Review of section 36 of the Commerce Act and other matters

Submission to the Ministry of Business, Innovation and Employment

Date: 1 April 2019

Submission on the Review of Section 36 of the Commerce Act and other matters Discussion Paper

1. We welcome the opportunity to submit on the review and look forward to our engagement with MBIE going forward.

2. Broadly speaking, we consider that MBIE has appropriately identified the policy issues and considerations relevant to: reform of section 36 of the Commerce Act (the Act); the provisions in the Act relating to intellectual property (IP); and the treatment of covenants under Part 2 of the Act.

3. We have previously submitted to MBIE on section 36[1] and to the Australian Competition Policy Review Panel on the Australian equivalent (the Harper Review).[2] Our submissions address the broad issues raised by MBIE in the Discussion Paper. We have not responded to every question. Rather, our observations and perspectives draw upon and refer to our previous submissions as appropriate.

Executive summary

4. We support reform in the three areas considered in the Discussion Paper. First, we agree that section 36 requires reform because it currently does not meet the Act's purpose to promote competition in markets for the long-term benefit of consumers within New Zealand. We also agree that such reform should follow the revised position in Australia. Second, we support repeal of the IP-related provisions in the Act, namely section 36(3), section 45 and section 7(2) and (3), so that intellectual property is subject to the same competition analysis as other property. Third, we support the proposed redefinition of "contract" to include covenants, to close the inadvertent creation of a loophole in the Act.

5. While perhaps obvious, competition plays a critical role in supporting a productive and well-functioning economy. It produces significant benefits to consumers, positively affects productivity across industries and has a role in fostering and incentivising innovation.[3] An effective rule against anti-competitive unilateral conduct by firms with substantial market power is critical to protect competition and the benefits it produces. Section 36, in its current form, simply does not achieve this.

6. In our view, while acknowledging that there may be legitimate justifications for firms engaging in certain conduct which require balancing, the focus of section 36 should be on the effect or likely effect of the conduct on competition in New Zealand. We therefore support adoption of a test which analyses the purpose or effect of the conduct. We agree that a substantial lessening of competition (SLC) test is the preferred option. An SLC test will more effectively capture anti-competitive unilateral conduct and is well understood and applied in the context of other

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1 Our initial submission, letter to the Minister and cross-submission on the Targeted Review of the Commerce Act Issues Paper are provided under Attachments A, B and C respectively.

2 Our submission on the Harper Review is provided under Attachment D.

3 See Attachment C, at [26]-[29].

provisions of the Act. Moving to an SLC test will also align New Zealand with the global norm.

7. We also support retaining sections 36A (with amendment) and 36B of the Act.

8. We agree with MBIE’s proposed repeal of the IP-related provisions in the Act. There is no strong rationale for treating IP rights differently to any other form of property or assets under competition law, and the current exemptions mean that conduct with significant anti-competitive effects may be exempt from the Act.

9. We also support MBIE’s proposal to redefine a “contract” in section 2 of the Act to include covenants as described in Option 3 of the Discussion Paper. Removing the prohibition against covenants in the cartel provision was an oversight. The absence of a specific prohibition against such covenants is undesirable and the proposed redefinition will adequately address any concerns.

Section 36 should be amended

10. We agree with the proposal that section 36 in its current form does not fully meet the Act’s purpose. We support a move towards an SLC test that focuses on the purpose, effect or likely effect of conduct. This view is consistent with our previous submissions on the *Targeted Review of the Commerce Act Issues Paper* and the Harper Review.

11. Section 36 is currently ineffective in addressing single firm conduct that is harmful to competition and the New Zealand economy, primarily due to the way courts have interpreted the “take advantage” limb. This interpretation necessitates a hypothetical counterfactual test that fails to capture all anti-competitive conduct. In practice, the effect the conduct has on competition is not even a core line of inquiry. The “taking advantage” test is also difficult, complex and costly to apply, and lacks certainty and predictability for day-to-day business decision-making.

12. Section 36 in its current form is also inappropriate for an economy such as New Zealand’s. Our small size and scale, and consequent acceptance of higher concentration in domestic markets, require effective rules to prohibit anti-competitive unilateral conduct by firms with a substantial degree of market power. Section 36 simply does not achieve this.

13. In our view, the most effective way to ensure that conduct does not harm the competitive process is to focus the test on the purpose, effect or likely effect of the relevant conduct.[4][5] We consider that an SLC test which does so is the most appropriate.[6] The SLC test is well understood by businesses, advisors and courts alike and would capture anti-competitive unilateral behaviour while enabling firms to

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[4] Attachment C at [8]-[9].

[5] Ministry of Business, Innovation & Employment “Discussion Paper: Review of Section 36 of the Commerce Act and other matters” (January 2019) [*Discussion Paper*], at Question 7.

[6] *Discussion Paper*, above n 5, at Question 9.

compete vigorously on the merits of their products and services. Further, it would align New Zealand with the global norm of considering the competitive effects of unilateral conduct, and importantly, with Australia's approach.

14. We discuss these three themes in more detail below.

Section 36 permits harm to competition

15. The "take advantage" test operates by asking whether a firm without substantial market power would have engaged in the same conduct as the firm with substantial market power. If "yes", then the conduct is protected: the firm cannot be found to have breached section 36.

16. This test is problematic. It assumes that harmless or pro-competitive unilateral conduct undertaken by a firm without substantial market power will have the same impact when undertaken by a firm with substantial market power.[7] This inference is not justified because the same conduct by a firm with substantial market power can harm competition in a way that does not arise when undertaken by a firm without substantial market power.[8] As noted in the Discussion Paper, the result is that section 36 (as interpreted) is inadequate at distinguishing between anti-competitive and pro-competitive conduct.[9] Cited examples of such conduct include cross-subsidisation,[10] exclusive dealing,[11] and refusals to deal.[12]

17. It is our view that the best way to ensure anti-competitive conduct is captured is to focus the inquiry on the purpose of the conduct or the effect of the conduct on the competitive process. We therefore consider that the prohibition should focus on purpose, effect **or** likely effect of the conduct.[13] This is distinct from the current test under s 36, which focusses on the whether a firm used their market power for a proscribed purpose. Our view is that this would be consistent with the underlying foundation of competition law – that what matters is the impact a firm's conduct may have on competition – and the fact that conduct can have pro-competitive and anti-competitive elements.

18. As acknowledged in the Discussion Paper, it is difficult to determine the extent to which section 36 is in fact leading to false negatives and we remain wary of any attempt to reanalyse past decisions under an SLC test. However, we also reiterate our previous submissions in which we noted two clear examples (Winstone

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[7] Attachment C at [37]-[58].

[8] Attachment C at [43].

[9] *Discussion Paper*, above n 5, at [51].

[10] Professor Ian Harper, Peter Anderson, Su McCluskey and Michael O'Bryan QC "Competition Policy Review: Final Report" (March 2015) [*Harper Review*] at 339.

[11] Paul Scott "Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act" (2011) 17 NZBLQ 260 at 277.

[12] Andrew Gavil "Imagining a counterfactual section 36: rebalancing New Zealand's competition law framework" (2015) 46 VUWLR 1043 [*Gavil*] at 1079.

[13] *Discussion Paper*, above n 5, at Question 7.

Wallboards and Sky) where section 36 has permitted conduct by large firms without regard to the anti-competitive effect.[14] [15]

Section 36 is complex and costly to apply

19. We agree that the nature of the hypothetical counterfactual test currently applied means that section 36 is particularly difficult to apply.[16]

20. The hypothetical counterfactual inquiry requires assumptions which may not be necessarily realistic or practical.[17] The analysis substitutes the actual motivations and incentives of a firm with substantial market power in actual markets, with the hypothetical motivations and incentives of the same firm in an artificial construct in which they lack market power. This comparison is unnecessarily complicated and may in fact be completely unrealistic. Additionally, this extra degree of complexity increases the resource required for each case from the Commission's perspective, and for businesses in monitoring compliance.

21. We agree that the counterfactual test under section 36 makes enforcement decisions unpredictable and creates uncertainty for existing competitors and entrants[18] as to whether they will be able to compete on their merits and for incumbents about what conduct is allowed. We have previously submitted an example of the consequences of this uncertainty in the Air NZ / Origin investigation.[19] The enforcement decision in that investigation turned on a single assumption about the number of seats on an aircraft that would have been flown by a firm without substantial market power. This decision was made late in the investigation but had a significant impact on the ultimate enforcement decision.

22. To the extent that the current test exhibits certainty in the form of the permissiveness of the test and a failure to examine economic harm, we do not consider such certainty is the type that promotes the long-term interests of consumers within New Zealand.[20] We discuss later in this submission the enhanced certainty that will come with the adoption of an SLC test.

The relevance of size and scale

23. It is our view that New Zealand's relatively small population and concentrated markets requires a high functioning rule against anti-competitive unilateral conduct. The role of unilateral conduct provisions like section 36 is to protect the competitive process by preventing a firm with substantial market power from maintaining or enhancing its position through means other than competition on the merits. We do not consider that section 36 achieves these goals.

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14 See Attachment C, at [58] for more details on these two past examples.
15 See Attachment C, at [37]-[58].
16 *Discussion Paper*, above n 5, at [73] and [74].
17 *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] 12 TCLR 843 [*0867*] at [29].
18 *Discussion Paper*, above n 5, at [44].
19 See Attachment B, at [20]-[23].
20 See Attachment C, at [69]-[78].

24. As noted in the Discussion Paper, there is likely to be a greater number of dominant players in markets in New Zealand,[21] and these players are often protected by high barriers to entry. Rather than suggesting a more relaxed approach to unilateral conduct, it is even more vital to have an effective rule on unilateral conduct by firms with substantial market power, as market forces cannot always be relied upon to remedy anti-competitive unilateral conduct and sustain competitive discipline.[22]

Section 27 is not an effective safety net

25. We agree with the proposal that section 27 is not an appropriate backstop or safeguard for the under-inclusive nature of section 36. Section 27 is aimed at contracts, agreements and understandings between parties while section 36 is aimed at unilateral conduct. While there may be some overlap (for example, exclusive dealing arrangements), section 27 simply cannot catch conduct which is unilateral at its core. One example is refusals to deal where there is no agreement or set of agreements that can be challenged.[23] This creates an arbitrary distinction where our competition law can only be enforced against conduct that is part of a contract, agreement or understanding.

An SLC test is most appropriate

26. We support the proposal in the Discussion Paper that an SLC test is the most appropriate standard for assessing unilateral conduct under the Act. As a starting point, the test will shift the focus of the assessment to the impact on competition which will better capture anti-competitive conduct. Further, adoption of an SLC test would bring enhanced certainty, consistency, and promote competition.

27. In terms of certainty, the Commission adopts a standard approach to assessing an SLC in sections 27 and 47. The framework uses a "with and without" counterfactual analysis, the meaning of which is well understood in those contexts. An obvious benefit of replacing the "taking advantage" test with the SLC test in respect of market power is therefore the ability to be guided by case law and commentary concerning these sections which will enhance predictability of outcomes. We are not aware of any concerns surrounding certainty from those who already advise on the SLC test under sections 27 and 47. On the contrary, while legislative changes always involve some uncertainty, this will likely be limited to the transitional phase because an SLC test will simplify compliance with Part 2 and be easier for firms and their advisors to engage with than the current test.[24]

28. An SLC test will also improve consistency with comparable competition law jurisdictions. Consistency of competition law has also been an agreed objective of

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21 *Discussion Paper*, above n 5, at [44].

22 See Michal S Gal *Competition Policy for Small Market Economies* (Harvard University Press, Cambridge, 2003) at 413-414 and Michal S Gal "The Effects of Smallness and Remoteness on Competition Law – the Case of New Zealand" (2007) 14 CCLJ 292 at 311-312.

23 For further examples, see Attachment C at [59]-[64].

24 See Attachment C, at [79]-[83].

trans-Tasman relations. Since Australia amended its market power provision to include an SLC test, New Zealand has become a global anomaly.[25] There are obvious benefits to adopting an SLC test to align our test with other jurisdictions. These include an enhanced body of case law and guidance for New Zealand businesses and courts to draw upon.

29. There are further benefits to comity with Australia in particular. For example, consistency of the competition law framework between the two countries would likely ease entry into New Zealand. Advice on conduct that incumbent firms may or may not engage in would also be largely consistent between New Zealand and Australia, reducing the overall cost of obtaining such advice. We also consider there would be benefits for businesses with substantial market power facing substantively the same provisions when undertaking unilateral conduct in both New Zealand and Australia, especially where such conduct has the potential to affect markets in both countries.

30. Finally, it is our view that switching to an SLC test will create the best conditions for competition to emerge. It is well established that the SLC test is not concerned with protecting individual competitors – rather it aims to protect the competitive process by ensuring that firms do not create obstacles to prevent competitors from entering and expanding based on the merits of their own products and services.

31. Relatedly, the SLC test is concerned with the net effect on competition.[26] It is our view that pro-competitive justifications including those arising from efficiencies for unilateral conduct can and should form part of an SLC-based assessment under section 36. We consider the ability to take into account pro-competitive justifications under an SLC test in section 36 will encourage businesses to compete vigorously on the merits.

The prohibition should be clarified

32. While we acknowledge that exclusion of equivalents to subsections 46(4)-(6) is a departure from the Australian approach, we agree that these subsections are surplus. They simply state factors that would be expected to be considered in an assessment of market power. However, an equivalent of subsection 46(7) relating to the ability of more than one firm to have a substantial degree of market power in a market would be a useful clarification to section 36 and ensure consistency with Australia in the consideration of this issue.[27]

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[25] *Gavil*, above n 12, at 1068.

[26] For example see Thomas Gault (ed) *Gault on Commercial Law* (online looseleaf ed, Brookers) at [CA27.12(4A)]; *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731 (HC) at 740 and 741.

[27] *Discussion Paper*, above n 5, Question 5.

The existing interpretation of "purpose" and section 36B should be retained

33. We are in favour of retaining the current approach to purpose as applied in the case law and of retaining section 36B of the Act.[28]

34. New Zealand's case law defines "purpose" as effectively a mixture of subjective and objective elements.[29] We consider the same approach should apply to an SLC test under section 36 for two reasons. First, a non-uniform approach would be more likely to cause confusion. If the new section 36 test mirrors the section 27 test, our courts and advisors will be able to seek guidance from the existing body of case law and other materials. Second, this broader approach usefully allows full consideration of pro- and anti-competitive reasons for a firm's behaviour which may be inferred from documents or circumstances. Section 36B codifies the ability to draw inferences in this way.

Section 36A should be amended

35. We consider section 36A should be amended to mirror the (proposed) new section 36 (including removal of the IP-related exception in section 36A(4)). We would encourage MBIE to consult with Australia in respect of parallel amendments to reciprocal provision in the Competition and Consumer Act (CCA). The past view on this provision was that it provides a necessary safeguard against conduct that leverages market power from an Australian or trans-Tasman market into a market in New Zealand.[30]

An authorisation regime could be introduced

36. In principle, we support the introduction of an authorisation regime for unilateral conduct that allows for authorisation of unilateral conduct that has a likely net public benefit to New Zealand. The introduction of an authorisation regime would also increase harmony with Australia. [31]

37. However, there are some material differences between the regimes in New Zealand and Australia that may impact the appropriateness of an authorisation process here. A key example is in respect of authorisations of access pricing, which would be costly, complex and contentious. The ACCC is unlikely to be asked to authorise access prices because a separate national access regime exists under Part IIIA of the CCA.

38. We would also support introducing rules to limit the ability of firms to "game" the authorisation process. The risk is that considerable resources are expended dealing with an applicant that then withdraws its application. This risk would be highest in

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[28] *Discussion Paper*, above n 5, Question 8.

[29] For a discussion on the assessment of purpose under sections 27 and 36, see Thomas Gault (ed) *Gault on Commercial Law* (online looseleaf ed, Brookers) at [CA27.08] and [CA36.08-09].

[30] *Discussion Paper*, above n 5, Question 15.

[31] *Discussion Paper*, above n 5, Question 14.

access cases, where the applicant may be negotiating with access seekers in parallel to the Commission's process.

39. Under section 53R, a supplier that makes a proposal for customised price-quality path cannot withdraw the proposal. Similarly, under section 54 of the Telecommunications Act 2001, applications for a standard terms determination or a designated multinetwork determination cannot be withdrawn. We consider the same should apply to parties that seek authorisation for unilateral conduct.

40. In terms of resourcing, although we expect that the regime may only be used in particular circumstances, the costs of considering an authorisation application would likely be high particularly compared to those estimated for authorisations in Australia, because of the quantitative analysis that we are required to undertake when applying the public benefit test and in the event that the regime was used as mechanism for authorising access prices. Appropriate resources would need to be provided to the Commission to process such applications.

The IP-related provisions should be repealed

41. We support MBIE's proposal to repeal each of sections 36(3) and 45 of the Act.[32] We agree with the issues as identified in the Discussion Paper and discourage amendment in favour of repeal principally because the exemptions are not necessary or desirable under the Act. We also do not oppose repeal of subsections 7(2) and (3) of the Act for the reasons that MBIE has identified.

Repeal of sections 36(3) and 45

42. We agree that there is no strong rationale for treating IP rights differently to any other form of property or assets under competition law.[33] Intellectual property rights find promotion and protection under the law on which they are based – be it statute (for example, trademarks are governed and protected under the Trade Marks Act 2002) or common law (for example, the tort of passing off). But in competition law, with its broader focus on the long-term benefits of competition for consumers, commercial transactions involving IP rights should be subject to the same anti-competitive prohibitions as transactions and unilateral conduct involving other forms of property and assets.

43. The current exemptions mean that anti-competitive conduct involving intellectual property may be exempt from the Act. For example, where there are competing IP rights within a market and IP owners enter into agreements which impose anti-competitive restrictions on each IP owner. On the other hand, where the conduct is pro-competitive, the exemptions are not needed as, plainly, the conduct is unlikely to cause an SLC. As noted by the Harper Panel, granting an exclusive licence to commercialise an IP right is unlikely to substantially lessen competition even if the manner of that commercialisation is restricted in accordance with the scope of the IP

[32] *Discussion Paper*, above n 5, Question 25.
[33] *Discussion Paper*, above n 5, at [240] and Question 21.

right – without the licence, the IP could not be commercialised at all.[34] In addition, we agree that IP-related conduct in relation to cartels may fall within the general exceptions for such conduct.[35] Accordingly, we are not concerned that pro-competitive conduct may be captured as a result of the proposed repeal.

44. Repeal of the IP-related exemptions would also align New Zealand with the global approach to IP in competition law. New Zealand has ventured further into special treatment of IP in competition law than Australia,[36] the US, Canada, the UK and the EU. Indeed, Australia has recently moved to repeal section 51(3) which provided a limited exception for conditions in a licence or assignment from most anti-competitive prohibitions for certain IP-related transactions. The ACCC favoured this repeal and said that the use of IP rights should be governed by the Competition and Consumer Act 2010 (CCA) in the ordinary way.[37]

45. In recommending repeal, the Harper Review Panel observed:[38]

> In those jurisdictions, IP assignments and licences and their conditions are assessed under competition laws in the same manner as all other commercial transactions. The courts in those jurisdictions distinguish between competitively benign and harmful IP transactions, taking account of all relevant circumstances of the transaction and the conditions imposed. There is no evidence that this has diminished the value of IP rights in those countries.

46. Australia has since introduced legislation to repeal the IP-related exemption in section 51(3)[39] and there is no equivalent of section 36(3) under the CCA. We have already summarised our views on the benefits of harmony with Australia's regime. The Harper Review's critique of the IP exemptions largely applies to New Zealand's current position, which is now an anomaly in comparable jurisdictions.

47. There are also interpretation issues and we agree that the precise boundaries of the provisions are unclear.[40] This uncertainty could be remedied by amendments to the language of these provisions; however, it is our view that the main issue is the possibility that anti-competitive IP-related conduct escapes analysis. Therefore, we favour repeal of these sections.

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[34] *Harper Review*, above n 10, at 109.

[35] Commerce (Cartels and Other Matters) Amendment Act 2017.

[36] Ian Eagles "Regulating the Interface Between Competition Law and Intellectual Property in New Zealand" (2007) 13 NZBLQ 95 [*Eagles*].

[37] ACCC "Reinvigorating Australia's Competition Policy: Submission to the Competition Policy Review" (25 June 2014) at 58.

[38] *Harper Review*, above n 10, at 109.

[39] The IP exemption has been repealed by the Treasury Laws Amendment (2018 Measures No. 5) Bill 2018 which is awaiting Royal Assent. IP licences remain exempt from the per se cartel provisions in the CCA insofar as they impose restrictions on the production of goods or services through licensed IP. We do not propose a similar exemption because of the general exceptions that already exist in the Act.

[40] *Discussion Paper*, above n 5, at [236]; also see generally *Eagles*, above n 36.

Repeal of subsections 7(2) and (3)

48. We agree with the observation in the Discussion Paper that the scope of and rationale for these subsections is unclear.[41] Indeed, it seems that the provisions were lifted from the Trade Practices Act 1974, in which context they would make more sense.[42] The tort of breach of confidence protects against the unauthorised use or disclosure of information that has the necessary quality of confidence about it and which was imparted in confidence. Section 7(2) provides that the Act does not affect claims for such a breach. It is unclear whether this means that conduct which is a breach of confidence is or is not still subject to the Act. There is no case law on this section nor the Australian equivalent, section 4M of the CCA.

49. In the Discussion Paper, MBIE has proposed repeal of subsections 7(2) and (3). We have not been able to identify any rationale for retention of these subsections and do not oppose repeal.

Section 2 should be amended to include covenants

50. We support MBIE's proposal to redefine a "contract" in section 2 of the Act to include a covenant as described in Option 3 of the Discussion Paper.[43] The removal of the prohibition against covenants involving a cartel provision was an oversight in the context of the broader amendments to the cartel provisions. We agree that the absence of a specific prohibition against such covenants is undesirable because it may create a loophole for cartel behaviour.

51. We agree with the reasons for preferring Option 3 advanced in the Discussion Paper.[44] In particular, although Option 2 is equally consistent with the policy intent that covenants should be treated the same as a provision of a contract, Option 3 will simplify the legislation relative to both the status quo (Option 1) and Option 2. This simplicity will increase certainty for parties as well as for enforcement because there will only be one set of relevant provisions.[45] This is also consistent with the position recently adopted in Australia which brings benefits already described in this submission.

Conclusion

52. It is our view that reform of section 36 to an SLC test, repeal of the IP-related provisions, and redefinition of "contract" as proposed in the Discussion Paper are appropriate moves to better fulfil the Act's policy objective of protecting the competitive process. As will be obvious from our submission, we consider that reform of section 36 to an SLC test will achieve significant and tangible benefits for New Zealand and will align New Zealand with comparable jurisdictions. Repeal of the IP-related provisions and redefining a "contract" in the Act to capture covenants will

[41] *Discussion Paper*, above n 5, at [223]; *Eagles*, above n 36 at 103-104.
[42] *Eagles*, above n 36, at 104.
[43] *Discussion Paper*, above n 5, Question 30.
[44] *Discussion Paper*, above n 5, at [309]-[310].
[45] *Discussion Paper*, above n 5, at [310].

better facilitate identification of anti-competitive conduct and enforcement of the Act – an outcome that must benefit New Zealand.

53. We hope this response is useful in your deliberations. Commission staff are happy to continue to engage with MBIE in relation to this review. If you have specific questions on this submission please contact John Stewart, Advocacy Adviser on 04 924 3706 or john.stewart@comcom.govt.nz in the first instance.