United Kingdom

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Targeted Commerce Act Review

This is the submission of Richard Davidson on the Ministry's targeted Commerce Act review. I am an Assistant Director in the Mergers Group of the Competition and Markets Authority of the UK. Prior to my current role, I was a competition lawyer in private practice in New Zealand and the UK. I have a Master of Laws specialising in competition law and law and economics. The views in this submission are my own and do not reflect those of my employer.

The targeted review is a very welcome development. Section 36 is broken and in urgent need of fixing. It fails to accurately identify exclusionary conduct, is out of step with the rest of the competition law world, and the Commerce Commission has no confidence in it. The status quo is not an option and the conversation needs to shift to finding the replacement that will generate the greatest net benefit to New Zealand.

If I had one wish for the Options Paper that will follow this consultation, it is that the subject of market studies would receive greater attention than it has received in the Issues Paper (having only two questions out of 46 allocated to it). The UK experience has shown that market studies have the potential to generate massive economic benefits. A well-designed market studies regime for New Zealand, with appropriate information-gathering and remedial powers, could produce gains that far outweigh those that may result from section 36 reform.

Kind regards

Richard Davidson

Anti-competitive exclusionary conduct

1	Has the Ministry accurately described the type of conduct that countries typically seek to prohibit?	Yes. Australia's attempt to reform its abuse of dominance provision has been seriously hampered by the 'protecting small business' narrative. The design of any new abuse of dominance provision, and its rationale, must be focussed on protecting the competitive process. New Zealand's competition policy DNA is closer to that of the United States, rather than the European Union. Accordingly, NZ's abuse of dominance law should not concern itself with the EU notion of 'excessive pricing'. Scalia's J comment in *Verizon v Trinko* is worth following in the New Zealand context: "The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices–at least for a short period–is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct".
2	Has the Ministry accurately described the different approaches countries take in their rules against anti-competitive exclusionary conduct?	Yes.
3	Has the Ministry accurately described the main elements of New Zealand's rule against anti-competitive exclusionary conduct?	Yes.
4	In your opinion, what justifications can there be for requiring that a firm with a substantial degree of market power "take advantage" of that power?	This is the crux of the matter. The government must decide whether it is content to permit conduct (eg. exclusivity rebates) by businesses with a substantial degree of market power (**SMP**) which harms competition because businesses without SMP could engage in the same conduct without harming competition, or prohibit the conduct because the harm to

		competition outweighs any benefit of allowing businesses with SMP to behave as if they had no such power. Every major antitrust jurisdiction has chosen the latter option. Scalia J provides a succinct description of the US position in *Eastman Kodak*: "Where a defendant maintains substantial market power, his activities are examined through a special lens: Behavior that might otherwise not be of concern to the antitrust laws — or that might even be viewed as procompetitive — can take on exclusionary connotations when practiced by a monopolist". So even the US – which is often regarded as a 'hands-off' regime (at least compared to the EU) – assesses the conduct of dominant firms through a "special lens".
5	What justifications can there be for a purpose-based (rather than effects-based) approach? Why do you think Australia adopted such an approach with its Trade Practices Act 1974?	For a piece of legislation that is solely concerned with economic outcomes (see *Tru Tone v Festival Records*), effects-based tests should be the starting point. But proving anticompetitive effects can be very burdensome – it requires defining a market, identifying a counterfactual, and weighing pro- and anticompetitive effects. Purpose-based tests relieve the prosecution of proving anticompetitive effects. This can be justifiable where the conduct is so obviously anticompetitive (eg. price fixing) it would be inefficient to require the prosecution to prove effects. Rarely is conduct associated with abuse of dominance sufficiently clear cut so as to absolve the prosecution of having to prove anticompetitive effects.
6	Does section 36(1) make sense, given that authorisations do not apply to section 36(2)?	No comment.
7	Has the Ministry identified the right criteria for assessing the adequacy of section 36 of the Commerce Act? Should any criteria identified be excluded, or should criteria not mentioned be added?	Yes. The Ministry has effectively outlined a decision-theoretic assessment framework which measures a particular rule based on the extent to which it maximises economic welfare. This is the appropriate approach for legislation which is concerned with economic outcomes.

		This approach is popular in United States antitrust academic work where it is presented as objective and scientific. However, it can be twisted to suit particular agendas – see *Taking the Error out of 'Error-Cost' analysis: What's Wrong with the Antitrust's Right?*, Jonathan Baker, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333736. Used properly, a decision-theoretic approach is the optimal assessment framework for antitrust rules. Additionally, the global trend in antitrust is toward convergence. As such, alignment with competition law in overseas jurisdictions is an important objective.
8	Should the criteria used be given equal weight?	Yes.
9	Do you agree that section 36 may not effectively assure the long-term benefit of consumers? If you agree, are there any sectors of the economy where you consider this to be well illustrated? If you disagree, please explain why.	Yes, section 36 does not promote the long-term benefit of consumers.
10	Is it fair to say that businesses will generally know if they are acting in a way that they would not in a competitive market – i.e. that the current test is sufficiently predictable?	The test is relatively predictable because it is very permissive. Businesses can be confident that their conduct will not breach section 36 except in very rare cases.
11	Do you agree that section 36 – as applied by the courts – is too complex to ensure that it is cost-effective and timely?	All abuse of dominance tests are complex and costly to enforce. The problem with section 36 is that it does not reliably identify anticompetitive exclusionary conduct and is therefore a poor enforcement tool against abuse of dominance.
12	Do you agree that section 36 – as applied by the courts – is not well aligned with other relevant provisions?	Yes.
13	Given your view on the correct implication of having a small and remote economy, do you consider that	No comment, other than to note that New Zealand already has a relatively permissive merger control regime. Whereas the UK, EU and US often find

	section 36 appropriately reflects that implication?	concerns with mergers resulting in the number of effective competitors in a market reducing from 4 to 3, New Zealand typically permits such mergers. Indeed, sometimes mergers to monopoly are permitted (eg. Cavalier Wool's acquisition of New Zealand Wool Services). Higher levels of market concentration are justified on the basis that New Zealand's small economy can sustain fewer businesses with minimum efficient scale. The continuing co-existence of a permissive abuse of dominance provision would make New Zealand's competition law substantially weaker compared to overseas jurisdictions.
14	For each of the criteria it has adopted, has the Ministry's assessment been well-reasoned?	Yes.
15	If you are submitting that the criteria for assessment should be different from those used by the Ministry, how might the assessment be different using your preferred criteria?	N/A
16	Do you agree with the Ministry's conclusion? Please explain why.	Yes. There is a broad consensus that section 36 is ineffective and, now that Australia is heading toward change, the status quo is not an option. The debate now needs to move forward to consider what the best replacement provision is. In this respect, the Ministry's comment that there is not necessarily a superior option is probably correct as a matter of logic but not of reality. There are likely to be several alternatives that would produce a higher net benefit to the New Zealand economy.
17	Do you have any other comments you wish to make about the Ministry's approach to assessing the current law on anti-competitive exclusionary conduct?	No.
18	Which of the potential options identified would you like to see discussed if the Ministry publishes an options paper next year? Please explain why these	The fourth option should be taken forward, because it removes the 'take advantage' element and introduces an effects test. The 'take advantage' element, and the associated counterfactual test, is at the heart of the problems with section 36. An effects test would bring the provision into

	options would be worthy of consideration.	line with other Commerce Act provisions and would properly reflect the fact that the legislation is concerned with real-world economic outcomes. These two core changes should be a bottom-line in any reform. The second and third options are weaker than the fourth as neither includes both of the above changes.
19	Which of the potential options identified are not worthy of discussion if the Ministry publishes an options paper next year? Please explain why these options would not be worthy of consideration.	The first option – the status quo – is not worthy of discussion. It is not tenable to retain an abuse of dominance provision which is widely considered to be ineffective, which the Commerce Commission has no confidence in, and will soon be a total outlier when Australia likely reforms its equivalent provision.
20	Are there any other potential options that the Ministry should consider?	A test which is able to draw on the rich US (and EU) abuse of dominance jurisprudence would provide greater certainty for businesses.
21	In the event that an options paper is issued, what criteria should the Ministry use to assess the options the paper includes? In principle, should they be the same as whatever criteria are finally used to assess the adequacy of the New Zealand regime?	No comment.

Alternative enforcement mechanisms

22	Do you agree that standard enforcement of the Commerce Act (litigation by the Commerce Commission in the courts) faces high costs and long delays? Please give reasons for your view.	No comment.
23	Has the Ministry accurately identified the main types of alternative enforcement mechanism that a given country can adopt? If not, please explain why.	No comment.

24	Has the Ministry accurately described the main elements of New Zealand's alternative enforcement mechanisms? If not, please explain why.	No comment.
25	Has the Ministry identified the right criteria for assessing the adequacy of alternative enforcement mechanisms under the Commerce Act? Should any criteria identified be excluded, or should criteria not mentioned be added?	No comment.
26	For the criteria that the Ministry has included, have they been accurately described? If not, please explain why.	No comment.
27	Do you agree that the current settlements regime has a number of weaknesses? Please give reasons for your answer.	No comment.
28	Do you agree that the cease and desist regime has proven ineffective? Please give reasons for your answer.	No comment.
29	Should the Commerce Commission make more use of the cease and desist process? Please explain why / why not.	No comment.
30	Do you agree that the settlements regime has proven simple enough to be cost-effective and timely, and that it is adequately predictable? Please explain why / why not.	No comment.
31	Do you agree that the cease and desist regime, if it were used, would be unlikely to be cost-effective, timely and predictable? Please explain why / why not.	No comment.

32	Do you agree that the settlement regime and the cease and desist regime both adequately protect the rights of firms? Please explain why / why not.	No comment.
33	Do you agree that there is a continued need for a settlement process, but a reduced need for an ad hoc adjudicative process such as the cease and desist regime, compared to the position in 2001? Please explain why / why not.	No comment.
34	Do you agree with the way that the Ministry has described the alignment and misalignment of the settlement process under the Commerce Act, on the one hand, with settlement processes under other legislation enforced by the Commerce Commission, on the other? Please explain why / why not.	No comment.
35	Do you agree that the cease and desist regime is misaligned with other relevant legislation?	No comment.
36	Do you think that the cease and desist regime unduly duplicates the (interim) injunction process?	No comment.
37	Given the criteria for assessment it has used, is the Ministry's assessment of the current New Zealand approach to alternative enforcement mechanisms well-reasoned?	No comment.
38	If you are submitting that the criteria for assessment should be different from those used by the Ministry, how might the assessment be different using your preferred criteria?	No comment.

39	Do you agree with the Ministry's conclusion? Please explain why.	No comment.
40	Do you have any other comments you wish to make about the Ministry's approach to assessing the current approach to alternative enforcement mechanisms under the Commerce Act?	No comment.
41	Which of the potential options identified would you like to see discussed if the Ministry publishes an options paper next year? Please explain why these options would be worthy of consideration.	No comment.
42	Which of the potential options identified would you NOT like to see discussed if the Ministry publishes an options paper next year? Please explain why these options would not be worthy of consideration.	No comment.
43	Are there any other potential options that the Ministry should consider? For example, could better use be made of arbitration proceedings under the Arbitration Act 1996?	No comment.
44	In the event that an options paper is issued, what criteria should the Ministry use to assess the options set out in the Issues Paper? In principle, should they be the same as whatever criteria are finally used to assess the adequacy of the New Zealand regime?	No comment.

Market studies

45	Do the approaches to market studies described in the Issues Paper align with a gap in New Zealand's institutional settings for promoting competition?	Yes, there is a gap, as the Issues paper identifies: "there is no single, broad power to investigate any market from a competition perspective and make recommendations on how improvements can be made". The real question is whether the benefits of a market studies regime outweigh the costs. The UK's Competition and Markets Authority estimated that its market studies function produced benefits of £576.6 million across three years from 2012-15, compared to £65 million from its competition enforcement (abuse of dominance, cartels) function. In the same period, its total costs across all functions was £66.5 million (see https://www.gov.uk/government/publications/cma-impact-assessment-2014-to-2015). Market studies clearly have the potential to produce massive benefits. Indeed, the potential benefits may well justify a higher prioritisation than appears to be reflected in the brief treatment of the topic in the Issues Paper. The Ministry is likely to hear concerns from a subset of businesses about the cost to them of a market studies regime, and of course this cost should be included in the net benefits assessment. However, the Ministry should bear the following things in mind. First, many businesses – especially SMEs and new entrants – stand to benefit from better functioning markets with lower barriers to entry and expansion. Second, the cost to business of the New Zealand competition regime is likely to be low compared to overseas jurisdictions. In particular, New Zealand has a merger control regime with voluntary notification which reduces costs. The importance of market studies functions has increased as understanding of the ways in which markets work imperfectly has improved. Behavioural economics, in particular, has revealed how cognitive biases can result in market equilibriums which are inefficient and do not benefit consumers. Market studies can help to identify such problems and design remedies to resolve them.
46	What procedural settings for a market studies power would best fit the identified gap, in terms of:	The procedural settings for a market studies regime are of immense importance and deserve comprehensive and careful consideration. The Commerce Commission is the locus of competition expertise and is

	a) Who may initiate a market study; b) Who should conduct market studies; c) Whether mandatory information-gathering powers would apply; d) The nature of recommendations the market studies body could make; and e) Whether the government should be required to respond.	well-suited to carry out a market studies function. There are valuable synergies in having the Commerce Commission responsible for competition enforcement, merger control and market studies, so long as it is appropriately funded to carry out the work. The Commerce Commission's competition expertise, and exposure to markets, also means that it is well-placed to decide when and which markets to investigate. Mandatory information-gathering powers are essential to carrying out regulatory functions, although there should be appropriate restrictions on their use to ensure proportionality. The worth of a market studies regime ultimately lies in the remedial action that follows its findings. The UK market studies regime generates massive benefits precisely because the Competition and Markets Authority has compulsory remedial powers. The Ministry should keep an open mind as to the types of action that may follow from a market study – from simple recommendations to formal remedial powers.