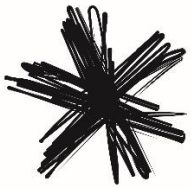

Spark New Zealand

Submission to the Ministry of Business, Innovation & Employment

Targeted Review of the Commerce Act 1986

Submission | MBIE

9 February 2016

Contents

Executive Summary

1. Spark welcomes the opportunity to comment on the Ministry of Business innovation and Employment's (**MBIE**) targeted review of the Commerce Act 1986 (**Act**) (**Review**).

2. We support Government initiatives that seek to improve the effectiveness, efficiency and performance of the New Zealand economy. We consider that improvements to regulatory settings can enhance the performance of the economy. Equally, we recognise the significant risk of regulation stifling legitimate productive and competitive economic activity.

3. In this case we consider that there has been insufficient evidence to justify a review of section 36 of the Act. On balance we consider that the law in this area is consistent with the broad purpose of the Act; it is more consistent with comparable provisions in other countries than has been alleged; and it has a strong deterrent effect.

4. We also recognise that while the cease and desist regime has not been used much we are unconvinced of the need to change it and we would not support an alternative regime. We consider that the settlements regime currently strikes the right balance and do not recommend any material changes to it.

5. Finally, in regard to market studies we suggest that a general market studies power under the Commerce Act is not likely to better promote competition and may be more likely to introduce unwarranted regulatory burdens on business and reduce efficiency and performance of the economy.

6. The Review correctly identifies that New Zealand laws already provide for prescriptive economic regulation, including market monitoring where warranted. In telecommunications markets, for example, the Commerce Commission has broader powers to conduct market studies,[1] require enforceable undertakings, impose a duty to deal on highly prescriptive terms, and impose substantial pecuniary penalties.[2] Given the existence of sector-specific regulatory monitoring powers in concentrated markets, we consider that broader market monitoring powers and enforceable undertakings should not be provided for under the Commerce Act. The Commerce Act should be less intrusive to normal business operations rather than more intrusive in order to best facilitate productivity, competition and ultimately consumer benefits.

7. In our submission on the Productivity Commission's Services Sector Review[3] we pointed out that distinguishing between legitimate commercial behaviour and abuses of market power has always been a difficult area of competition law in New Zealand and equally so in a number of other comparative jurisdictions. The Act has a significant impact on market behaviour and it must strike the right balance between deterring anti-competitive conduct and promoting beneficial competitive activity. Accordingly, changes to the legal policy and the way the law is applied in this respect should not be made lightly.

8. New Zealand firms operate within a stable and predictable legal framework. It is the existence of a stable and predictable environment which is more important for business operation, investment and competitive activity than perceived alignment with other jurisdictions.

9. Introducing changes to section 36 will introduce significant uncertainty while markets and firms develop an understanding of what the impact of those changes on their legal operating environment means (and that understanding will require years of judicial consideration to

[1] Section 9A of the Telecommunications Act 2001 for example
[2] Such as the in respect of regulated services under Schedule 1 of the Telecommunications Act
[3] Telecom Submission on the Productivity Commission Report, *Boosting Productivity in the Services Sector: second interim report*, 13 March 2014

develop). There will be productivity and efficiency impacts (and thus costs) as a result of this uncertainty, so there needs to be clear and compelling benefits from any such change before we consider it. Amending section 36 to make it easier for the Commerce Commission to successfully prosecute cases is not on its own a legitimate basis for change and could jeopardise economic performance absent clear evidence that the current section 36 does not provide the current incentives and powers to market participants and the regulator of competition in those markets. We have not seen any such evidence and therefore do not support change.

10. We are also unlikely to support amendment of the law for the sake of alignment with amendments to Australian law. Australia's Harper Review recommended a series of changes to Australia's competition laws which respond to specific problems identified in that country. The majority of the Harper recommendations are not relevant to New Zealand and several competition-specific elements of the Australian Competition and Consumer Act 2010 have no parallel in New Zealand.

11. In the event that MBIE considers taking any further steps towards an Options Paper, we would recommend further consultation on the matter and would be available to participate more fully, as required.

A - Taking advantage of market power

Review not warranted

12. The case for amendment of section 36 should be based on evidence that the markets in NZ are not working because of:

    a. The existence of powerful enduring monopolies;

    b. A lack of workable competition that is unlikely to develop as a result of insurmountable barriers to entry and conduct by incumbent monopolies;

    c. A lack of alternative regulatory mechanisms to address structural issues in concentrated markets; and

    d. Evidence of a failure of section 36 to achieve its purpose, resultant distortions in competition and long term detriment to consumers in New Zealand.

13. In this case we genuinely consider that the case has not been made for a change to or review of section 36. A review of this established legislation should be based on high quality evidence of poor economic performance resulting from the current legal framework.

14. We find it difficult to reconcile the Ministry's preliminary view with our own experience of competition law in New Zealand.

    a. **The Ministry's initial view that section 36 has failed to maximise long term benefit of consumers (LTBC**) because it has failed to punish powerful firms is misguided. The purpose of the Act is not to maximise LTBC by punishing powerful firms. The broad purpose of the Act is to promote competition for the long term benefit of consumers.[4] Section 36 is but one component of the tapestry of provisions that seek to promote competition. And it is workable or effective competition which delivers long term to consumers in markets (not punishment of firms). The Review fails to identify enduring competition problems arising from or illustrative of a lack of workable competition. Nor could it link enduring competition problems to the courts' application of section 36. As far as punishment is concerned, we remain acutely mindful of the punitive consequences of a breach of the Act and consider these to constitute a significant deterrent against unlawful conduct.

    b. **Section 36 is too complex to allow for cost-effective and timely application** - Distinguishing between legitimate commercial behaviour and abuses of market power has always been a difficult area of competition law in New Zealand and in comparable jurisdictions. The stakes are high as are the incentives on parties to challenge any initial finding to the highest level. New Zealand is not an outlier in this regard. A cursory review of the website of the UK Competition and Markets Authority (**CMA**)[5] shows that it has, on a number of occasions conduced detailed investigations into alleged abuses of market power, found preliminary evidence of potentially unlawful activity and, after 3, 5 or even 10 years in some cases, elected to simply close the matter and not prosecute parties on the basis of their administrative priorities. This indicates that the introduction of an effect

[4] Section 1A
[5] Competition and Markets Authority https://www.gov.uk/cma-cases?keywords=&case_type%5B%5D=ca98-and-civil-cartels&closed_date%5Bfrom%5D=&closed_date%5Bto%5D=

test, as proposed, is unlikely in itself to materially reduce the complexity, cost-effectiveness or timeliness of prosecuting such cases in future.

c. **Section 36 is misaligned with other parts of the Act.** Section 36 relates to single firm conduct and it makes sense to assess the conduct of a single firm differently to the conduct of two or more firms in a market. Section 36 accordingly is not misaligned with the rest of the Act, there are good grounds for the differences. And when we consider the practice of the Commerce Commission we note that it has prosecuted key cases under both section 36 and section 27 – thus placing both the purpose and the effect of the powerful firm's conduct at issue. We also note that the courts have looked at the effect of unilateral conduct in order to infer the existence of an anti-competitive purpose. In our view, alignment with s27 and 45 is not a particularly useful objective. Each prohibition in the Act seeks to promote competition by deterring specific types of potentially anti-competitive conduct by firms and so each section warrants a particular type of approach. In addition, the substantially lessening of competition (**SLC**) test applied under section 27 provides an alternative cause of action in cases against firms with market power. Aligning the tests is therefore not necessary for courts to evaluate the effect of unilateral conduct on competition in a relevant market.

15. We find that, contrary to the suggestions in the discussion paper, the current law is fit for purpose because it:

a. Provides a strong deterrent to unilateral anti-competitive exclusionary conduct. The consequences of a breach for firms are daunting. Pecuniary penalties of up to 10% of gross turnover could penalise firms to the tune of hundreds of millions of dollars. This is aligned with Australia and other jurisdictions and is more severe than Canada which limits administrative fines for anticompetitive conduct by dominant firms to $10 million. The $12 million fine imposed on Telecom in 2012[6] undoubtedly has a significant deterrent effect on other large firms. In our experience large firms pay close attention to punitive action taken by the courts, establish compliance and training programmes and are mindful of the potential consequences when dealing with regulators.

b. Sets a high set of standards for powerful firms to meet. It provides no defence, no scope for efficiency justifications and no authorisation regime. Again more onerous than other jurisdictions such as Canada, which provides for binding opinions that certain conduct would not be a breach, and the UK which enables defendants to lead evidence of efficiencies to be weighed against detriments to assess the net effect of actual conduct on on consumer welfare.

c. Enables the Commission to prosecute and penalise powerful firms if they enter into contracts or arrangements that have the effect of substantially lessening competition in a market;[7]

d. Is reasonably well understood by New Zealand businesses, the courts and the regulator. Section 36 is established law that has been tested in New Zealand's highest courts.

e. Is consistent with the purpose of promoting competition for the long term benefit of New Zealand consumers. There is just no evidence that the Supreme Court and the Privy Council, understanding the law, its purpose and context as they do, would consistently fail

[6] New Zealand Commerce Commission v Telecom Corporation of New Zealand (Data tails) where the High Court imposed a pecuniary penalty of $12 million on Telecom.
[7] Pursuant to section 27 of the Commerce Act 1986. We also note that the NZCC has brought section 36 cases together with section 27 cases on a number of occasions.

to make decisions in section 36 cases that are inconsistent with the long term interests of consumers.

f. Businesses can conduct their affairs efficiently in a predictable and stable regulatory stability.

16. New Zealand law and policy should be based on our country's unique requirements. We consider that section 36 remains good law for NZ. The decision of the Supreme Court in the 0867 case traversed a series of objections to the courts' historic application of the section and found that it remains capable of facilitating competition consistent with the purpose of the Act. We have read Russell McVeagh's more detailed submission on this point and agree with it.

17. There is no evidence that New Zealand's highest courts have failed to interpret section 36 in light of the purpose of the Act.[8] In fact the courts have established a line of clear judicial precedents which have provided parties with meaningful detailed guidance on how to understand section 36 and how to conduct business in compliance with the law in this area.

Greater alignment than suggested

18. We think that alignment with the way the law is perceived to operate in other countries is not sufficient to justify a material change to established law in New Zealand in this case.

19. Our analysis of section 36 indicates that there is greater alignment with international comparators than suggested in the Review. The "taking advantage" limb and the "anti-competitive purpose" limbs are elements of comparable prohibitions in Australia and Canada, for example.

20. The counterfactual test applied in section 36 cases has been criticised. But use of a counterfactual analysis is not uncommon. It is used in UK competition analysis for abuse of dominance cases, was used by the US Supreme Court in Verizon v Trinko (also a monopolisation case), it is used in Australia and it is the practice of the NZCC to conduct a counterfactual analysis when assessing whether conduct has or is likely to substantially lessen competition under section 27, 36 and 45 of the Commerce Act. The counterfactual test as a tool of analysis in competition cases is likely to therefore continue to be used whether an effects test was added to the section 36 prohibition or not.

21. An effects test is no panacea to issues raised in the Review. In some ways it could be more complex, more difficult to predict, and equally difficult to prove. As mentioned above, abuse of dominance investigations by the UK CMA are complex. They are known to involve considerations of whether the alleged conduct has pro-competitive benefits which, when weighed up against likely exclusionary effects, result in a net detriment to consumers that passes the substantiality threshold. This dimension is likely to be more resource intensive (require more expert economic evidence, more evidence of determinants to consumers in markets, more complex measurement of exclusionary effects) and provides additional limbs for appeals.

22. No matter how we look at it, the introduction of an effects test is unlikely to simplify New Zealand's market power regime. It is more than likely to create significant uncertainty for businesses. The costs of the uncertainty to business is likely to outweigh the benefits suggested to date.

[8] Section 5(1) of the Interpretation Act requires that the meaning of an Act must be ascertained from its text and in light of its purpose.

Further Alignment with Australia would require evidence of need

23. The case for alignment with Australian recommendations which have emerged from the Harper Review[9] has not been made out. The Harper review was Australia's second detailed analysis of the performance of Australia's economy, its competition law and competition policy. Many issues that the Harper Review identified require changes to their law to address those issues directly. Many are not broadly consistent with issues or performance of New Zealand markets. If a similar review was to be conducted here it would likely find that New Zealand is a more open, dynamic economy with broader application of competition law and lower regulatory burdens.

24. The Harper Review's recommendations in respect of section 46 of the Competition and Consumer Act 2010 have been controversial. At the very least the objections to the proposed insertion of an additional effects test suggest that an effects test may not be an appropriate legislative response to improve Australia's economic performance either.

25. And even though there are similarities between the New Zealand and Australian regimes, there are sufficient differences in our economies and competition law regimes to justify a different approach, even if Australia decides to insert an effects test to section 46.

26. New Zealand's economy is small and remote but open, dynamic and efficient. The small market means that industries that require substantial investments and significant scale may be able to accommodate fewer participants than in other countries. So any provision dealing with market power needs to be fit for New Zealand's purpose first and foremost. When considering where to draw the balance between the risk of type 1 and type 2 errors it is relevant that a market or an industry in New Zealand may only be able to accommodate a comparatively small number of efficient competitors and that temporary but comparatively more enduring positions of dominance may emerge than in larger markets. The unique dynamics of New Zealand markets provide a legitimate basis for a difference in competition law and policy and it provides reasonable grounds for guarding against errors that overly penalise large firms for conduct that would be legitimate if done by smaller firms.

27. An analysis of the Harper Review illustrates other differences between the two countries. For example:

    a. Australian competition laws had limited application to the conduct of government entities when acting in trade – Harper recommended extending the application of competition law to government bodies acting in trade;

    b. Australia prohibits parallel imports which the Harper review has recommended changing in order to improve the openness and competitiveness of the economy;

    c. Australia has a complex competitive neutrality regime which various government bodies are required to adhere to, which has no parallel in New Zealand;

    d. Australia's regimes relating to the regulation of competition in network industries such as telecommunications are materially different to that in New Zealand.

    e. Australia retains restrictive regulations with regard to trading hours, trading permits, and various other restrictions which Harper has recommended should be amended or abolished to improve the effectiveness and efficiency of the economy.

    f. Australia's competition law has specific sections which create prohibitions of their own which have no parallel in New Zealand, such as the prohibitions against secondary

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boycotts, third line forcing, unconscionable conduct and price signalling, and criminal cartels.

28. If Australia were to amend section 46 to include an effects test on the basis of recommendations in the Harper Review, New Zealand would require evidence of the same issues, existing to the same extent, and a proportionate justification before considering a similar amendment. We think such justifications do not exist here.

29. New Zealand firms (and regulators) now operate within a settled framework. It is the existence of a settled framework which is more important for business operation, investment and competitive activity than perceived alignment with other jurisdictions.

30. We consider that differences in the application of competition laws between jurisdictions do not materially impact on investment. It is relatively clear, for example that competition (antitrust) law in the USA is applied in a materially different way to competition law in the European Union. But few commentators would suggest that businesses from one of those jurisdictions will fail to invest in the other jurisdiction because of a difference in the application of their competition laws.

31. It is also not uncommon for neighbouring jurisdictions with significant cultural, legal and commercial alignment to apply competition law provisions differently. The USA and Canada for example have materially different approaches. With Canadian law requiring impugned conduct of a dominant firm to have both an anti-competitive purpose *and* substantially lessen competition in a market before it can be found to be unlawful.[10] Again we have not seen evidence that the difference discouraged cross-border investment.

Conclusion

32. In summary we consider that the case for extending the general ambit of section 36, as a means to improve the performance of the New Zealand economy for the long term benefit of consumers, is not made out. It risks first order errors which are difficult to reverse and could be disastrous for New Zealand's small economy where scale benefits are often difficult to achieve in comparison with international markets.

B – Alternative Enforcement Mechanisms

Settlements remain as is but cease and desist of limited value

33. The cease and desist regime has been used so seldom the case for its retention seems difficult to make. However, we do not support a variant of the cease and desist regime for the sake of change and consider that other tools and processes available today provide parties with efficient avenues for dispute resolution. In particular, we consider that the settlements regime in its current form is well used and provides sufficient incentives on parties to resolve matters with the Commission. We do not support the extension of the settlements regime through the introduction of enforceable undertakings. There has not been any evidence that sector specific regulation that already provides for enforceable undertakings should be extended to improve competition New Zealand markets.

C – Market Studies

No generic market studies power

34. We do not support the creation of a generic market studies power. The UK regime has been shown to have a chilling effect on business activity, raise business costs substantially and create

[10] Section 78(1) and section 79 of the Canadian Competition Act R.S.C., 1985, c. C-34

unjustifiable regulatory compliance burdens. We are aware of the high costs that the UK market studies regime has on business in that country and would be alarmed if a similar regime were imposed in New Zealand, where the effects on business in our smaller economy could be felt more acutely.

35. Spark and other telecommunications industry participants already provide market data to the Commerce Commission under section 9A of the Telecommunications Act 2001. Meeting the Commission's requirements are onerous and resource intensive. The saving grace of the market studies under the Telecommunications Act is that they are annual market monitoring studies that simply measure performance of the market. They are not a pre-cursor to regulation or prosecution. If they were, parties would dedicate greater legal and economic resources and have incentives to manage the data provision process more cautiously.

36. Sector-specific regulation and other legislative tools provide more targeted ways to manage the performance of markets with enduring structural issues. The Telecommunications Act and other sector-specific legislation enables regulators to conduct market studies,[11] require enforceable undertakings, impose a duty to deal on highly prescriptive terms, and impose substantial pecuniary penalties.[12]

37. Given the existence of sector-specific regulatory monitoring powers in concentrated markets, we consider that broader market monitoring powers and enforceable undertakings should not be provided for under the Commerce Act. The Commerce Act should be less intrusive to normal business operations rather than more intrusive in order to best facilitate productivity, competition and ultimately consumer benefits.

END

[11] Section 9A of the Telecommunications Act 2001 for example
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