance advice or warnings, which can address anti-competitive behaviour and educate market participants.

4 Market studies

As noted in our initial submission market studies can play an important role in assisting the regulator in better understanding markets where it has concerns, and identify whether or not there are market problems or regulatory barriers (if any) that may need addressing. In some cases, it will identify no further action is required.

We consider the Commerce Commission is likely to be well-placed to carry these market studies given its competition and industry expertise, however studies could be initiated by the Commerce Commission or the Minister. Any study should result in recommendations that are non-binding, however we support a response being provided within a reasonable timeframe to ensure the findings are considered and the regime effective.

Issues regarding a potential conflict of interest between carrying out the study and enforcement may be overstated. We note multiple overseas countries have market studies carried out by the competition regulator and consider these beneficial.

That said, we recognise concerns about introducing unwarranted costs and we agree market studies should focus on how a market operates/potential market failures rather than specific firms. Further, if a market study power is adopted, it is not clear whether information gathering powers are required. In any case, even if such powers are introduced we expect most cases could be addressed through voluntary requests rather than using statutory powers, and agree these powers should be used sparingly. Any request should be targeted rather than a very broad request, which has higher compliance costs.