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24 March 2016

Targeted Commerce Act Review
Competition and Consumer Policy
Ministry of Business, Innovation and Enterprise

By email: commerceact@mbie,govt.nz

Dear Sir/Madam,

Targeted Review of the Commerce Act 1986: Air New Zealand response

1. Air New Zealand welcomes the opportunity to comment on the Ministry's *Targeted Review of the Commerce Act 1986* (**Review**). Our comments focus on the Report's discussion of anti-competitive exclusionary conduct proposal and the issue of market studies. While we have not answered each of the questions posed by in the Review, we have indicated in parenthesis where our submission is relevant to a particular question in the review.

Background and summary

2. As New Zealand's national airline Air New Zealand operates more services in New Zealand than any other airline, but we are relatively small by international standards, and compete with a number of significantly larger airlines (both internationally and domestically). Given the highly competitive nature of airline markets, the efficient operation of the market power prohibition, and the proposed market study function, are both particularly relevant to the aviation industry.

3. We have previously provided a submission to the Productivity Commission on the reform of section 36 of the Commerce Act 1986 (section 36), a copy of which is attached for information and which is expanded upon in this submission. We have also had the opportunity to review the submissions of both Bell Gully and BusinessNZ, both of which we refer to.

4. Air New Zealand urges the Ministry to be particularly mindful during the Review to ensure that any reform (question 7):

   a) is made with a view to increasing the certainty of the legislation and allowing businesses to understand the law. Any reform that does not achieve this aim will create additional uncertainty and costs for business resulting in unnecessarily conservative business decisions; and

   b) takes into account the unique operating environment in New Zealand, in particular the size of the economy and the need for New Zealand businesses to compete globally or against overseas competitors.

5. Based on these two factors, and for the reasons discussed further below, Air New Zealand does not consider that section 36 requires amendment. Similarly, the introduction of market studies would create costs for both business and government, without any clear benefit over and above the current regulatory regimes.

Market power prohibition

6. Air New Zealand has a good working relationship with the Commission, and has been involved in market power investigations, both as the subject of the investigation and as a third party. We are therefore well placed to comment on the application of section 36, and the implications for business involved in a section 36 investigation.

7. We set out below some comments on the Review's framework for assessment, and how the current section 36 compares to the Review's proposed alternatives, in particular an effects-based test. In assessing proposals for reform, the Ministry must demonstrate that any proposed alternative better meets the framework relative to the current test (question 21).

Long term benefit of consumers

8. The Review does not clearly demonstrate that section 36 does not currently ensure the long term benefit of consumers (question 9).

9. Objections to section 36 on the basis that it can lead to uncertain results are overstated. Air New Zealand does not agree with the Ministry's view that the current section 36 is particularly prone to Type I or Type 2 errors, such that section 36 may not effectively assure the long term benefits of consumers (question 9).

10. The Review's Type 1 example is a firm with market power achieving greater efficiencies than the same conduct carried out by a firm without market power. However, if a firm is able to achieve such efficiencies, the conduct is unlikely to satisfy the 'purpose' limb of the test, as the firm should be able to show that such efficiency enhancing conduct was not for an anti-competitive purpose.

11. The Review's Type 2 example is a firm undertaking anti-competitive exclusive dealing, where that exclusive dealing might also be a feature of a competitive market. While it is correct that this may not be captured by section 36, the conduct will be subject to the significant lessening of competition test set out in section 27, as such conduct will be part of an contract, arrangement or understanding.

12. Alternatives for reform come with greater potential for both under and over enforcement. Effects-based tests may not necessary lead to more enforcement of section 36. Other than cartel offences (where an anticompetitive effect is deemed form the conduct), the Commerce Commission (and the ACCC in Australia) has not had great success in bringing enforcement action under current effects-based prohibitions. Many prohibitions in the Commerce Act deem conduct to substantially lessen competition, illustrating the difficulty in assessing effect for both businesses and regulators, even in hindsight.

13. Notwithstanding this lack of enforcement, there is also the possibility that an effects based test would chill pro-competitive activity, due to the uncertainty created by such a test (discussed further below). The US DOJ recognises that a key aspect of Type I error analysis is the loss of procompetitive conduct by businesses, due to an overly inclusive or vague prohibition, who are deterred from undertaking such conduct by enforcement action.[1]

[1] U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (2008).

14. A reluctance to undertake effects based analysis is illustrated by the very limited use in recent years of the authorisation process under section 58 of the Commerce Act.[2]

Simplicity

15. Despite the issues raised in the Review, Air New Zealand has found that the current section 36, and in particular the "taking advantage" limb, relatively simple to apply to its own conduct and the conduct of its competitors. As set out in the Report, there is a substantial and consistent body of case law from both the Privy Council and the Supreme Court which sets out how the counterfactual test applies in practice ie. whether a non-dominant firm otherwise in the same position would have acted the same way in a competitive market.

16. As the Review acknowledges, the rule provides businesses with certainty *ex ante* as to whether conduct is lawful, minimising the risk of a chilling effect on legitimate business activities. Air NZ agrees with the Review (question 10) that the current test is sufficiently predictable, easy to apply and generally understood not just by lawyers but also by business managers. As stated by the Privy Council, section 36 "must be construed in such a way as to enable the monopolist, before he enters upon a line of conduct, to know with some certainty whether or not it is lawful".[3]

17. Air New Zealand does not agree that section 36 is too complex to ensure that it is cost effective and timely (question 11). The Review bases this conclusion on the fact that the evidential burden is a high one. However, as set out in this submission, there are a number of reasons why a high standard for the misuse of market power, and that the evidential burden being on the plaintiff, are necessary and appropriate to ensure that section 36 does not inadvertently prohibit pro-competitive conduct.

18. An effects based test is not simple, certain, or predictable. It requires a business to look beyond its own intentions and strategies, which are certain, and predict the effects of its conduct, including on potentially unpredictable competitors and in changing market conditions. These consequences are not, entirely inconsistent with the principles developed by the Privy Council (see paragraph 12 above).

19. In addition, distinguishing between pro-competitive and anti-competitive conduct in any particular case is extremely complex and expensive. Competition is by its very nature intended to have an effect on competitors. As Judge Easterbrook, of the US Court of Appeal, observed:[4]

> Aggressive, competitive conduct by any firm, even one with market power, is beneficial to consumers. Courts should prize and encourage it. Aggressive, exclusionary conduct is deleterious to consumers, and courts should condemn it. The big problem lies in this: competitive and exclusionary conduct look alike.

20. An effects test would require businesses to make an *ex ante* assessment of the likely future effect of its conduct and assess whether this conduct falls over the line in terms of competitive v anti-competitive conduct, or risk an extremely complicated and expensive enforcement process. In many cases it will be simpler and more cost effective for the business to simply refrain from that conduct, whether or not it is pro-competitive. Air New Zealand's view is that it

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[2] Section 58 allows for authorisation of restrictive trade practices where the public benefits of the practice will outweigh any anti-competitive effects.

[3] Telecom v Clear [1995] 1 NZLR 385 (PC).

[4] Frank H. Easterbrook, When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?, 2003 Colum. Bus. L. Rev. 345, 345.

is crucial that any reform avoid encouraging the business community to take a business risk averse approach to decisions.

Alignment with other provisions

21. Alignment of section 36 with other provisions in the Commerce Act is not a compelling reason to introduce an effects test (question 12). As the Review states, most competition law regimes treat multilateral conduct more harshly than unilateral conduct. There are sound policy reasons for this, as set out in the *Copperweld* judgment to which the Review refers.

22. The Review classifies the Australian and New Zealand test as outliers internationally, comparing them to other jurisdictions with an effects based test. However, the categorisation is overly simplistic - the distinction between purpose and effect is not always clear cut. For example, the US test requires a wilful intent specific intent to monopolize[5], which is equivalent to a purpose element, and has also developed a number of bright line tests which removes the need for a full effects based test. In New Zealand, the effect of unilateral conduct is one factor in assessing the purpose limb under section 36.[6] Finally, many overseas jurisdictions use 'purpose' as an essential element and 'effects' as an additional test, not an alternative. Such a simple comparison also fails to recognise the differences in application between the different regimes. There are, for example, vast differences in the application of US and EU unilateral conduct laws. One such difference is the EU concept of "special responsibility" for large firms, which contrasts sharply with the narrower application of the monopolization prohibition in the US.

Appropriateness to a small and remote economy

23. Whether or not section 36 aligns with similar prohibitions in other jurisdictions, the focus of the Review must be on whether the current section 36 is appropriate in the New Zealand context. While Air New Zealand operates internationally and supports consistency of laws and their application wherever practical, any form of harmonisation should only occur where there is a clear benefit to doing so.

24. The Review notes that commercial sectors in New Zealand tend to attract fewer strong market entrants, the reason is simply that there is less money to be made. This is largely correct, although another reason is simply that a certain size is required in order to achieve sufficient economies of scale to make a product/service viable, and that the total size of the market is just not sufficient for two firms to achieve that scale. One example was included in our submission to the Productivity Commission - 'thin' airline routes, being regional or international airline routes that only have sufficient patronage to support one airline. In these instances, competition is often "for the market", and given the size of the market are only marginally profitable even with a single carrier. Air New Zealand is constrained in its pricing decisions by the potential entry of competitor airlines, as has in fact occurred by the recent introduction of new regional services by Jetstar, part of an airline group many times larger than Air New Zealand.

25. Air New Zealand's view is that New Zealand small and remote economy supports the current interpretation of section 36:

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[5] See U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (2008).

[6] *Telecom Corporation of NZ Ltd v Commerce Commission [2012] NZCA 278*.

a) while section 36 should not be aimed at protecting "national champions", it should acknowledge the international market within which many New Zealand businesses compete, and the constraint provided by large international businesses;

b) given the small size of the New Zealand economy, competition is often 'for the market', requiring businesses to continuously monitor the threat of potential competition. As set out above, many of the markets in which Air New Zealand is the only direct operator are only marginally profitable given the size of the market;

c) as noted in Bell Gully's submission, the smaller scale of New Zealand's firms makes ensuring compliance with the law relatively more burdensome. This amplifies the chilling effect of an effect based test;

d) to the extent that there are higher entry barriers into New Zealand markets, as suggested by the Productivity Commission, the focus of any regulatory reform should be to lower these barriers to encourage entry, rather than limit the ability of incumbents to react to the threat of entry.

Market studies

26. We agree with and endorse the submissions of Bell Gully and BusinessNZ in relation to the need for a market investigations power in New Zealand, with the key points summarised below:

    a) market studies are expensive and time consuming for all parties involved;

    b) many of the issues that a market studies function would be tasked with solving are already adequately addressed through existing investigatory powers of the Commerce Commission and other government agencies, as the Review acknowledges; and

    c) imposing a further research function on the Commission will further stretch their already limited resources. In addition, there will be limited if any benefit from increasing Commission resources to provide for such studies.

27. In addition to the points raised above, if any market investigation power is adopted, whether for the Commission or for another regulatory body, it must clearly focus on market failures, rather than on any individual or small group of companies. Anything that could allow for investigation of individual companies risks unnecessary expanding the scope of the Commission's powers to investigate unilaterally conduct, which should be limited to Section 36. As noted by the Ministry, the structure and behaviour of the market itself should be the focus.

28. Thank you again for providing us with the opportunity to respond to the Commission's Report. Please feel free to contact the author, or John Blair (General Counsel) at john.blair@airnz.co.nz if you wish to discuss this submission further, or to seek Air New Zealand's view on any other issues.

Regards

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