FACT SHEET

COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

The Commerce Act

Misuse of Market Power

This fact sheet explains the prohibition on the misuse of market power set out in Section 36 of the Commerce Act 1986. It is intended to give businesses a better understanding of the types of behaviour that risk breaking the law. Further information on the prohibition is provided in our Misuse of Market Power Guidelines.

One of the ways the Commerce Act promotes competition is by prohibiting firms with substantial market power from misusing that market power to harm competition.

A firm with market power may be able to damage the competitive process if it can significantly restrict or hinder the ability of its rivals to compete. It may also be able to deter potential rivals from competing by imposing barriers to slow down their entry or expansion or prevent them from entering a market altogether.

What is illegal under section 36?

Section 36 of the Commerce Act provides:

36 Misuse of market power

(1) A person that has a substantial degree of power in a market must not engage in conduct that has the purpose, or has or is likely to have the effect, of substantially lessening competition in—

(a) that market; or

(b) any other market in which the person, or an interconnected person,—

(i) supplies or acquires, or is likely to supply or acquire, goods or services; or

(ii) supplies or acquires, or is likely to supply or acquire, goods or services indirectly through 1 or more other persons.

In summary, a business will breach the Commerce Act if it:

- Has a substantial degree of market power in a market
- Engages in conduct
- With the purpose, effect, or likely effect of substantially lessening competition
- In a market in which the business supplies or acquires goods and services.

What is the relevant market?

To decide whether a business has a substantial degree of market power, we first need to understand the market, or markets, in which the business operates.

A market includes those products or services that are considered substitutable for one another as a matter of fact and commercial common sense.

In defining markets, we look at the extent to which consumers and suppliers could viably substitute products and services for each other in the face of price increases.[1]

Businesses may have power in one market but may use that power in a different (but related) market. This can still be illegal under section 36.

What is substantial market power?

Only businesses that have substantial market power can harm competition in breach of section 36. A business has substantial market power when it can profitably hold prices above competitive levels for a sustained period. Such a price rise will only be profitable if the business does not face effective competition from rivals in the same market.

When assessing whether a business has substantial market power, we consider how much existing and potential competition the business faces. We also look at other factors such as how much power buyers have.

1 Sometimes defining the market is a more technical exercise. You can read more about how we define a market at www.comcom. govt.nz/business/merging-or-acquiring-a-company

Engaging in Conduct

Engaging in conduct includes both doing something and refusing to do something. Refusing to do something includes making it known that it will not be done.

Purpose, Effect, Likely Effect

When assessing a firm's conduct, the Commission considers the nature and extent of that conduct.

The purpose of conduct is the firm's object or aim; what it was intended to achieve. If the conduct was engaged in for multiple reasons, it will be sufficient if a substantial purpose is anticompetitive. Once an anti-competitive purpose is established, the existence of some other motive is irrelevant.

Conduct can have a purpose of substantially lessening competition in a market even if it does not have that effect or is not likely to have that effect.

Whether a provision has the actual or likely effect of substantially lessening competition is a question of fact.

- 'Effect' refers to the consequence of a firm's conduct. This is determined objectively by examining the actual impact on the competitive process and the relevant market.
- 'Likely effect' involves considering results that may happen or could have happened. 'Likely' means that there is a real chance or possibility that is not remote. Conduct may have the likely effect of substantially lessening competition at the time it occurs, even though it does not in fact result in a substantial lessening of competition.

How we analyse competitive effects and likely effects

To assess whether conduct has substantially lessened competition, or is likely to have done so, we typically compare the state or likely state of competition with the conduct (often referred to as the factual) with the state of competition without the conduct (often referred to as the counterfactual).

This is often referred to as a "with-or-without" test:

- In the case of an "effect", we typically compare the actual state of competition in the market with the state of competition that would have occurred in the absence of the conduct.
- In the case of "likely effect", we typically compare the likely state of competition if the conduct is engaged in with the likely state of competition if it is not.

A substantial lessening of competition may arise where the conduct makes entry and expansion more difficult, or otherwise reduces the ability or incentive of competitors to compete. Conduct does not need to make it impossible for a competitor to enter or compete to have this effect.

The ultimate question is whether the conduct has lessened, or is likely to lessen, the constraints on the firm with market power, compared with the constraints it would have felt absent the conduct.

Types of conduct that are unlikely to substantially lessen competition

The Commission aims to distinguish between desirable vigorous competition, which may harm individual competitors but which delivers good outcomes for consumers, and conduct that harms the competitive process and results in consumer harm.

Section 36 does not prohibit a firm from having substantial market power. A firm with substantial market power may continue to possess market power, provided it does not engage in conduct to substantially lessen competition.

Section 36 also does not prohibit a firm from charging high prices to end consumers.

It is not unlawful for a firm with substantial market power to compete strongly, even where that causes competitors to lose sales or even to exit. Competition is unlikely to be substantially lessened by:

- Genuine innovation, including the offering of new products or better or more efficient ways of delivering existing products;
- Conduct that improves efficiency and drives down costs and prices to consumers; and
- Firms responding to competitive offerings in the market by sustainably improving the quality or price of their product.

Firms and advisors should reassess their position at appropriate intervals and consider whether conduct remains unlikely to breach section 36 of the Commerce Act, for example where there have been significant changes in market dynamics and/or the firm's market power.

What types of behaviour may be illegal under section 36?

The types of conduct that may substantially lessen competition are potentially broad. The misuse of market power prohibition applies to any conduct by firms with substantial market power that has the purpose, effect or likely effect of substantially lessening competition.

We can, however, identify some conduct that is at increased risk of substantially lessening competition based on New Zealand and overseas experience.

Refusal to Supply

Firms are generally entitled to choose who they will supply. However, when a firm with substantial market power refuses to supply an input to downstream rival(s), it may hinder or prevent those firms from competing in the downstream market.

Two factors relevant to an assessment of whether a refusal to supply has the purpose, effect, or likely effect of substantially lessening competition are:

- The extent to which the input is required for competition in the relevant downstream market. If there are sufficiently close substitute inputs, or alternative methods that do not require the input, competition is less likely to be affected by a refusal to supply.
- The extent to which there are alternative sources of competitive supply of the input, including through entry. If the input is available from other sources on similar terms, or could become available with commercially viable investment within a reasonable timeframe, competition is less likely to be affected.

A refusal to supply may substantially lessen competition without completely preventing the downstream rival from competing. For example, a refusal to supply might raise rivals' costs significantly because the rival must use a more costly alternative, thus reducing their competitive constraint and enabling a firm with substantial market power to increase its prices or reduce quality and innovation in the downstream market.

Price Squeeze

A price/margin squeeze can occur when a vertically integrated firm with substantial market power sets prices in an upstream wholesale market in a manner that prevents efficient competitors from profitably operating in the downstream retail market. In some situations, a price squeeze may also be viewed as a constructive refusal to supply.

Where competitors in the downstream market require the input and have limited or no alternative sources of competitive supply, a margin or price squeeze has the potential to prevent competitors in the downstream market from competing with the firm in that market on their merits, or prevent competing firms from gaining sufficient size and scale to achieve an equal footing with existing participants in the market.

Tying and Bundling

'Tying' occurs when a supplier sells one good or service on the condition that the purchaser buys another good or service from the supplier. In other words, product A is only available if the buyer also agrees to buy product B.

'Bundling' occurs when a supplier offers two or more products for a lower price if the products are purchased as a package.

Selling products together in this way can often be good for both consumers and suppliers but, sometimes, tying and bundling can harm competition. Where the firm engaging in the tying or bundling strategy has market power, and the tying or bundling conduct impedes the ability of rival players to compete, this can harm competition.

Predation

Firms compete by providing more compelling offers to consumers than their competitors. This often involves firms undercutting prices offered by rivals. In almost all circumstances low pricing is beneficial for consumers and is part of the competitive process. However, very low pricing by a firm with substantial market power may in some situations have the effect or likely effect of substantially lessening competition.

Predatory pricing occurs when a firm substantially reduces its prices for a sustained period or at strategic times, with the purpose, effect or likely effect of damaging a competitor, inducing exit or deterring entry.

Other Conduct

As noted above, it is not possible to precisely and exhaustively identify and categorise all types of conduct that may substantially lessen competition. Some other ways in which conduct may be harmful include (but are not limited to):

- **Raising rivals' costs:** conduct by a firm with substantial market power can raise the cost of, or partially or totally restrict, competitors from accessing customers or the inputs they need for their business. This may cause the competitors to raise their own prices or reduce their output, allowing the firm with substantial market power to raise its prices.

- **Raising regulatory barriers:** conduct by a firm with substantial market power can make the conditions for entry more difficult where the firm has the ability to influence the creation or maintenance of regulatory barriers. This may reduce the constraint that entry places on the firm with substantial market power. This could include standard setting, where standards exclude actual or potential competitors.
- **Abuse of legal rights:** a firm with substantial market power may use legal or regulatory proceedings in an unreasonable or vexatious manner in order to hinder or exclude rivals or potential entrants.
- **Restricting interoperability:** conduct by a firm with substantial market power can restrict the ability of its products to operate with the products of its competitors. This can impact competition, for example by hindering switching or multi-homing, and reducing the attractiveness and value of rival products. This can foreclose existing competition and make entry more difficult.
- **Facilitating practices:** conduct by a firm or firms with substantial market power which has the effect of softening competition between firms or enabling them to coordinate their behaviour, potentially resulting in higher prices or lower quality for downstream consumers.
- **Self-preferencing:** Self-preferencing involves conduct by a firm with substantial market power that is designed to favour its own products or services over those of its competitors. For example, an online marketplace may show products of the marketplace owner even where these are not the best fit for the customer's search terms.
- **Forced Free Riding:** Forced free riding involves conduct by a firm with substantial market power to appropriate the innovation or effort undertaken by rival firms. For example, an online platform may use data or content generated by rivals' use of the platform in order to produce rival products that divert sales or traffic away from those rivals.

Penalties

If the courts find an individual or body corporate has breached the Commerce Act, penalties can be heavy:

- For an individual the maximum penalty is $500,000.
- The maximum penalty for a firm is, the greater of:
  - $10 million, or
  - Three times the commercial gain, or
  - If this cannot be easily established, 10 percent of turnover in each accounting period in which the breach occurred.

Penalties can also be imposed on firms or individuals who are directly or indirectly involved in another person's breach of the Commerce Act.

Every separate breach of the Commerce Act (even if done by the same person) may incur a penalty.

Authorisation

Authorisation provides protection against legal action for future conduct that might breach the Commerce Act, including the misuse of market power prohibition.

A firm can apply to the Commission for authorisation where they propose engaging in conduct that they consider would or may breach section 36 of the Commerce Act. Authorisation is not available for historic or ongoing conduct.

We must only authorise conduct that would otherwise breach section 36 of the Commerce Act if we are satisfied that engaging in the conduct will be likely to result in a benefit to the public that would outweigh the lessening in competition (the 'public benefit' test).[2]

2 Refer to our Authorisation Guidelines, available at https://comcom.govt.nz/__data/assets/pdf_file/0012/91011/Authorisation-Guidelines-December-2020.pdf

Contact us with information about possible breaches of the laws we enforce:
Phone: 0800 943 600 **Write**: Enquiries Team, PO Box 2351, Wellington 6140 **Email**: contact@comcom.govt.nz