

10 February 2016

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

Dear Review Team

Commerce Commission submission to Targeted Commerce Act Review Issues Paper

1. We welcome the opportunity to submit to this stage of the review and look forward to our engagement with MBIE going forward.
2. As a general comment, we consider that the Issues Paper appropriately identifies the policy issues and considerations relevant to: reform of section 36 (s 36) of the Commerce Act; an evaluation of the Commerce Act's enforcement mechanisms; and the question of whether market studies should be introduced to New Zealand.
3. As a result, we have not addressed every question posed in the Issues Paper. Rather, we have offered some observations and perspectives on the three topics addressed in the paper.

Section 36

4. We support reform of s 36 and the Commission's current preference is to move s 36 to a substantial lessening of competition (SLC) test. This view is consistent with the view we expressed in our submission to the Australian Competition Policy Review (Harper Review).¹
5. New Zealand is a small economy, some distance from many of its trading partners. We appreciate that these features can make it challenging for New Zealand businesses to acquire the scale they believe they need to operate efficiently and compete effectively in global markets. It is perhaps for these reasons that the level of aggregation often tolerated in New Zealand's domestic markets is higher than in some larger economies.
6. Some argue that New Zealand's small size and apparent need for increased scale also necessitate a more relaxed attitude towards single firm conduct in New Zealand markets. We disagree. As discussed in the relevant literature², we consider that any

¹ <http://competitionpolicyreview.gov.au/files/2014/11/NZCC.pdf>

² Michal Gal *Competition Policy for Small Market Economies* (Harvard University Press, Cambridge, 2003) at

tolerance for higher market shares in domestic markets reinforces rather than undermines the need for effective rules prohibiting anti-competitive practices by firms with substantial market power. That is, an effective s 36 is needed to ensure that competition in New Zealand domestic markets serves the long term interests of consumers.

7. Section 36 does not achieve this. Simply put, it is not effective at identifying single firm conduct that is harmful to competition and the New Zealand economy. The reason is primarily the way the courts have interpreted the “taking advantage” part of s 36, by introducing a counterfactual test.
8. The purposes in s 36 are phrased in terms that might suggest that s 36 is directed to protecting competitors rather than competition. Courts have been concerned that all firms act with the purpose of harming their competitors. There is a need therefore to distinguish between conduct by a firm which, while designed to harm its competitors can be regarded as vigorous ‘competitive’ conduct (ie, that which promotes competition) as opposed to ‘anti-competitive’ conduct (ie, that which diminishes competition). New Zealand courts have done this through their interpretation of the taking advantage limb of s 36. The counterfactual test, as interpreted by the courts, examines the conduct of a firm with a substantial degree of market power compared to the likely conduct of a firm without such market power.
9. The result of this interpretation of the counterfactual test is that conduct by a firm with substantial market power, which has the effect of a SLC (substantially lessening competition) in a New Zealand market, may not be prohibited even though New Zealand consumers will more than likely be worse off. The test is, therefore, at odds with an underlying foundation of competition law that what matters is the impact of a firm’s conduct on competition, because of the benefits that competition brings to an economy.
10. Neglecting the effect of the conduct is not in keeping with rest of New Zealand’s competition law. Other sections of the Commerce Act look at the effect of the conduct on the relevant market.³ These sections provide a good base for a revised 36. Section 36 is also misaligned with international best practice in considering unilateral conduct.⁴ The only country with a similar provision is Australia,⁵ and there the Harper Review recommended reform to remove “taking advantage” and adopt an SLC based provision.

Potential options for reform of section 36

11. Having said all this, we recognise that the challenge is to frame a law that captures anti-competitive unilateral behaviour but does not constrain vigorous competitive conduct.

³ For example, s 27 looks at whether the conduct has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

⁴ Andrew Gavil “Imagining a Counterfactual Section 36: Rebalancing New Zealand’s Competition Law Framework” (2015) 46 VUWLR

⁵ Competition and Consumer Act 2010 (Australia), Section 46

12. We note the potential options on page 32 of the Issues Paper. As set out above our preferred option at this point is option 4 – a SLC test. We consider this test would capture anti-competitive unilateral behaviour while enabling firms to compete vigorously on the merits of their products and services, including in international markets. It would also shift the focus to protecting the competitive process and not competitors.

Alternative enforcement mechanisms

Cease and Desist

13. The Commission supports the repeal of the cease and desist regime. In the Commission’s assessment, injunctions provide a more cost effective and efficient method of stopping harmful conduct.
14. This is because, as illustrated by Table 4 in the Issues Paper, the Commission has to navigate more procedural and practical hurdles to secure a Cease and Desist Order than it does to secure an interim injunction. In addition, a Cease and Desist Order is appealable to the High Court, at which point litigation commences in another forum.
15. For example, to secure a Cease and Desist Order, the Commission must establish a prima facie case of breach, a standard which is likely higher than the serious question to be tried threshold for an interim injunction. The practical implication of having to reach a prima facie case standard (and the requirement that a report be submitted to Commissioners before an order is sought) means that it may be difficult for the Commission to obtain a Cease and Desist Order quickly, as more extensive investigation will be required to meet the prima facie case threshold.⁶ This then raises the question of whether at the time a Cease and Desist Order is sought (after comprehensive investigation), the Commission could satisfy the “necessary to act urgently” limb of the test.

	Interim Injunction ⁷	Cease and desist order
Legal threshold	<ul style="list-style-type: none"> • There is a serious question to be tried • The balance of convenience favours the granting of an injunction • It is in the interest of justice to grant the injunction 	<ul style="list-style-type: none"> • A prima facie case of conduct that breaches the Act (this is the same standard the Commission uses for warnings). • Necessary to act urgently to prevent serious loss or damage to a particular person or consumers. • It is in the interests of the public to grant the order.
Key procedural steps	<ul style="list-style-type: none"> • Staff investigation to indicate serious question to be tried • Recommendation to 	<ul style="list-style-type: none"> • Staff investigation to indicate prima facie breach of the Act • Recommendation to Commerce

⁶ Of course, appropriate evidence would still need to be adduced before the Court to obtain an interim injunction.

⁷ See generally McGechan on Procedure at [7.53].

	<p>Commerce Commissioners to apply for an injunction.</p> <ul style="list-style-type: none"> • Application for injunction • Usually service of application followed by opposed hearing • Interim injunction may be sought in some circumstances without notice (HCR 7.46). 	<p>Commissioners to apply for a Cease and Desist order.</p> <ul style="list-style-type: none"> • Application to a Cease and Desist Commissioner • Service of proposed order • Mandatory opportunity to be heard. • Appealable to High Court.
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16. The (lack of) utility of Cease and Desist Orders is illustrated by the fact that the Commission has only used the Cease and Desist regime once since its enactment in 2001.⁸ For various reasons, including those explained above, we do not believe that the Commission could have used these orders more regularly. We do not believe that the lack of use of these orders has affected the Commission's ability to achieve appropriate enforcement outcomes.

Settlements

17. The Commission does not believe it is accurate to describe the current settlement process as 'weak', or the lack of administrative settlements as being indicative of a problem with the system. In most cases the Commission regards conduct as requiring a court approved settlement involving admissions of breach. Administrative settlements occur in the minority of Commerce Act matters. Moreover, we have not faced a situation where a party to a settlement agreement (administrative or court approved) has ultimately reneged on the agreement, when faced with steps to enforce the settlement in Court.
18. Having said that, we do consider that enforceable undertakings would be a useful addition to our enforcement toolkit. The Commission was granted these powers in recent amendments to the Fair Trading and Credit Contracts and Consumer Finance Acts and has already entered into these undertakings a number of times. This has been beneficial as a way to promptly effect change in a trader's behaviour, and to benefit consumers.
19. In the Commerce Act context, while we do not believe that the number of administrative settlements/enforceable undertakings would be likely to increase at the expense of court approved settlements, there would be some benefit in being able to settle some matters involving future behavioural changes without needing recourse to the courts.
20. An example of this is a recent warning we issued to Consolidated Alloys (N.Z) Limited as a result of an agreement it had reached with one its competitors. The agreement contained a restrictive clause (which had yet to have an anti-competitive effect, but

⁸ <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2006/firsteverceaseanddesistorderissued>

would have had in the future), which the parties agreed not to enforce as a result of our investigation. The Commission considered the parties decision not to enforce the clause as part of its enforcement response. However, an enforceable undertaking would have allowed the Commission to have had more certainty and a straight forward remedy in the case that the parties subsequently gave effect to the clause.

21. There is also benefit in the fact that these undertakings can also be amended by agreement with the Commission. This would allow the Commission to agree changes that both parties see as positive but that were not foreseen at the time the original undertaking was given.

Market Studies

22. We believe there may be a gap in New Zealand's competition framework that could be filled by market studies. These studies would allow an agency to analyse competition in a market in a more holistic way. The result of a study could range from policy change to remove anti-competitive regulation to Commerce Act enforcement.
23. At this point the Commission has no policy position on who should conduct market studies if a market study regime is introduced. We think this matter is best left to discussion at the options paper stage. However, we provide some general comment to assist officials in determining which options should be considered.

Is there a gap?

24. In short, the Commission's current power to undertake inquiries or studies similar to market studies is fairly narrow. Specifically, it is confined to formal questions about whether a market should be regulated, and matters related to the telecommunications and dairy industries.
25. Several other agencies such as the Productivity Commission and MBIE undertake studies of markets, and while competition issues feature they are not the focus of these studies.
26. The Commission may undertake studies and publish reports and information regarding matters affecting the interests of consumers under section 6(b) of the Fair Trading Act 1986 (FTA). A recent example is the Commission's report into mobile traders.⁹ The Commission's ability to undertake studies into matters affecting consumer interests provides some scope to look at particular competition concerns (when linked to consumer matters), but it is unlikely to provide the power to look at all determinants of competition in a particular market.

Structure of a regime

27. The agency receiving market studies powers would need to be adequately funded for these studies. We consider that the funding required would be significant. Based on our experience of 'market study type investigations' (eg, the current DIRA Review),

⁹ Commerce Commission *Mobile Trader 2014/2015 Project* (2015) available at <http://www.comcom.govt.nz/the-commission/consumer-reports/mobile-trader-201415-project/>.

market studies are a specialised activity that will require staff, contractors and experts with relevant experience and a specialised skillset. This would require additional funding in order for market studies to be conducted without affecting the agency's other responsibilities.

Powers

28. We believe that the responsible agency does need powers to compel information. In order for the regime to be effective, the agency needs to be able to gather the information required to conduct its analysis. There may be instances where market participants will be unwilling or unable absent being compelled to provide information.
29. We also consider that there should be adequate safeguards on the use of those powers. We consider that the current formulation and interpretation of s 98 of the Commerce Act provides adequate safeguards. If the Commission were to receive market study powers, then we consider they should simply form part of the Commission's s 98 powers rather than introducing a new and unknown framework. Similar considerations should apply to any other agency that was to receive a market study power.

Outcome of the study

30. We do not believe that a remedies based market studies system is appropriate in a New Zealand context.¹⁰ We believe the best option is a recommendation based system where the agency makes recommendations to the government. To ensure this system is effective, we suggest there should be a statutory requirement for the government to respond in a certain timeframe.

Conclusion

31. 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 _____ in the first instance.

Yours sincerely

General Manager, Competition

¹⁰ Example of such a system would be the UK (Part 4 Enterprise Act 2002).

Targeted Review of the Commerce Act 1986

Cross-submission to the Ministry of Business, Innovation and Employment

Date: 21 July 2016

Executive summary

1. Competition, and competitive behaviour, delivers benefits for consumers. New Zealand's economic laws, including the Commerce Act, are based on that premise.
2. However, in the Commission's view section 36 of the Commerce Act is not apt to fulfil its policy objective of protecting the competitive process. This creates the real and appreciable risk that the competitive process in many New Zealand markets can be damaged by anti-competitive unilateral conduct. Because section 36 is (appropriately) focussed on firms with substantial market power, any damage caused would be significant.
3. Concern is raised in submissions that examining the impact of a firm with substantial market power's conduct on the competitive process would hinder innovation or competitive conduct. It is said innovative or competitive conduct would be chilled.
4. We do not agree. A properly effective unilateral conduct provision should not 'chill' competitive or innovative conduct. This has not been the experience overseas, and we cannot see why it would be in New Zealand. To the contrary, an effective unilateral conduct provision will prevent firms with substantial market power from engaging in conduct that excludes 'challenger' firms.
5. We emphasise that the Commission has no interest in promoting a test that harms the competitive process. The Commission's role is to promote the competitive process, not hinder it. We also emphasise that an effective unilateral conduct provision should protect the process of competition, rather than any particular market structure. This competitive process is what delivers benefits to New Zealand. And while we can understand why large firms would wish to maintain the current permissive section 36, we disagree with their arguments in support of the status quo.
6. Focussing on whether the test is an effects test or a purpose test tends to obscure the crux of the problem with section 36 – the taking advantage test. The problem with the taking advantage test is that it effectively exempts conduct undertaken by a firm with substantial market power if it can be shown that a firm in a competitive market would have engaged in the same conduct. In doing so the test makes the main focus a hypothetical inquiry into the possible reasons why another firm may undertake conduct as opposed to the more important question of why the particular firm with market power undertook the conduct and the impact of that conduct, both pro- and anti-competitive.
7. In effect the test means that if conduct would be undertaken by a firm in a competitive market, it is presumed that it will not harm the competitive process if undertaken by a firm with substantial market power.
8. This is not a safe way to sort conduct that is liable to harm the competitive process, from conduct that is not. Indeed, as can be seen, the impact of the conduct is not even a core question that is asked as part of the taking advantage test. The test assumes that the firm in a competitive market would have the same business

rationale for undertaking the conduct, where in reality, the business rationale will often differ as the real-life impact of the conduct will differ.

9. We consider the best way to ensure that conduct does not harm the competitive process is to focus a test directly on the impact of the conduct on the competitive process. We consider that MBIE should move to an options paper stage with tests focussed directly on the impact of conduct on the competitive process. We have suggested a substantial lessening of competition test be one of those options.
10. We disagree with the submissions that suggest such a change would create uncertainty and costs. In any event,
 - 10.1 Moving from the taking advantage test to a competition test does not replace a highly certain test with a highly uncertain test. To the extent the current test can be regarded as certain, it is not the kind of business certainty that promotes New Zealand's economic welfare. Rather, any certainty arises from the test's permissiveness and its failure to examine economic harms.
 - 10.2 The taking advantage test is not as certain as proponents of it portray. The inherent uncertainties involved in applying the test through ascertaining the counterfactual are well documented.
 - 10.3 Moving to a competition based test would not mean that firms would be unable to engage in competitive conduct. The actual reasons why a firm has engaged in conduct will be highly relevant to that enquiry. Other parts of the Commerce Act already have tests focussed on protecting the competitive process directly. Firms and their advisors are currently dealing with these and there is no suggestion they are impeding competitive conduct.
 - 10.4 As noted above, globally, unilateral conduct tests focus on harm to the competitive process directly and there is no suggestion New Zealand markets are more competitive, dynamic or innovative than those markets, let alone that this is because section 36 exists in its current form.
11. On the flip side, greater competition delivers demonstrable benefits. In the Commission's view, a change would be justified if it deterred or prevented one anti-competitive act by a firm with substantial market power. By definition, the impact of such behaviour will be significant for New Zealand.

Introduction

12. Thank you for the opportunity to cross-submit on the Targeted Commerce Act Review (the Review).
13. We consider that section 36 of the Commerce Act is not apt to fulfil its policy objective of acting as an effective mechanism to deter firms with substantial market power from engaging in anti-competitive conduct. The reasons for this view are stated in our submission on the issues paper, and in this cross-submission which responds to many of the submissions made in opposition to reform.
14. We consider that there is ample evidence to support the view that section 36 is in need of reform, and that warrants issuing an Options Paper. The evidence comprises academic commentary, an international consensus of what unilateral market power prohibitions should be concerned with, and practical evidence of the complications caused by section 36.
15. Conversely, there is no strong case for concluding that there is no need for reform at this stage. The essence of that view, from submitters in opposition, is that the benefits from reform do not outweigh the costs of increased uncertainty for business. We do not agree with those submissions, nor have we seen any evidence to suggest that a change to a competition test would undermine business certainty in a way that would result in New Zealand being worse off. Moreover, any trade off can only be made after a full and robust consideration of the competing arguments. This is a process that can only happen when options for reform are on the table.
16. We consider one of the options for reform should be the introduction of a substantial lessening of competition test. There may be other apt tests, but we consider that the substantial lessening of competition test is the one test likely to have the lowest transitional costs. One of the options could be the current section 36, although for the reasons we explain, we do not consider that is justified.
17. In making our original submission and this cross-submission, and advocating for reform, we are motivated by ensuring New Zealand has competition laws which promote competitive outcomes and the long-term interests of New Zealand consumers.
18. There is an irony in the submissions in opposition that have a sub-text of regulatory overreach. The Commission simply has no interest in advocating for a unilateral conduct test that prevents firms, of whatever size, engaging in innovative or pro-competitive conduct. Competition delivers benefits for consumers, and New Zealand's competition laws should provide a framework in which that competition can flourish. That is why we are advocating for reform. We are also on record stating that in our view there is a legitimate role for firms to put forward efficiency and other justifications for their conduct as this helps to sort the pro-competitive effects from the anti-competitive effects.¹

¹ Commerce Commission submission to the Competition Policy Review (2014) at [3.3].

19. **Attachment A** provides a comprehensive response to the points made in submissions opposing reform. However, while various submissions were made and are responded to in Attachment A, they can essentially be classified under one of two themes, being:
- 19.1 there is currently no real problem with the operation of section 36, and so there will be little or no benefit from reform; and
 - 19.2 reform will be too costly: it will result in reduced business certainty and prevent businesses from engaging in competitive conduct.
20. This cross-submission addresses both of those themes.
21. It is relevant to note that these same essential submissions were advanced to Australia’s Competition Policy Review (Harper Review). They were rejected with the Harper Review concluding that change to a substantial lessening of competition test (removing the ‘take advantage’ limb) would promote Australia’s economic interests.
22. While we acknowledge that New Zealand should not blindly follow Australia on matters of policy, it is very relevant that the Harper Review considered and rejected the very same arguments being used to oppose reform in New Zealand. We have seen no analysis which suggests that the arguments against reform put forward and rejected in Australia should apply with more force in New Zealand. Indeed, as explained in this cross submission, we consider the opposite is the case.

The case for change

Submissions that there is no problem with section 36

23. Submitters opposed to reform argue variously that there is no demonstrated problem with section 36. They say the test is “relatively simple to apply; relatively predictable due to the well-established body of case law; proportionate; and appropriate for the size of our economy where concentrated markets are more likely”,² that there is “no clear experience outlined of definitively anti-competitive conduct by powerful firms in New Zealand worthy of justifying a change to the status quo”,³ “current law is well understood”,⁴ and there is “insufficient evidence to justify a review of section 36”.⁵ Various submitters also argue that section 36 – and the taking advantage test – is not so different to approaches overseas.
24. For the reasons explained below, we disagree. We consider that reform of section 36 is necessary because section 36 is not currently effective in promoting competition in New Zealand domestic markets for the long term interests of consumers. Section 36 is not effective primarily because of the way the courts have interpreted the “taking

² Chorus submission to the Ministry of Business, Innovation and Employment (**MBIE**) (February 2016) at [7].

³ Insurance Council of New Zealand submission to MBIE (9 February 2016) at 1.

⁴ Retail NZ submission to MBIE (9 February 2016) at [13].

⁵ Spark New Zealand submission to MBIE (9 February 2016) at [3].

advantage” part of section 36, a view shared by the Harper Review, which concluded:⁶

In the Panel’s view, the ‘take advantage’ limb of section 46 is not a useful test by which to distinguish competitive from anti-competitive unilateral conduct. The test has given rise to substantial difficulties of interpretation, revealed in the decided cases, undermining confidence in the effectiveness of the law.

The role of unilateral conduct provisions

25. When assessing the performance (and options for reform) of section 36 it is important to reflect on the role that it, and the Commerce Act more generally, are supposed to play in New Zealand’s economy.
26. There can be no question that competition plays a critical role in supporting a productive and well-functioning economy. It is well-accepted that competitive markets bring significant benefits to consumers, as competition incentivises businesses to compete on price and non-price components of their goods and services. This principle is enshrined in the purpose of the Act: to promote competition in markets for the long-term benefit of consumers within New Zealand.⁷ As the Court of Appeal has recognised:⁸

[The Act] is based on the premise that society’s resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources.

27. Competition positively affects productivity for firms and across industries.⁹ Businesses in competitive markets are incentivised to minimise their costs and improve efficiency, which in turn drives both productive and dynamic efficiency in the economy.¹⁰ This has been demonstrated in New Zealand, where increased competition in markets has been shown to drive increased efficiency and significant local benefits.¹¹

⁶ Professor Ian Harper, Peter Anderson, Su McCluskey, and Michael O’Byrne QC “Competition Policy Review: Final Report” (March 2015) (**Harper Report**) at 338.

⁷ Commerce Act 1986, s 1A.

⁸ *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA) at 358.

⁹ See Productivity Commission “Boosting Productivity in the Services Sector” (2014) at 81-82, citing Sanghoon Ahn “Competition, Innovation and Productivity Growth: a Review of Theory and Evidence” (OECD Economics Department Working Papers No. 317, 17 January 2002) at 16-19; United Kingdom Office of Fair Trading “Productivity and competition, an OFT perspective on the productivity debate” (2003) at 15; Chad Syverson “What determines productivity?” (2011) 49(2) *Journal of Economic Literature* 326 at 351; and OECD “Factsheet on competition and growth” (Working Party No. 2 on Competition and Regulation, 28 October 2013) at 3.

¹⁰ See Commerce Commission *Authorisation Guidelines* (July 2013) at [63] to [74]; and *Air New Zealand v Commerce Commission* (No. 6) 11 TCLR 347 (HC) at [272] and [298].

¹¹ See, for example, Venture Consulting “Economic study of the benefits to the New Zealand economy of new competition in the New Zealand mobile market” (2011), further discussed at paragraph 109. Significant benefits have also been linked to the introduction of competition in the telecommunications and transport industries following deregulation from 1984 to 1995. See Lewis Evan, Arthur Grimes, Bryce Wilkinson and David Teece “Economic reform in New Zealand 1984-95: The Pursuit of Efficiency” (1996) 34(4) *Journal of Economic Literature* 1856 at 1887; and Allan Bollard and Michael Pickford “Deregulation

28. Competition also has particular relevance to fostering and incentivising innovation. The importance of innovation to New Zealand's economy has been recognised in the Government's Business Growth Agenda. Innovation has been identified as a key input for businesses to succeed and grow, and a focus area to ensure businesses have the opportunity to lead New Zealand's economic growth.¹²
29. It is particularly important in this context because a number of submissions emphasise that reforming section 36 will dampen incentives for firms with substantial market power to innovate or prevent firms from competing aggressively.¹³ However, empirical studies indicate that there is a positive relationship between competition and innovation (outside of extremely competitive markets, which are not the focus of unilateral conduct provisions),¹⁴ a point we return to later in this cross-submission. Moreover, and what has not been addressed in submissions is the importance of preserving incentives for innovation by challenger firms, something that is especially true in smaller markets such as New Zealand.¹⁵
30. So, while trite, it must be remembered that competition law regimes are about protecting competition. The Commerce Act, in common with other regimes around the world, does this through merger control, and prohibitions on anti-competitive agreements and anti-competitive conduct by firms with substantial market power.
31. Unilateral conduct provisions, like section 36, generally seek to protect the competitive process by preventing a firm with substantial market power from maintaining or enhancing its market power through means other than competition on the merits.
32. The subtext of many of the submissions opposed to reform is that firms with substantial market power should be treated the same as firms without substantial market power. That is inconsistent with jurisdictions around the world where unilateral market power provisions are the norm.¹⁶ It is because firms with substantial market power are different that we have these rules. They are different because it is well-accepted that a firm with substantial market power can damage

and competition policy in the transport sector in New Zealand" (1998) 32(2) *Journal of Transport Economics and Policy* 267 at 276.

¹² New Zealand Government "Business Growth Agenda: Towards 2025" (2015)

<<http://www.mbie.govt.nz/info-services/business/business-growth-agenda/towards-2025>>.

¹³ For example, Air New Zealand submission to MBIE (24 March 2016) at [13]; Retail NZ submission to MBIE (9 February 2016) at [14]; Chorus submission to MBIE (February 2016) at [29].

¹⁴ This is consistent with the theory that firms have an incentive to innovate to escape low profit levels that accompany competitive markets. Instances of extremely high levels of competition can be associated with low levels of innovation on the reasoning that such firms have insufficient funds to innovate. See P Aghion, N Bloom, R Blundell, R Griffith, P Howitt "Competition and innovation: an inverted-U relationship" (2005) 120 *Q J Econ* 701. See also *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (2004) 11 *TCLR* 347 (HC) at [299].

¹⁵ Andrew Gavil "Imagining a counterfactual section 36: rebalancing New Zealand's competition law framework" (2015) 46 *VUWLR* 1043.

¹⁶ Indeed, in some jurisdictions such as the United States, it is also illegal to attempt to monopolise.

the competitive process in a market in a way that a firm without substantial market power cannot.¹⁷

33. It is this central premise, on which provisions against anti-competitive unilateral conduct around the world are based, that section 36 fails to deliver on.

Why section 36 does not, and cannot, achieve its policy objective

34. We disagree with the submissions that there are no problems with section 36 and that section 36 is not so different from regimes elsewhere around the world. As explained below, the problems with section 36 have been recognised by the Harper Review, and by academics in New Zealand, Australia, and the United States.

The purpose element is not an effective filter

35. Some submissions asserted that the purpose element of section 36 acts as an effective filter between anti-competitive and permissible unilateral conduct by firms with substantial market power.¹⁸ We disagree. The purpose element of section 36 is an ineffective filter because the proscribed purposes do not focus on the process of competition, but rather on the impact of unilateral conduct on individual competitors. The Harper Review explained this as follows in relation to the similarly worded proscribed purposes in s 46:¹⁹

The debate over whether section 46 should include a subjective purpose test or an objective effects test tends to obscure a more significant issue. Presently, the purpose test in section 46 focuses on harm to individual competitors — conduct will be prohibited if it has the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into a market, or deterring or preventing a person from engaging in competitive conduct.

Ordinarily, competition law is not concerned with harm to individual competitors. Indeed, harm to competitors is an expected outcome of vigorous competition. Competition law is concerned with harm to competition itself — that is, the competitive process.

Given the existing focus of the purpose test in section 46, resistance to changing the word ‘purpose’ to ‘effect’ is understandable. It would not be sound policy to prohibit unilateral conduct that had the effect of damaging individual competitors. However, an important question arises whether section 46 ought to be directed at conduct that has the purpose of harming individual competitors (under the existing purpose test) or whether it ought to be directed at conduct that has the purpose or effect of harming the competitive process (consistent with the other main prohibitions in sections 45, 47 and 50 of the CCA).

36. The focus of the purpose element on individual competitors means that this element is too easily satisfied. This in turn means that the ‘taking advantage’ element of section 36 must try to do the ‘heavy lifting’ of filtering between permissible and anti-competitive unilateral conduct. However, the taking advantage test as interpreted by the Courts is not capable of doing so.

¹⁷ This is the reason why section 36 contains a substantial market power threshold.

¹⁸ See, for example, Russell McVeagh submission to MBIE (9 February 2016) at [2.3(b)], [4.12], and [4.32]; Air New Zealand submission, above n 13, at [10].

¹⁹ Harper Report, above n 6, at 339.

The problems with the 'taking advantage' test

37. The taking 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 the answer to this question is 'yes', then the firm with substantial market power's conduct comes within a safe harbour: the firm cannot be found to have breached section 36.²⁰
38. It can immediately be seen from this formulation that it overlooks the fact that conduct undertaken by a firm without substantial market power can be benign or even pro-competitive, but that same conduct can be anticompetitive when undertaken by a firm with substantial market power. That is, a firm's conduct could pass the taking advantage test even though it demonstrably damages the competitive process. In effect, what the take advantage test does is create a safe harbour based on the form of the conduct, rather than the substance of its impact. The substantive effect of the conduct is never examined as part of the counterfactual test.
39. Katherine Kemp, an academic from the University of New South Wales, in her submission on the Harper Review's Draft Report, accurately described the counterfactual test's underlying rationale in the following way.²¹

This approach to 'taking advantage' relies on the assumption that conduct that is profitable for a firm without substantial market power is competitive conduct, even when adopted by a dominant firm. The underlying rationale is that firms in a competitive market are likely to engage in efficient conduct since non-efficient conduct would be sanctioned by the normal outcomes of the competitive process.

In other jurisdictions, however, the courts do not consider it necessary to determine whether a firm would have acted in the same way without market power, because it is recognized that firms with and without market power 'can do the same things for different reasons and with different competitive consequences'.

40. In other words, the taking advantage test assumes that a firm in a competitive market would have the same business rationale for undertaking conduct as a firm with substantial market power, where in reality, the business rationale will often differ as the real-life impact of the conduct will differ. Professor Andy Gavil recognises this in his paper on section 36.²²

As noted, in operation the counterfactual relies on inference: from the prediction that a hypothetical firm without market power would have adopted the conduct, it infers a non-prohibited (that is, non-exclusionary) purpose to the conduct, a purpose unrelated to "taking advantage of" market power. Whether s 36 requires a showing of "substantial" or "sole" purpose, this approach once again ignores the distinctiveness of the firm with market power and the potential differences between its incentives and the incentives of a counterfactual

²⁰ This comparison is also referred to as the 'counterfactual test' in s 36, although this is a very different counterfactual test to that found in other provisions of the Commerce Act, which focus on the state of competition in the market 'with and without' the impugned agreement or business acquisition.

²¹ Katherine Kemp submission to the Competition Policy Review (17 November 2014).

²² Gavil, above n 15, at 1058.

non-dominant firm. As already noted, although the dominant firm might share a beneficial purpose for adopting the conduct with the non-dominant firm (perhaps it might even realise greater benefits), it might also and simultaneously have a substantial anticompetitive purpose; one that could derive from its ability to take advantage of its market power and thus be unavailable (and hence irrelevant) to the non-dominant firm. In other words, the substantial purpose of the non-dominant firm will not necessarily be a valid predictor of the substantial purpose of the dominant firm.

The counterfactual will miss this possibility because it does not examine any real world evidence of purpose or effects...

41. The taking advantage test simply assumes that benign expectations of a firm without substantial market power would motivate the firm with substantial market power to engage in the same conduct.²³ That may or may not be the case. There is certainly no reason to assume it is the case.²⁴
42. The inferences depended on by the taking advantage test are unreliable predictors of competitive impact, or of whether the conduct is in fact motivated by pro-competitive considerations. Professor Gavil describes the inferences implicit in the taking advantage test in this way.²⁵

(1) if a non-dominant firm would adopt the conduct, by inference the conduct is deemed harmless, and by double-inference it is deemed harmless even when practised by the dominant firm; and (2) if a non-dominant firm would not adopt the practice, by inference it is deemed harmful, and by double-inference it is presumed that when practised by the dominant firm it must be "taking advantage" of its market power.

43. The inferences implicit in the taking advantage test are not justified and are unreliable predictors of competitive impact 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. In an academic article on section 36, a group of leading US professors and practitioners make this point:²⁶

[W]hether firms with or without market power would have engaged in that conduct does not necessarily preclude anticompetitive purpose or effect... As the Court in *Berkey Photo Inc v Eastman Kodak Co* 603 F.2d 263, 275 (2nd Cir. 1979) noted:

²³ That is, the firm without market power's purpose may be misattributed in one or both of two ways: the absence of an anti-competitive purpose, and/or the presence of a competitively benign purpose.

²⁴ The Microsoft litigation in the US illustrates this. This case focussed on Microsoft's conduct in favouring its own software for its operating system. Microsoft failed to establish any technical justification for its strategy to favour its own software on its operating system. Under the taking advantage test, however, if Microsoft could point to evidence of a firm without market power favouring its own software for technical reasons, Microsoft might well have avoided liability (we further discuss the Microsoft case at paragraphs 52 to 53 and paragraph 108). See Gavil, above n 15, at 1073-1074.

²⁵ Gavil, above n 15, at 1067.

²⁶ Jeffery M Cross, J Douglas Richards, Maurice E Stucke and Spencer Weber Waller "Use of Dominance, Unlawful Conduct, and Causation Under Section 36 of the New Zealand Commerce Act: A U.S. Perspective" (2012) 18 NZBLQ 333 at 338.

Such conduct is illegal when taken by a monopolist because it tends to destroy competition, although in the hands of a smaller market participant it might be considered harmless, or even “honestly industrial”.

44. This was a point also noted by the Harper Review Panel who concluded:²⁷

Business conduct should not be immunised merely because it is often undertaken by firms without market power. Conduct such as exclusive dealing, loss-leader pricing and cross subsidisation may all be undertaken by firms without market power without raising competition concerns, while the same conduct undertaken by a firm with market power might raise competition concerns.

45. We agree with the Harper Review’s conclusion. Indeed, at its core, the counterfactual test rests on a premise that firms with substantial market power should have the ‘right’ to act in the same manner as firms without substantial market power, regardless of the consequences of that conduct. The taking advantage test therefore focuses on the ‘rights’ of the firm with substantial market power to the exclusion of a focus on the competitive impact of the conduct.
46. However, the focus on the right of firms with substantial market power to do whatever a firm without market power would do is not a safe premise. It is not a safe premise precisely because the competitive effects of the conduct of a firm with market power can differ to the competitive effects caused by those without substantial market power.²⁸

Although pronounced as it were a self-evident truth, the proposition is simply wrong. It is specious because powerful firms are not the same as small, ordinary firms. They are not ‘like everyone else’ because their economic strength renders them especially likely to damage the competitive process. That is the correct starting premise and that is why we have sections like s 36. If legislatures really believed that powerful corporations were the same as non-powerful ones we would not have a monopolisation prohibition at all. But policy makers have always believed powerful firms are different. As Justice Antonin Scalia observed:

Where a defendant maintains substantial market power, his activities are examined through a special lens: behaviour that might otherwise not be of concern to the antitrust laws — or might even be viewed as pro-competitive — can take on exclusionary connotations when practiced by a monopolist.

47. By imposing this ‘short cut’ inferential test, New Zealand’s section 36 (and section 46 in Australia) are global anomalies. As Professor Gavil, in his paper on section 36, observes:²⁹

²⁷ Harper Report, above n 6, at 339.

²⁸ Rex Adhar “The unfulfilled promise of New Zealand’s monopolisation law: Sources, symptoms and solutions” (2009) 16 CCLJ 291 at 293.

²⁹ Gavil, above n 15, at 1049. Similarly, US practitioners and professors have noted that the s 36 counterfactual test is out of step with US law: “the US monopolisation law does not exonerate a monopolist from liability merely for being able to show that it might have engaged in the same conduct when it lacked market power”: Cross, Richards, Stucke and Waller, above n 26, at 339.

... the counterfactual is an anomaly in the global competition policy community. It is unique and arguably inconsistent with global norms for evaluating single-firm conduct. In other jurisdictions, courts and enforcement agencies tend to focus on the effects of dominant firm conduct in both the assessment of market power and in judging "exclusionary" or "abusive" conduct. In using counterfactual analysis, other jurisdictions focus solely on the dominant firm and compare the performance of the relevant market with and without the dominant firm's challenged conduct. As far as I can tell, none rely on the behaviour of a hypothetical non-dominant firm as the basis for counterfactual analysis.

48. Moreover, by creating safe harbours in this way, the taking advantage test is not acting to promote New Zealand's economic welfare. As RBB Economics explains in its submission to the Harper Review:³⁰

We leave it to legal experts to comment on the state of the case law and whether it does create such a safe harbour, but as a matter of economics it is clear that any such safe harbour would not be appropriate, and would carry a significant risk of false negatives. It would prevent the law from intervening in some instances where the unilateral exercise of market power does lead to adverse effects on the competitive process.

Impact of the safe harbour – conduct that section 36 does not capture

49. Exclusive dealing has been described as a paradigm example of the problems created by this test. Paul Scott, a leading New Zealand academic in this area, notes this in a paper on section 36.³¹

The harm [from exclusive dealing] only arises when the firm imposing exclusive dealing has significant market power, particularly when it affects a significant amount of effective distribution methods. Without significant ... market power, the anti-competitive effects do not arise. Exclusive dealing is thus a prime example of the behaviour that the High Court in *Melway* and *Scalia J* in *Eastman Kodak* were talking about.

The trouble with the Supreme Court's comparative exercise test [for section 36] is that it does not capture this sort of behaviour. A firm would impose exclusive dealing in a competitive market because it has efficiency enhancing aspects. Yet it only has anti-competitive effects when a firm that has an exclusive dealing contract has substantial market power. This meets the comparative exercise test, as it would have acted this way in a competitive market.

The fact that a firm would impose exclusive dealing in a competitive market only shows that there can be an efficiency enhancing reason for it. Also, just because there is an efficiency benefit does not mean the practice cannot also be anti-competitive.

50. Professor Gavil, in his paper, makes a similar point regarding refusals to deal.

³⁰ RBB Economics submission to Competition Policy Review (November 2014) at 4.

³¹ Paul Scott "Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act" (2011) 17 NZBLQ 260 at 277.

What is clear is that the effects of a dominant firm's refusal to deal are likely to be so different when compared to a refusal by a non-dominant firm as to make reliance on the counterfactual unlikely to yield any reliable inferences.³²

51. Another example is *Rural Press*,³³ which involved a publisher threatening to enter the prime circulation area of another publisher. *Rural Press* has been described as a case that is clearly exclusionary but which passed the taking advantage test.³⁴

There should be no doubt that the acts in *Rural Press* constituted unilateral anticompetitive conduct. Conduct of this kind has been described by antitrust commentators as 'plain' exclusion: that is, behaviour that 'unambiguously fails to enhance any party's efficiency, provides no benefits (short or long-term) to consumers, and in its economic effect produces only costs for the victims and wealth transfers to the firm(s) engaging in the conduct'. Eleanor Fox calls this the 'consensus wrong'. That is, regardless of the ongoing debate over the precise kind of effect a plaintiff should have to prove in a unilateral conduct case, all agree that conduct that has the purpose and effect of lessening output and increasing prices should be condemned.

While it is to be expected that unilateral conduct rules will sometimes fail in ambiguous cases, it is unacceptable that they should fail to condemn straightforward instances of the consensus wrong.

52. With respect, we agree. These are examples of the types of conduct that section 36 does not effectively capture. However, it is not just these types of conduct that section 36 does not capture. In his paper Professor Gavil provides the example of the Microsoft cases in the US and Europe.³⁵

The selected cases resulted in findings of liability, but the results might have been different had the conduct been judged under New Zealand's version of the counterfactual test. That should not come as a surprise. Much of the conduct considered shares a characteristic often found in close-call unilateral conduct cases: despite evidence of harm, a plausible argument could be made that at least under some circumstances the conduct could yield efficiencies. The counterfactual will perform especially poorly in such cases; that is, the error rate will be high when it is invoked to judge conduct that can be exclusionary under some circumstances, but can also yield efficiencies.

...

Precisely because the counterfactual fails to account for market power, and infers justifications based on the conduct of other, non-dominant firms, it will systematically err in cases such as *Microsoft*, where adverse competitive effects flow from the dominant firm's market power and conduct-specific efficiency evidence is lacking.

³² Gavil, above n 15, at 1079.

³³ *Rural Press v ACCC* (2003) 216 CLR 53.

³⁴ Kemp, above n 21, at 7.

³⁵ Gavil, above n 15, at 1071.

53. As noted in Dr Berry's letter to the Minister, in the US the Microsoft litigation has enabled significant economic benefits from the continued development of a middleware market and cross-platform technologies and software (we expand on those benefits further below at paragraph 108).³⁶
54. There are likely to be many other examples, not all of which are obvious on their face. But given the Minister's concern with ensuring that barriers to entry into markets are lowered one type of conduct that immediately springs to mind is the use of legal or regulatory mechanisms to increase barriers to entry to a market. This type of conduct is conduct that would pass a taking advantage test (as a defendant is likely to be able to show that the conduct would be undertaken by a firm without substantial market power) but could well fail a competition focussed test.
55. Various submitters stated that the Commission needed to demonstrate cases that it could not take in the past because of section 36 before there could be said to be a case for reform.
56. We do not agree and express some caution about retrofitting a substantial lessening of competition test to past cases. As Dr Berry commented in his letter to the Minister, it is difficult to examine all the cases we have considered (or screened out) and say with certainty whether the matter would have led to successful enforcement action if an alternative section 36 was in place – "much like the hypothetical counterfactual test, such a hypothetical analysis would be fraught". In this context we endorse the comments of the Harper Review Panel on this issue:³⁷
- The important point is not whether the outcomes of those cases, on the facts before the court, were correct or incorrect from a competition policy perspective. The issue is whether the 'take advantage' limb of section 46 is sufficiently clear and predictable in interpretation and application to distinguish between anti-competitive and pro-competitive conduct.
57. As explained above, we do not consider that section 36 is apt at distinguishing between anti-competitive and pro-competitive conduct. We address the certainty of the take advantage test further below.
58. Nevertheless, for completeness we reiterate the two other recent examples provided in Dr Berry's letter (Winstone Wallboards and Sky) of the practical problems associated with section 36 – ie, cases where section 36 has effectively provided a safe harbour for conduct by large firms without regard to anti-competitive effect.
- 58.1 Winstone was a case that considered loyalty rebates. While there were a number of reasons why we ultimately concluded Winstone's rebates were unlikely to substantially lessen competition (under s 27) by foreclosing

³⁶ See US Department of Justice and other plaintiffs "*US v Microsoft Corporation: Review of the Final Judgments by the United States and New York Group*" (30 August 2007) <<https://www.justice.gov/atr/case-document/review-final-judgments-united-states-and-new-york-group>>.

³⁷ Harper Report, above n 6, at 338.

competitors, the pertinent point is that the section 36 conclusion was driven solely by the counterfactual test regardless of competitive impact. We concluded a firm without market power was likely to offer loyalty rebates of the type offered by Winstone because loyalty rebates are common in competitive markets (indeed many of the merchants offered them). We reached this conclusion applying the counterfactual test without ever having to examine the impact of the conduct.

- 58.2 Similar comments can be made about our Sky TV investigation, where we assessed whether Sky's content contracts amounted to Sky taking advantage of any substantial market power it had. This required us to ask whether Sky would have entered into similar contracts if it did not have substantial market power. If it would have, then Sky's contracts could not be in breach of section 36, even if those contracts had an anti-competitive effect. The counterfactual test, therefore, provided a safe harbour regardless of any anti-competitive effect that may have existed, such as raising barriers to entry.

Section 27 is not an effective safety net

59. Various submitters have suggested that there is little need to reform section 36 because section 27 operates to catch almost all conduct that should be captured by section 36.
60. Dr Berry responded to those submissions in his letter to the Minister. To reiterate, section 27 does not solve all the issues with section 36, particularly when conduct is unilateral at its core.
61. We acknowledge that the Commerce Act allows the Commission to assess whether an agreement entered into by a firm, combined with all other agreements that firm is a party to, breaches section 27.
62. This ability to aggregate contracts provides some assistance, however it remains the case that there are some types of conduct that simply cannot be caught under section 27 even with this aggregation provision. One example is refusal to deal cases, where there is simply no agreement (or set of agreements) that can be challenged. Another example is the Commission's Air New Zealand/Origin investigation. That investigation involved the Commission assessing the conduct of Air New Zealand in announcing its new service and redeploying an aircraft. It would not have been possible to adequately capture the conduct by attempting to aggregate all of Air New Zealand's ticket sales to customers on the Hamilton-Christchurch route for the purposes of a section 27 case.
63. Furthermore, trying to fit what is ultimately a unilateral conduct case into section 27 creates complications. The Winstone case illustrates this.
- 63.1 Section 27 is directed towards agreements between parties, not unilateral conduct. Our Winstone investigation concerned Winstone's loyalty rebates with large merchants and whether Winstone was inducing merchants not to use alternative plasterboard suppliers through a lump sum (rather than a per

unit) loyalty rebate that the merchants would retain rather than pass through to end consumers.

- 63.2 The rebate provisions in the merchant agreements said nothing about whether merchants would retain the rebates or not. They were silent on this.
- 63.3 For a s 27 case to succeed, would we have had to prove that each merchant had agreed with Winstone to retain the rebate? Arguably, this is a more difficult and wide ranging case than if the question was just whether Winstone's conduct in structuring and paying the rebates as it did had the purpose, effect or likely effect of substantially lessening competition.
64. None of this should be taken as suggesting that section 27 cannot be useful in some cases. Merely, that for unilateral conduct, section 27 either will not be adequate to capture the conduct, or can create complications because it adds the requirement of needing to show an agreement or set of agreements.

The costs and risks of change

65. As described in this cross-submission, we consider there is a strong basis for amending section 36. We believe the test should be one that focuses directly on the competitive effects of conduct, rather than on unreliable inferences about whether the conduct is harmful based on what firms without market power would do.
66. We have suggested an SLC based test because it is already used successfully in section 27 and section 47, and its meaning is understood. We therefore consider that any transition costs would be minimised. This is also the same as the test recommended by the Harper Review Panel.
67. Various submitters have expressed concern that the change will bring uncertainty and risk chilling legitimate competitive conduct. These same submissions were made in Australia, but the Harper Review Panel concluded:³⁸

The Panel's proposed reform to section 46 is an important change, which will (like all regulatory change) involve some transitional costs, as firms become familiar with the prohibition and as courts develop jurisprudence on its application. In the Panel's view, the change is justified as transitional costs should not be excessive and will be outweighed by benefits.

The Panel agrees with the [ACCC] that the uncertainty 'should not be unduly significant as the change is to an existing test [equivalent to s 45] with which business are already familiar – that is, the substantial lessening of competition test used in other provisions of the CCA. This incorporates 'standards and concepts ... at least well enough known as to be susceptible to practically workable ex ante analysis' ...

Indeed, framing the offence by reference to the impact on competition in a market enables major businesses to advance pro-competitive justifications for their conduct, in the absence of an anti-competitive purpose.

³⁸ Harper Report, above n 6, at 341.

68. We agree with that conclusion entirely and submit that there is no reason why those conclusions would not apply equally in New Zealand. Nevertheless, we respond below to the various concerns that have been raised by parties about changing the test.

How certain is the counterfactual test?

69. We start with the proposition that because the counterfactual test is certain we should not change it. Much is made in submissions opposing reform of the certainty of the counterfactual test.
70. While we consider the submission that the test is certain is questionable, to the extent it is regarded as certain we do not consider it is the kind of business certainty that promotes New Zealand's economic welfare. This is because the type of certainty advocated for arises from the permissiveness of the test and its failure to examine economic harms. As Professor Gavil notes:³⁹

It is a permissive test that will provide firms with substantial market power a wide berth to pursue aggressive competitive strategies, leaving little room for successful challenges to their conduct. As I have argued, however, there should be no pretence that it will achieve this goal because it accurately differentiates competitive from exclusionary conduct. To the contrary, it will do so by default, often misdiagnosing the competitive desirability of conduct because it fails to consider its market effects. If it is certain and predictable, it is because it imposes burdens that will rarely be met.

71. Similarly, Rex Adhar, a leading New Zealand academic in this area, notes:⁴⁰

The counterfactual test does achieve the aim of providing certainty, but it is the wrong kind of certainty. The counterfactual test is nothing less than a 'green light' for aspiring monopolists to proceed with business as usual for, as the lengthy record of unsuccessful s 36 cases shows, it is not difficult for a defendant monopolist to show that a non-dominant firm in the same circumstances would have done just the same.

72. We also question the certainty of the counterfactual test, from an enforcement and judicial perspective. As Paul Scott notes:⁴¹

One recurring criticism of the counterfactual test is that it is hard to apply. As the New Zealand Court of Appeal in 0867 put it, the test is not always one of utility and plausible, a view in line with that of Kirby J in *Rural Press Ltd v Australian Competition and Consumer Commission*. The High Court in *Melway* also suggested the counterfactual test was valid only if it could be undertaken with sufficient cogency, a view endorsed by the Court of Appeal in 0867.

73. Similarly Rex Adhar in the same article describes the test, from the point of view of establishing liability, as:⁴²

³⁹ Gavil, above n 15, at 1079

⁴⁰ Adhar, above n 28, at 298.

⁴¹ Scott, above n 31, at 263.

...very difficult to apply (prompting debate over precisely what are the salient factual features and circumstances that have endowed the defendant with substantial market power) and it requires courts to engage in hypothetical comparisons that are ‘wholly unreal’.

74. The Court of Appeal has also noted the practical uncertainties created by the counterfactual within a section 36 hearing.⁴³

What happened in this case is that three very well qualified expert witnesses were called upon to assist the Court. They observed all the appropriate requirements for expert witnesses, which are designed to avoid partisanship. At one point a lengthy “hot tub” session was held. This is an exchange of views between the various experts with them able to speak directly to each other (of course, under court supervision) in an endeavour to clarify and articulate the various points of concern which have arisen between them. The process has been found to be sufficiently beneficial to be resorted to from time to time in competition law cases. It does however have some downsides, one of which bears mention here.

Plainly, if the counterfactual is to play a significant part, it would be better if counsel knew precisely what counterfactual the Court is proposing to adopt before their final arguments are made. There would be much to be said, as a matter of case management, if, after the economic evidence (including any hot tub evidence) is in, the Court could be addressed on what counterfactual should be adopted, and if the Court could then issue a minute or memorandum as to what counterfactual it does propose to adopt. Counsel could then be heard on the application or consequences of that particular counterfactual. Otherwise, final addresses are addressing a somewhat shadowy target. We do not intend to lay down any rule, let alone a prescriptive rule, on this point. Our suggestion is one which trial judges may find helpful in the context of a given case. If it had been followed in this instance, it may have avoided some of the difficulties in submissions over what was to be assumed.

75. These statements from the Court, albeit focussed on procedure, underscore both how central the counterfactual is to a final decision, and how uncertain it can be.
76. As an example of this uncertainty, when we investigated complaints by independent milk processors that Fonterra’s raw milk buying practices breached section 36, we had to construct a hypothetical competitive market, where all of the features that gave rise to Fonterra’s market power were removed. In doing this we had to determine whether Fonterra would be subject to special regulation in the counterfactual, where on the one hand, under the courts’ interpretation this should still be included in the counterfactual (as it was not a feature that gave rise to Fonterra’s market power), although plainly it would be nonsensical for a non-dominant version of Fonterra to be regulated in this way. This created real uncertainty for our assessment of how Fonterra would have acted in the counterfactual.
77. The example of the Air NZ/Origin investigation which was cited in Dr Berry’s letter to the Minister is another example of this uncertainty. In that case, the Commission’s

⁴² Adhar, above n 28, at 298.

⁴³ *Commerce Commission v Telecom Corporation of New Zealand* [2009] NZCA 338 at [78].

enforcement decision 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. As Dr Berry explained in his letter this example neatly illustrates the dangers of a test not focussed on a competition test and which relies on a hypothetical analysis, and that business is already exposed to significant risks around how the Commission and the courts will undertake the hypothetical analysis.

78. The taking advantage test, therefore, has implicit uncertainty imbedded in it. This arises from the nature of the test itself. In his submission to the Australian Treasury on reform of Australia's section 46, Michael Hodge, an Australian Barrister, neatly illustrated why this uncertainty arises and why that uncertainty is more acute under the taking advantage test than under a SLC test.⁴⁴

Of course, many aspects of the law, both civil and criminal, call for a hypothetical inquiry as part of testing whether one thing has caused another thing. This is sometimes referred to as using a "counterfactual". For example:

(a) Would the accident have occurred even if the defendant had not driven through the red light?

(b) Would the deceased still be alive even if the accused had not fired the gun?

The "substantially lessening competition" test employs this type of hypothetical inquiry. In the case of section 45 [NZ's s 27], it asks whether the state of the competitive process would have been the same even if the respondent corporation had not made or arrived at the contract, arrangement or understanding. The form of section 46 proposed by the Harper Panel would ask whether the state of the competitive process would have been the same even if the respondent corporation had not engaged in the conduct.

The "take advantage" test employs a different type of hypothetical inquiry. It asks whether the corporation would have engaged in the conduct if the commercial world in which the corporation operated was different. It does not look at the effect of conduct on the world. It looks at the effect of the world on conduct. It asks, if the world was different (so that the corporation lacked substantial market power), would (or could) the corporation nevertheless have engaged in the conduct (or would it have been as easy to engage in the conduct)?

The "take advantage" test reverses the question posed by the "substantially lessening competition" test. The "substantially lessening competition" test compares the effect of changes in the conduct on the market. The "take advantage" test compares the effect of changes in the market on the conduct. Posing a change in conduct and then asking how that is likely to affect an outcome in the world in the future is a more practical task than posing a change in the world in the past and then asking how that might have affected conduct. The difficulty of applying the "take advantage" test is further exacerbated by the imprecision in identifying what change in the world is sufficient to convert "substantial market power" to merely "market power". The "substantially lessening competition" test is binary: with or without the conduct.

⁴⁴ Michael Hodge submission to Australian Treasury on options to strengthen misuse of market power law (12 February 2016).

The practical difficulty of applying the type of hypothetical inquiry required by the “take advantage” test can be illustrated by adapting the two examples given above and considering the inherent difficulty with answering these questions:

(a) Would the defendant have driven through the red light if traffic design had been better in the area?

(b) Would the accused have fired the gun if there was stronger firearm regulation?

It is immensely difficult to evaluate whether specific conduct that occurred in the actual world would have occurred, or been likely to occur, if broad hypothetical changes had been made to the world. It invites intuitive judgments that may be idiosyncratic and dependent upon the perceptions of the particular person making the evaluation. For these reasons, it is very difficult to understand how it could be claimed that there is certainty or predictability as to how the “take advantage” test (and therefore the current section 46) will be applied in particular cases.

A new test focussed on competition would not be too uncertain

79. Related to submitters’ argument that the current test provides certainty and so should not be changed, many submitters also argued that moving to a new test would involve too much uncertainty for business.
80. While we accept that changes to the law always involve some uncertainty, and there will also always be a degree of uncertainty about where the line is drawn between competitive and anti-competitive conduct, a new substantial lessening of competition test would cause only very limited uncertainty. To the extent that there is any residual business uncertainty, we are also as always open to issuing guidelines on our intended approach to a new test, as we have done for example in our draft Competitor Collaboration Guidelines.⁴⁵
81. We have suggested an SLC based test as this is already used in sections 27 and 47, and its meaning is understood. As discussed above, this test (or another competition based test) avoids the hypothetical thought experiments involved under the current ‘taking advantage test’, and the uncertainties that this creates. We are also not aware of any concerns from those who already advise on the SLC test in the context of sections 27 and 47 that it is too uncertain. Rather, as real life evidence of commercial motives and market characteristics are central to applying the SLC test, it may be easier for firms with market power and their advisors to engage with.
82. As alluded to above, where a firm with market power engages in conduct that involves a clear provision in an agreement that may be impugned (for example, the firm proposes to enter into a long-term exclusive supply agreement), the firm already needs to consider whether the conduct would breach the SLC test in section 27. Extending this to all unilateral conduct will not involve a big change in terms of the scope of the advice that would be required. Rather, compliance with Part 2 of the Act would be simplified as the current section 36 test is clearly anomalous in relation to the other provisions of Part 2.

⁴⁵ Commerce Commission *Draft Competitor Collaboration Guidelines* (August 2014).

83. Firms with market power in New Zealand that are multinationals with global operations are also already accustomed to a unilateral market power provision that centres on the actual impact of conduct on competition, as such provisions are the global norm (we expand on this below). Moving to an SLC test would also result in more uniformity for those firms.

A unilateral market power test focussed on competition effects is the global norm

84. Despite the suggestion that New Zealand would be a guinea pig if it were to move to a test focussed on competitive effects,⁴⁶ this is the global norm. Professor Andy Gavil described this in his article on section 36:⁴⁷

Although a comprehensive canvassing of the world's competition laws is beyond the scope of this article, those laws are reflected in the policy statements and guidelines adopted by a variety of enforcement agencies around the world, including the European Commission (EC), the Canadian Competition Bureau (CCB), and the United Kingdom's Competition and Markets Authority (CMA), each of which has issued formal guidance documents in connection with their prohibitions of unilateral conduct by dominant firms. None appear to use an analytical approach like the counterfactual as it is applied in New Zealand. To the contrary, in their guidance documents, it is clear that all three jurisdictions focus on an examination of the market in which the dominant firm operates, and the actual or likely effects of its conduct in that market. This is not surprising given the interdependence of power, conduct and effects. And although these other jurisdictions rely on inferences, those inferences are drawn from the power and conduct of the dominant firm and the characteristics of the market in which it operates, not a hypothetical non-dominant firm. Indeed, as has been argued throughout this article, it is precisely because the effect of a firm's conduct on competition is a function of its power that jurisdictions include prohibitions of single-firm conduct. It is anomalous, therefore, to have such a prohibition and then to interpret it in such a way as to eschew consideration of effects based on the most probative evidence.

85. To illustrate, the US Federal Trade Commission has described their laws on anti-competitive unilateral conduct as involving a two-pronged test that requires both substantial market power and harmful effects, as follows:⁴⁸

United States antitrust law prohibits conduct by a single firm that unreasonably restrains competition by creating or maintaining monopoly power. Most monopolization cases involve the conduct of a firm with substantial market power, although Section 2 of the Sherman Act also prohibits attempts to monopolize and conspiracies to monopolize. The legal analysis of monopolization claims requires a plaintiff to make two showings: monopoly power and conduct resulting in harmful effects. Under the first prong, courts consider evidence of substantial market power. Courts next ask if that market power was gained or maintained through improper exclusionary or predatory conduct – that is, something other than having a better product or superior management, or as a result of historical accident. One

⁴⁶ Submissions to MBIE of Metals New Zealand (February 2016) at 5; DLA Piper (9 February 2016) at [22.5]; and Retail NZ, above n 4, at [15].

⁴⁷ Gavil, above n 15, at 1068. See also Cross, Richards, Stucke and Waller, above n 26, which compares s 36 to United States law on unilateral conduct by firms with market power, and outlines how the US approach focuses on whether the conduct has an anti-competitive effect.

⁴⁸ US Federal Trade Commission submission to the Competition Policy Review Panel (22 July 2014) at 1.

commentator described this inquiry as requiring conduct that excludes rivals on some basis other than efficiency.

A competition test will not deter competitive conduct

86. Another recurring theme in the submissions is that any change to section 36 will deter large firms from engaging in competitive conduct and innovating.
87. We do not believe a test focussed on competition would deter competitive conduct, and indeed we have no interest in advocating for such a test. As we said in our submission to the Harper Review Panel:⁴⁹

We recognise the Panel's desire to avoid capturing pro-competitive conduct. However, we consider that a defence that the conduct was pro-competitive can, and should, be captured within the main test as to whether the conduct had the effect, or likely effect of substantially lessening competition. This can occur, for example, through the recognition of actual or potential efficiency gains.

88. In any event, there is no evidence to suggest that pro-competitive conduct will be deterred.
89. The submissions misapprehend the basis of a test focussed on competition. There seems to be a concern that simply 'beating' one's competitors would create a violation of the Act. This is not what a competition test is about. It is about preserving the process of competition by ensuring that firms do not put in place obstacles that mean its competitors are unable to enter and expand based on the merits of their own products and services. A firm which offers better products or better services and so 'beats' its competitors has not lessened competition as that term is correctly understood.
90. This point was well made by RBB in their submission to the Harper Review:⁵⁰

Some of the prominent objections to an effects-based test see an effects-based test as synonymous with a law that condemns firms with market power whenever they succeed in competition i.e. when they beat competitors and win market share. If an effects-based test were interpreted in this way, then that would indeed be a serious problem, but we would not agree that winning on merit constitutes an anti-competitive effect even if it harms competitors.

91. The Harper Review Panel also commented:⁵¹

The proposed test of 'substantial lessening of competition' is the same as that found in section 45 (anti competitive arrangements), section 47 (exclusive dealing) and section 50 (mergers) of the CCA, and the test is well accepted within those sections. As explained by the former Trade Practices Tribunal in QCMA, competition 'expresses itself as rivalrous market behaviour' and 'is a process rather than a situation'.

⁴⁹ Commerce Commission submission to the Competition Policy Review (2014) at [12].

⁵⁰ RBB Economics, above n 30, at 1.

⁵¹ Harper Report, above n 6, at 341.

....

Section 4G of the CCA defines ‘lessening of competition’ to include ‘preventing or hindering competition’. The proper application of the ‘substantial lessening of competition’ test is to consider how the conduct in question affects the competitive process — in other words, whether the conduct prevents or hinders the process of rivalry between businesses seeking to satisfy consumer requirements.

92. As described above, empirical studies indicate that there is a positive relationship between competition and innovation. Innovation and efficiencies tend to increase with increased competition, not decrease.
93. Moreover there is also a need to preserve incentives for innovative challenger firms to enter and expand in New Zealand markets. A properly functioning section 36 is part of this incentive, although the Commission agrees that the competition test should be focussed on the competitive process and not competitors.
94. There is simply no evidence that New Zealand has experienced greater pro-competitive conduct or greater innovation than those jurisdictions that have tests focussed on competitive effects. This is what we would expect to see if, indeed, there is substance to the argument that an effects based test may deter competitive or innovative conduct.
95. New Zealand businesses already undertake actions with a competition test in place. Indeed, they argue that section 27 is a close substitute for section 36 reform. While the Commission has a different view on that, submitters opposed to reform cannot both argue that section 27 is a safety net and that a move to an effects test will promote uncertainty. Indeed, one firm in their submission noted that:⁵²

...firms are already subject to effects-based tests that require them to self-assess the effect of their conduct (when manifested in “contracts, arrangements or understandings”) – this is not a novel concept.

96. Overseas jurisdictions with an effects test do consider business rationale or business justification in assessing whether competition is adversely affected. This was highlighted by the Harper Review Panel which concluded that:⁵³

The approach adopted in comparable overseas jurisdictions is to empower the court to take into account the pro competitive and anti competitive aspects of business conduct. Professor Stephen Corones submits that ‘under both EU competition law and US antitrust law, firms with substantial market power are provided with the opportunity of demonstrating pro competitive efficiency justifications for their conduct’.

97. We would advocate for a competition test that would allow for full consideration of any pro-competitive or efficiency-enhancing reasons for the conduct. We consider an SLC test achieves this. This is because the rationale for conduct by a firm with market power would be a key relevant consideration under an SLC (or any other

⁵² Matthews Law submission to MBIE at 8.

⁵³ Harper Report, above n 6, 352.

competition) test. To illustrate, at present under the SLC test in sections 27 and 47, we look at any evidence on why the firms engaged in the conduct, and we would expect the courts to do the same in applying a test in section 36 that focuses on competition. Where there is strong evidence, for example in internal documents, that the conduct is motivated by a competitive justification, for example, to achieve cost savings that help the firm compete on price, or enhancements to the end good or service, then such conduct is unlikely to breach an SLC test.

98. On the other hand, where the evidence does not disclose a competitive justification for the conduct and the conduct has the effect of raising competitors' costs, rendering them less competitively effective, then a finding of an adverse effect on competition is more likely.

The relevance of size and scale

99. Some submitters have also implied that because New Zealand has a small population and more concentrated markets are more prevalent compared to other larger countries, we need to be concerned about scale, and so this means that New Zealand should have a more relaxed approach to rules regarding unilateral conduct by firms with substantial market power. These submitters also seek to distance New Zealand from Australia, where these arguments were rejected, by stating that New Zealand is smaller than Australia and even more remote.
100. While we agree that scale is a means by which cost savings can be achieved and so should form part of the consideration of a competition test, we disagree that New Zealand's market size and global position mean a more relaxed attitude to unilateral conduct by firms with market power is warranted. In our view, the opposite is the case. It is even more important for a small economy like New Zealand to have an effective rule on unilateral market power. In the leading work on competition policy in small market economies, Professor Michal Gal notes:⁵⁴

Given the prevalence of dominant firms in small economies and the relative inability of market forces to erode them, a small economy cannot afford to leave the regulation of monopoly power to market forces alone. Competition law must focus particularly on deterring the creation and maintenance of artificial barriers to entry. New entrants must have the opportunity to enter a market without handicaps other than those arising from the first-mover advantages enjoyed by existing competitors.

101. Without an effective rule on unilateral conduct by firms with market power, market forces cannot be relied upon to remedy any anti-competitive unilateral conduct and so sustain competitive discipline, and this is even more the case in smaller economies like New Zealand.

⁵⁴ Michal S Gal *Competition Policy for Small Market Economies* (Harvard University Press, Cambridge, 2003), at 413-14. Professor Gal has undertaken a review of New Zealand as a case study, and affirmed the need for strong monopolisation laws here. See Michal S Gal "The Effects of Smallness and Remoteness on Competition Law – the Case of New Zealand" (2007) 14 CCLJ 292 at 311-12.

The need for causation and the spectre of ‘special responsibility’

102. A number of parties submit that there is a need to retain the taking advantage test in order to ensure that there is a causal nexus between a firm’s substantial market power and any anti-competitive effect and we should not adopt a special responsibility doctrine as in Europe.⁵⁵ A similar concern is that a firm will be found to be in breach merely because it has substantial market power.⁵⁶ One submission goes as far as to say that by removing the taking advantage element section 36 will be out of step with sections 27 and 47.⁵⁷
103. Removing the taking advantage limb of section 36 would not remove a requirement that the conduct of a firm with substantial market power conduct harmed competition. That is, a plaintiff would still need to prove a causal nexus between the conduct and the harm to competition. This is entirely consistent with section 27 which requires a causal nexus between the conduct (an agreement) and the harm (an SLC), and section 47 which requires a causal nexus between the conduct (a merger) and the harm (an SLC).
104. Insofar as Europe has adopted particular form based rather than substance based rules we agree that New Zealand should not follow that model.⁵⁸ What matters is the competitive effects of a firm with substantial market power’s conduct on competition. As has already been explained, this conduct can harm competition in a way that the same conduct by a firm without substantial market power does not. In this sense, as described by the US Courts, that conduct is examined through a special lens. The global norm of unilateral conduct provisions that apply only to firms with substantial market power (or a serious danger of achieving substantial market power) recognises this.

Reform would benefit New Zealand

105. As will be obvious from our submissions above we consider that reform of section 36 to a test focussed on the competitive impact of conduct will be of real benefit to New Zealand and New Zealanders.

⁵⁵ ANZ submission to MBIE (9 February 2016) at 4; Bell Gully submission to MBIE (9 February 2016) at [4.5]; Air New Zealand submission, above n 13, at [22].

⁵⁶ Retail NZ submission, above n 4, at [8]; IAG submission to MBIE (9 February 2016) at [3.10].

⁵⁷ Russell McVeagh submission, above n 18, at [4.26].

⁵⁸ See for example RBB Economics’ submission, above n 30, at [3]. “We have extensive experience in working with the EU abuse of dominance laws, and it is important that the Australian review should learn from the policy errors that have prevented a more rational enforcement approach from emerging in the EU. Despite efforts by the EU Commission to move away from ill-judged form-based rules and towards a more effects-oriented approach to Article 102, the EU case law retains an unhealthy tendency to condemn behaviour because of the form it takes, without due consideration for its actual effects on the competitive process. In the June 2014 Judgment in the *Intel v Commission* case, the General Court in Luxembourg went so far as to state that, when addressing discounts granted by a dominant firm in return for exclusivity, there is no need for the enforcement body to consider effects-based questions such as the size of the discounts, the proportion of the total market they covered or the impact that these discounts had on the market share of rival suppliers. Such an approach creates an obvious and seriously damaging risk of false positive errors and a general chilling effect on competition”.

106. As will be obvious from our submissions above, we consider that the costs of any change have been overstated. We do not consider that a competition test would deter competitive conduct, or generate significant uncertainty. We reiterate our agreement with the conclusion of the Harper Review Panel that any transitional costs from changing “should not be excessive and will be outweighed by benefits”.⁵⁹ This is particularly so if reform adopted a SLC test given its existing use in New Zealand law.
107. On the other side of the equation, the benefits of reform are significant. While we acknowledge that we do not have a pocket book full of cases that we would suddenly bring if the test were changed, this indicates that a new test would not overreach and result in a large number of new cases, as some submissions have apprehended. Rather, amending the test would allow us to bring the right cases, where it matters.
108. We consider the benefits to New Zealand consumers and the overall economy from changing the section 36 test will be tangible and significant, and not esoteric. To illustrate, in the United States the following benefits have arisen following the Microsoft litigation:⁶⁰

Since the entry of the Final Judgments, there have been a number of developments in the competitive landscape relating to middleware and to PC operating systems generally that suggest that the Final Judgments are accomplishing their stated goal of fostering competitive conditions among middleware products, unimpeded by anticompetitive exclusionary obstacles erected by Microsoft.

Microsoft's Internet Explorer web browser faces renewed competition, primarily from Firefox but also from a range of other products including Opera and Apple's Safari browser. All of these competing browsers are cross-platform and therefore allow applications delivered over the Internet, either directly via the browser or as browser "plugins," to work on multiple operating systems.

Increasingly, for example, web content is delivered through cross-platform browser plug-ins such as Adobe's Flash and Apple's QuickTime. Flash in particular has rapidly become a popular vehicle for delivering multimedia content on websites such as YouTube. Both technologies enable streaming of audio-video content over the web to multiple web browsers on multiple operating systems.⁽⁵⁾ Apple's iTunes software has also become enormously popular on Windows, competing with Microsoft's media middleware; a number of other media players, including those from Real and Yahoo, also provide Microsoft with substantial competition.

The increasing popularity of "software as a service" applications depends upon the ability to deliver these applications across a range of browsers and platforms. A number of companies, for example, use the network-based customer-relations management service provided by Salesforce.com in place of or in addition to traditional software products that are installed on the companies' computers. Another example of the growing provision of functionality over the Internet via the browser is web-based e-mail -- from companies such as Yahoo, Google, and Microsoft itself -- which has grown dramatically in popularity over the last several years.

⁵⁹ Harper Report, above n 6, at 355.

⁶⁰ US Department of Justice, above n 36.

Web-based e-mail typically works across platforms on a variety of browsers, and can obviate the need to install a separate e-mail software program on the user's computer. Microsoft has largely responded to the competitive significance of web-based e-mail and related tools by developing its own web-based functionality, rather than necessarily by focusing on improving the e-mail client or other tools in the operating system itself.

109. Competition is a significant driver of economic progress and a reformed section 36 focussed on competition will be directly focussed on maintaining competition. By their nature, any interventions would focus on significant markets in New Zealand with low competition. The benefits of competition in these markets would be likely to be very substantial, meaning that even one successful intervention is likely to generate significant benefit. As an example of the tangible benefits that competition can bring to a market, it is estimated that increased competition in mobile related markets from 2Degrees Mobile's entry was worth at least \$10.1 billion to the New Zealand economy for the period from 2007 to 2021 (this figure excludes intangible benefits).⁶¹
110. The success of reform should not be judged on the number of cases successfully brought by the Commission (or private plaintiffs). Rather, with reform firms would make business decisions, and advisors would provide legal and economic advice, focussed on what we consider to be the correct question – does the conduct impede the competitive process. This changed focus would, in our view, deter some conduct that is anti-competitive but would pass the taking advantage test. We do not accept that this is problematic – rather we consider that such an outcome would deliver benefits for New Zealand.

⁶¹ Venture Consulting, above n 11.

Attachment A

1. The table below provides a key to the Commission's responses to the themes raised in submissions made in opposition to reform of section 36. If a theme has been omitted from the table it should not be taken as the Commission agreeing with that submission.
2. A number of submitters supported reform. We largely agree with the points raised in those submissions and we have not repeated those submissions below. A number of other submitters did not comment on reform of section 36. We have not included those submissions in the table.

Submitter	Key section 36 points	NZCC response
Air New Zealand	Any reform should introduce a clearer regime than that which currently exists.	We consider that the primary consideration should be to ensure New Zealand has a test which accurately detects and deters anti-competitive unilateral conduct.
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]. It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	The 'purpose' element of section 36 means there is no risk of section 36 capturing legitimate competitive conduct undertaken by a dominant firm.	We disagree as the 'take advantage' element of the test effectively provides a safe harbour even where the conduct is anti-competitive. See at [37] to [48]. There is also the risk of false positives. The 'purpose' element of section 36 is also over-inclusive in that it focusses on the impact on individual competitors, rather than the process of competition. See at [35] to [36].
	Any deficiencies in section 36 are already covered by section 27.	We do not consider section 27 to be an effective 'safety net' for section 36. See at [59] to [64].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants	For the reasons discussed at [79] to [98] we disagree.
	An effects based test will impose a special responsibility on market leaders resulting in an unfair regulatory burden.	The law already recognises, through the existing substantial market power threshold, that firms with substantial market power have a unique ability to damage competition (see at [32] to [33] and [46]). Insofar as Europe has adopted particular form based rather than substance based rules we agree that New Zealand should not follow that model (see at [102] to [104]).
	MBIE should focus on reducing barriers to entry, rather than limiting incumbent's ability to respond to threats of entry.	We agree that New Zealand should focus on reducing barriers to entry. We do not consider that goal is mutually exclusive to ensuring New Zealand has an effective anti-competitive unilateral conduct provision. Indeed, we consider the goals are complimentary and an effective

		unilateral conduct provision should encourage innovative challenge firms and also encourage incumbents to respond competitively to threats of entry.
ANZ	No demonstrated problem with existing section 36 and therefore review is unwarranted. Section 36 itself is fine, the issue lies in poor application and understanding of the counterfactual test in the courtroom.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We agree that the judicial interpretation of section 36 has rendered it ineffective in promoting competition. This interpretation is largely due to the 'take advantage' element of section 36. See at [37] to [58].
	The 'taking advantage' limb of section 36 is necessary to identify the causal nexus between harm and conduct.	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on competition. At present the test focusses on the causal nexus between the firm's market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
	Any deficiencies in section 36 are already covered by section 27.	We do not consider section 27 to be an effective 'safety net' for section 36. See at [59] to [64].
Bell Gully	An effects based test will impose a special responsibility on market leaders resulting in an unfair regulatory burden.	The law already recognises, through the existing substantial market power threshold, that firms with substantial market power have a unique ability to damage competition. See at [32] to [33] and [46]. Insofar as Europe has adopted particular form based rather than substance based rules we agree that New Zealand should not follow that model. See at [102] to [104].
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test.

		See at [69] to [78].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	New Zealand should wait for Australia to conclude its reform.	In Australia the Harper Review has been completed, and the Government has announced its intention to implement the Harper Review's recommendations.
Building Industry Federation	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	New Zealand should wait for Australia to conclude its reform.	In Australia the Harper Review has been completed, and the Government has announced its intention to implement the Harper Review's recommendations.
Business NZ	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	If the issue lies in the complexity of the test, then there should be a list of examples where the subsequent actions of a successful defendant might have appeared to call into question a court decision.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with Section 36. We also believe that the current test is the wrong one, as did the Harper Review. See in particular at [34] to [58].
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58].

	competition and our markets are naturally highly concentrated.	It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	Any deficiencies in section 36 are already covered by section 27.	We do not consider section 27 to be an effective 'safety net' for section 36. See at paras [59] to [64].
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
	Abuse of market power is an inherently complex area of law.	We agree, but do not consider that is a barrier to ensuring a more effective unilateral conduct provision is enacted.
	Requests that MBIE release an exposure draft, in the event that it is contemplated that any amendment is necessary.	We agree.
Chorus	No demonstrated problem with existing section 36 and therefore review is unwarranted. Section 36 itself is fine, the issue lies in poor application and understanding of the counterfactual test in the courtroom.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We agree that the judicial interpretation of section 36 has rendered it ineffective in promoting competition. This interpretation is largely due to the 'take advantage' element of section 36. See at [37] to [58].
	An effects based test will impose a special responsibility on market leaders resulting in an unfair regulatory burden.	The law already recognises, through the existing substantial market power threshold, that firms with substantial market power have a unique ability to damage competition. See at [32] to [33] and [46]. Insofar as Europe has adopted particular form based rather than substance based rules we agree that New Zealand should not follow that model. See at [102] to [104].
	The review presents an overly simplistic approach to categorising effects based and purpose based unilateral conduct prohibitions. The effects and purpose based tests are more similar than MBIE presents.	We consider the main issue with section 36 is the taking advantage test. See at [37] to [48].
	Abuse of market power is an inherently complex area of law.	We agree, but do not consider that is a barrier to ensuring a more effective unilateral market power provision than section 36 is enacted.

	Quotes the PC judgement in the <i>Telecom v Clear</i> decision: “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.”	We agree, but note that while there is always a risk of some uncertainty with legislative change, we consider that any uncertainty would be limited, and outweighed by significant benefits. Moreover, there are already competition tests contained in the Commerce Act that are not deterring competitive conduct by all firms.
	There is a lack of regulator guidance on section 36 and such guidance will be particularly important if the provision is reformed.	To the extent that there is any residual business uncertainty from a new test, we are always open to issuing guidelines on our intended approach. See at [80].
	If section 36 is reformed it will be important that “a complainant will be required to demonstrate not merely an effect on competitors, but an effect on competition, in the sense that price, output or consumer choice are demonstrably harmed”.	We agree that a new test should focus on the process of competition and not on how individual competitors are harmed (a problem with section 36 is that its purpose element focusses on individual competitors and not the process of competition). See at [5], [35] to [36], and [89] to [91]. If there is no evidence of likely harm to consumers, for example through changes to price, output or consumer choice, then it is extremely unlikely that the test will be satisfied.
DLA Piper	Any deficiencies in section 36 are already covered by section 27.	We do not consider section 27 to be an effective ‘safety net’ for section 36. See at [59] to [64].
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
	Abuse of market power is an inherently complex area of law.	We agree, but do not consider that is a barrier to ensuring a more effective unilateral conduct provision is enacted.
	The 'taking advantage' limb of section 36 is necessary to identify the causal nexus between harm and conduct.	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on competition. At present the test focusses on the causal nexus between the firm’s market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].

	Considers the counterfactual is an overly complex, artificial construct, which is not a good proxy for anti-competitive unilateral conduct.	We agree.
	New Zealand should wait for Australia to conclude its reform.	In Australia the Harper Review has been completed, and the Government has announced its intention to implement the Harper Review's recommendations.
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]. It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	New Zealand should not be a guinea pig for a new effects based unilateral conduct prohibition.	For the reasons discussed at [84] to [85] we disagree.
Genesis	Supports the Russell McVeagh submission.	See comments below.
IAG	The 'taking advantage' limb of section 36 is necessary to identify the causal nexus between harm and conduct.	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on competition. At present the test focusses on the causal nexus between the firm's market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].
	No demonstrated problem with existing section 36 and therefore review is unwarranted. Section 36 itself is fine, the issue lies in poor application and understanding of the counterfactual test in the courtroom.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We agree that the judicial interpretation of section 36 has rendered it ineffective in promoting competition. This interpretation is largely due to the 'take advantage' element of section 36. See at [37] to [58].
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]. It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	An effects based test has a chilling effect on competition and	For the reasons discussed at [79] to [98] we disagree.

	innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
Insurance Council of New Zealand	No demonstrated problem with existing section 36 and therefore review is unwarranted. Section 36 itself is fine, the issue lies in poor application and understanding of the counterfactual test in the courtroom.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We agree that the judicial interpretation of section 36 has rendered it ineffective in promoting competition. This interpretation is largely due to the 'take advantage' element of section 36. See at [37] to [58].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	Benefits from harmonising with Australia should not be overstated – local markets have their own factors.	In Australia the Harper Review has been completed, and the Government has announced its intention to implement the Harper Review's recommendations. Moreover, we consider there is a stronger case for reform in New Zealand given its inherently more concentrated domestic markets. See at [99] to [101].
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]. It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	Insurers need to have freedom to appoint approved suppliers without fear of being targeted as engaging in anti-competitive conduct. Large economies of scale ensure lower premiums.	Competitive conduct should not be unlawful under a new test. See at [86] to [98]. For the appointment of approved suppliers, insurers already need to assess their compliance with section 27.

Metals New Zealand	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]). It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	No inherent value in aligning with other jurisdictions unilateral conduct prohibitions except for Australia.	We agree, but note that new Zealand should learn policy lessons from other jurisdictions.
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	New Zealand should not be a guinea pig for a new effects based unilateral conduct prohibition.	For the reasons discussed at [84] to [85] we disagree.
	No demonstrated problem with existing section 36 and therefore review is unwarranted. Metals NZ disagrees that there has been a failure to punish anti-competitive conduct by dominant firms. There is a consumer misunderstanding that “big is bad”. That there have been a small number of cases is not an indication of the effectiveness of the act.	In our cross-submission, and Dr Berry’s letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We do not expect to suddenly take a large number of cases under a reformed section 36, but reform will allow us to bring the right cases, where it matters. See at [107].
	Existing counterfactual test is clear, predictable and well understood.	For the reasons discussed at [69] to [78] we disagree.
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	Could seek authorisations from the Commission but given that decisions are made on a weekly basis, the cost, delay and intrusion would be stifling.	We do not consider that a competition based test for unilateral conduct will deter competitive conduct. See at [86] to [98]. Authorisations are rare for agreements to which section 27 applies, or mergers to which section 47 applies.
	Purpose is not difficult to prove, and even in jurisdictions with effects based tests proscribed purposes have been found.	We consider the main issue with section 36 is the taking advantage test. See at [37] to [48].

		The purpose element of section 36 is over-inclusive as it focusses on the impact of conduct on individual competitors rather than the process of competition. This requires the 'taking advantage' element to act as a filter between permissible and anti-competitive conduct, which it is ineffective at doing. See at [35] to [36].
Orion New Zealand Limited	The 'taking advantage' limb of section 36 is necessary to identify the causal nexus between harm and conduct.	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on competition. At present the test focusses on the causal nexus between the firm's market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].
	No inherent value in aligning with other jurisdictions unilateral conduct prohibitions except Australia.	We agree, but note that new Zealand should learn policy lessons from other jurisdictions. The Australian Government announced earlier this year that it will implement the Harper Review's recommendations on s 46.
	No value in aligning sections 36, 27 and 47.	We consider that what is relevant is that all parts of the Commerce Act effectively prevent anti-competitive conduct. Section 36 does not currently achieve this.
	No demonstrated problem with existing section 36 and therefore review is unwarranted. Section 36 itself is fine, the issue lies in poor application and understanding of the counterfactual test in the courtroom.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58]. We agree that the judicial interpretation of section 36 has rendered it ineffective in promoting competition. This interpretation is largely due to the 'take advantage' element of section 36. See [37] to [58].
	MBIE does not address the fact that section 36 was created against a policy background of deregulation, but many of the markets where section 36 was needed have been re-regulated (i.e.: electricity regulation). MBIE should take into account the effect of this regulatory policy when considering whether 36 is 'broken'.	We agree that other regulatory regimes are relevant, but there will be many concentrated markets that are not subject to specific regulation. The experience with de-regulation and associated benefits are an illustration of substantial benefits being derived from increased competition. We would expect similar benefits from a reformed section 36 that focusses on competition. Economic regulation of the electricity industry in New Zealand is focussed on price-quality regulation rather than foreclosure issues.
	Existing counterfactual test is clear, predictable and well	For the reasons discussed at [69] to [78] we disagree.

	understood.	
Retail NZ	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.
	Existing counterfactual test is clear, predictable and well understood.	For the reasons discussed at [69] to [78] we disagree.
	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	Seeking authorisations for section 36 is not practicable for business as too expensive and time consuming.	We do not consider that a competition based test for unilateral conduct will deter competitive conduct. See at [86] to [98]. Authorisations are rare for agreements to which section 27 applies, or mergers to which section 47 applies.
	No inherent value in aligning with other jurisdictions unilateral conduct prohibitions except Australia under its current regime.	We agree, but note that new Zealand should learn policy lessons from other jurisdictions. The Australian Government announced earlier this year that it will implement the Harper Review's recommendations on section 46.
Russell McVeagh	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	Any deficiencies in section 36 are already covered by section 27.	We do not consider section 27 to be an effective 'safety net' for section 36. See at [59] to [64].
	The 'taking advantage' limb of section 36 is necessary to identify the causal nexus between harm and conduct.	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on

		competition. At present the test focusses on the causal nexus between the firm's market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].
	The review presents an overly simplistic approach to categorising effects based and purpose based unilateral conduct prohibitions. The effects and purpose based tests are more similar than MBIE presents.	We consider the main issue with section 36 is the taking advantage test. See at [37] to [48].
	Moving to a new test will create uncertainty by empowering the regulator with the benefit of hindsight.	We disagree. Section 36 cases are already decided after the fact. We do not consider that a competition test would deter competitive conduct. See at [79] to [98].
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58] It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	Sections 27, 47 and 36 are currently aligned as they all require a causal connection. Removing the 'take advantage' requirement will make section 36 the outlier (rather than the other way around).	For the reasons discussed at [78] and [102] to [103] we disagree.
	Abuse of market power is an inherently complex area of law. There is no perfect solution for abuse of dominance.	We agree, but do not consider that a barrier to ensuring a more effective unilateral conduct provision is enacted.
	Argue that Sky TV, Winstone and Progressive, where section 36/27 outcomes were the same, indicating if section 36 had an effects based test, there would be no advantage.	We disagree. See at [59] to [64] in particular.
Spark	No demonstrated problem with existing section 36 and therefore review is unwarranted.	In our cross-submission, and Dr Berry's letter to the Minister, we have canvassed extensively the problems with section 36. See in particular at [34] to [58].
	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and

	interpretation.	[105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
	Making it easier for the Commission to prosecute is not a legitimate basis for change.	We consider that making it easier to detect, punish and therefore deter anti-competitive unilateral conduct is a legitimate basis for change.
	Abuse of market power is an inherently complex area of law.	We agree, but do not consider that is a barrier to ensuring a more effective unilateral conduct provision is enacted.
	Not concerned that section 36 is not aligned with sections 27 and 47; those provisions deal with multiple companies and the unilateral provision should, therefore, be different.	We consider that what is relevant is that all parts of the Commerce Act effectively prevent anti-competitive conduct. Section 36 does not currently achieve this.
	Existing section 36 is appropriate for New Zealand's small and remote economy as domestic firms face strong international competition and our markets are naturally highly concentrated.	Section 36 does not properly perform the role of a unilateral conduct provision. See at [25] to [58]. It is even more important that New Zealand has an effective rule on anti-competitive unilateral conduct. See at [99] to [101].
	Existing counterfactual test is clear, predictable and well understood.	For the reasons discussed at [69] to [78] we disagree.
	The review presents an overly simplistic approach to categorising effects based and purpose based unilateral conduct prohibitions. The effects and purpose based tests are more similar than MBIE presents.	We consider the main issue with section 36 is the taking advantage test. See at [37] to [48].
	No inherent value in aligning with other jurisdictions' unilateral conduct prohibitions. For example, the US and Canada are also close neighbours that have different competition laws.	New Zealand should learn policy lessons from other jurisdictions.
Vero	Wholesale reform will create uncertainties with respect to increased compliance costs and unexpected judicial interpretation.	We consider that uncertainty related costs would be limited, and outweighed by significant benefits. See in particular at [79] to [98] and [105] to [110]. There are already uncertainty related risks inherent in the current test. See at [69] to [78].
Westpac	The 'taking advantage' limb of section 36 is necessary to identify	We agree that a unilateral market conduct provision should focus on the causal nexus between the conduct undertaken and the impact on

	the causal nexus between harm and conduct.	competition. At present the test focusses on the causal nexus between the firm's market power and the conduct. This is not a good filter for identifying problematic unilateral conduct. It is not a good proxy for the actual purpose with which a firm with market power is acting and the actual impact of its conduct. See in particular at [37] to [48].
	An effects based test has a chilling effect on competition and innovation because business decisions will fall foul of the law depending on the unpredictable response of other market participants.	For the reasons discussed at [79] to [98] we disagree.



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 36¹ 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

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.⁴⁵ 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

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

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’Byrne 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 entrants¹⁸ 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.

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

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

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

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 multinet network 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.

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.