Draft Misuse of Market Power Guidelines

Submission to the Commerce Commission

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Preliminary

1 My name is Dr Edward Willis. I am an academic at the University of Auckland's Faculty of Law where my research includes competition and regulatory law issues. I am also a consultant specialising in competition, regulation and micro-economic policy. Until 2017 I was a practising lawyer and have previously worked as a staff solicitor at the Commerce Commission. I have advised government and private sector clients on market power issues for over a decade.

2 I welcome further questions or inquiries in relation to my views as the Commission works towards finalising the draft Misuse of Market Power Guidelines (**draft Guidelines**). I can be contacted at

Summary

3 The majority of this submission addresses the Commission's general approach to the draft Guidelines, with my comments coalescing around a central theme. That theme is that the draft Guidelines do not in their current form provide the New Zealand business community with sufficient guidance as to how the Commission intends to distinguish between justified and unjustified enforcement action taken under the new misuse of market power provisions.

4 I am aware that these views may come across as unduly critical, and I do wish to acknowledge the evident hard work that has been undertaken on the draft Guidelines to date. I also acknowledge that this central theme cannot be adequately addressed with specific recommendations in this submission. There is a need for careful reflection on the conceptual issues raised by the amendments to section 36, as well as detailed work to be done on how enforcement can best proceed in specific circumstances. It is unlikely that Commission staff can complete the necessary work before the amendments take effect. But if the draft Guidelines are to serve any useful purpose this work still needs to undertaken. This may be something that can only occur over time, as working ideas are tested against the reality of market conduct and enforcement. But I strongly encourage the Commission to invest the resources upfront to provide the necessary clarity and predictability to ensure broad-based compliance with the Commerce Act.

5 I do make one specific recommendation in relation to this theme: that the Commission be explicit as to whether it is adopting a granular economic or risk-based legalistic approach to the new legal tests. I also indulge in a number of specific comments on more detailed points in the final section of this submission.

Purpose of Commission guidelines

6 My comments about the Commission's general approach are informed by a particular viewpoint concerning the purpose of Commission guidelines. I consider that the purpose of any formal guidance from a competition agency is to ensure that the business community can understand how any discretion conferred on that competition agency by its governing legislation can be exercised reasonably and predictably. The draft Guidelines, in their current form, fall short of achieving that purpose.

7 Formal guidelines ought to do the work of setting standards and expectations that can be reasonably relied on. In this respect, the development of the draft Guidelines is not dissimilar from notice and comment rule-making that the Commission undertakes in other areas. The process of developing guidance involves dialogue with affected stakeholders and experts to determine when a regulatory response can be justified, so that expectations are clear and the business community can arrange its affairs and govern its conduct according to those expectations. In this case, the regulatory response is the initiation of enforcement action and the expectations concern the specific examples of business conduct. If the draft Guidelines are to fulfil their purpose, then they must provide sufficiently reliable guidance so that members of the business community can take tangible action in response.

8 I appreciate that, in some respects, the Commission may be reluctant to accept this characterisation of its process of providing guidance. In the case of the draft Guidelines, Commission staff will immediately recognise that the administrative rule against fettering means that the Commission cannot bind itself to a particular interpretation of the legislation in advance, and that the scheme of section 36 determines that the courts

rather than the Commission are the ultimate enforces of the statute. I accept both of these points. However, it needs to also be recognised that:

(a) the business community will organise itself with reference to the expectations set by the draft Guidelines;

(b) the perceived credibility and reasonableness of Commission decisions to pursue enforcement action will be materially informed by consistency with the draft Guidelines; and

(c) initial engagement with a firm suspected of breaching the law is likely to be framed around whether the draft Guidelines have been complied with.

9 These consequences fall short of establishing 'hard law' in the sense of definitive legal standards and court-enforced compliance. But they are a crucial part of the 'soft law' context where businesses take their cue from the Commission, where hard law enforcement action is justified and takes effect, and where the Commission has considerable influence. It is therefore necessary that any guidance is rendered in sufficient detail that this 'soft law' context is meaningfully developed.

10 In my view, the draft Guidelines fall short of any such meaningful development. The Commission's approach in the draft Guidelines has been to identify issues at a high level of abstraction and then lean heavily on 'overall judgement' or 'weighing and balancing' approaches. Not even tentative conclusions are reached. This is an overly cautious approach that emphasises the retention of discretion and a lack of analytical precision when engaging with context rather than promoting understanding of the possible application of the law or developing expectations for how enforcement discretion should best be exercised.

11 It is, with respect, unclear what purpose the draft Guidelines can usefully serve if they are limited to expressing a view that context and judgement will determine the application of the law in the face of particular conduct. It must be in the articulation of what constitutes *relevant* context and *responsible* judgement that the draft Guidelines can perform any useful function. While there has clearly been some attempt to engage with and explain contextual factors, especially in light of specific categories of harm to competition, the draft Guidelines simply do not go far enough.

12 I want to be abundantly clear that goal here is not to bind the Commission with respect to decisions relating to future enforcement action or to restrict the development of the Commission's thinking. That would be irresponsible and probably impossible as a strict matter of law. Rather, the goal is to promote an understanding of the circumstances in which enforcement action will likely be justified (and, consequently, when it will not be). This latter approach is the one taken by credible competition law authorities internationally. It is also an approach that the Commission itself can adopt, given appropriate timeframes and resources.

Specific examples

13 I illustrate the general concerns raised in the previous section with two specific examples drawn from the draft Guidelines: refusals to deal and predatory pricing.

14 Refusals to deal are a core aspect of misuse of market power prohibitions, but they raise conceptually difficulties. Taking enforcement action against a refusal to deal comes very close to mandating access. Traditionally, mandating access is a regulatory function rather than a feature of a competition law regime, although the boundary is not clear. It is not at all apparent on the face of the draft Guidelines where the Commission considers that line ought to be drawn and what exactly it would be asking the courts to enforce under a section 36 action. There is no attempt to distinguish between exclusionary and exploitative conduct if that distinction is intended, for example.[1]

15 There is also the added difficulty that prudent business practices can result in a refusal-to-deal-like conduct in some circumstances. Would, say, refusing to continue to supply an input because of non-payment be safe from competition law scrutiny? The draft Guidelines do not give any meaningful indication of how is the line between harm to competition and legitimate business practice is to be determined under the new law. Failing to address these conceptual issues in the draft Guidelines results is an acute lack of certainty in respect of the approach the Commission is likely to adopt in practice. This lack of certainty can be avoided, and it has consequences as I explain below.

16 Price-based predation is notoriously difficult to identify and punish for evidentiary reasons, with no consensus on the best approach to identify harmful conduct emerging from the relevant literature. Lower prices can deter entry and foreclose markets, but they can also deliver tangible benefits in consumer welfare. It is unclear from the draft Guidelines how the Commission intends to address this evidentiary challenge. Is the Commission contemplating the use of cost-based tests, the possibility of recoupment, or some other measure? The Commission refers to both cost-based and recoupment-based tests (at paragraphs 113 and 112 of the draft Guidelines respectively) only to note that they are not determinative. This approach does nothing to advance an understanding of how such evidentiary matters will actually be assessed.

17 Failing to address these evidentiary questions means that the draft Guidelines do not promote a shared understanding with the business community as to when intervention and enforcement action will be justified. Again, this is problematic. Both refusals to deal and predatory pricing raise basic issues on which any credible misuse of market power regime should have a ready working position. Articulating a position on these issues, even tentatively, demonstrates the competence and confidence of a competition authority to address these and other difficult issues as necessary. But even more tangibly, the lack of guidance on these points has the following consequences:

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1 Presumably it is, given the statement at paragraph 80.

(a) a potential chilling of desirable competitive conduct, as firms mirror the Commission's overly cautious approach and forego welfare-enhancing opportunities;

(b) an increase in costs over time as a position on issues needs to be worked out on an ad hoc basis with no meaningful ex ante guidance to cabin the scope of inquiry and analysis; and

(c) controversy associated with enforcement action that has not been squarely addressed in Commission guidance, with associated litigation costs and delays.

18 These are negative consequences that can and should be avoided by putting in the work to develop meaningful draft Guidelines from the outset, rather than leaving issues to be worked out through nebulous concepts such as 'judgement and context'. These consequences also illustrate that while refusals to deal and predatory pricing are specific examples, they are not niche issues. Addressing them properly in the draft Guidelines goes directly to the effect and intended enforcement of the amended misuse of market power provisions.

Law or economics?

19 Broadly, effects-based misuse of market power regimes can adopt one of two approaches. The first is to base enforcement on detailed economic evidence, carefully sifting harmful conduct from commercial activity that is benign. The second is a more legalistic, risk-based approach that avoids the cost of proving precise measures of harm are satisfied but takes a blunt approach that in primarily concerned with the reasonable minimisation of regulatory error rather than accuracy per se.

20 One useful thing the Commission could do relatively easily to improve its draft Guidelines is to determine explicitly which approach it intends to take. To be clear, neither approach rules out the use of economic evidence or legal analysis as part of determining whether enforcement action is appropriate in all the circumstances. But there is still a broad choice to be made in terms of whether tangible economic harm or legalistic approximations best serve the New Zealand economy. A choice should be made and explicitly defended as both reasonable and appropriate in the draft Guidelines.

21 The Commission's general approach in the draft Guidelines, which outlines factors to be considered in respect of categories of conduct without committing to any substantive guidance, implicitly indicates a deliberate policy choice to undertake a granular economic effects-based analysis on a case-by-case basis. This is a resource intensive undertaking, and not one that is necessarily compelled by the statutory language or justified by the efficient administration of competition law rules. And there is certainly no real attempt to justify this approach in the draft Guidelines.

22 That lack of justification is, of course, understandable. What is more likely in practice is that the Commission will use economic effects in a way to generally understand when particular categories of conduct fail the relevant legal tests. This is an approach that is more ideological driven than evidence based, but is still centred on economic effects and is much less information-intensive. In a resource constrained environment, this is likely to be the most prudent and useful approach.[2]

23 And yet, because the Commission has taken a 'context and judgement' approach in its draft Guidelines it has obscured the benefits of this more realistic approach and given strong indications that a granular, evidence and economics heavy approach will be preferred. I suspect strongly that the Commission has not intended to give credence to an approach that makes such granular analysis necessary, but that is the clear tone and direction of the draft Guidelines. Engaging with these framework questions directly rather than avoiding detailed analysis and clearly working positions is the only way to provide meaningful certainty and predictability for the regime.

Specific comments

24 I conclude my submission with a number of specific comments about detailed points.

25 At paragraph 3, the draft Guidelines state that the amendments "strengthen" section 36. At paragraph 4, the draft Guidelines state that the amendments are "likely to capture anti-competitive conduct that was not previously prohibited". These statements should be recognised as contingent. The amendments change the type of test that applies to misuse of market power rather than simply changing the threshold for satisfaction of the previous legal test. It is possible that conduct that was previously prohibited by section 36 is not captured under the amendments (such as where exclusionary conduct persists but there is no material change in the level of competition between the factual and counterfactual).

26 At paragraph 25, the draft Guidelines indicate that the same approach to market definition will be used in respect of determining the existence of market power and whether conduct has the effect of substantially lessening competition. This is a somewhat odd approach. The purpose of the substantial market power threshold is not to invite a detailed economic assessment.[3] Rather, it is a legalistic standard intended to focus the Commission's limited resources on conduct that is most likely to injure the competitive process. The level of evidential probity required to establish that there has been a substantial lessening of competition is simply not necessary to determine

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2 It is understandable if the Commission is reluctant to openly embrace a risk-based approach when conventional competition law error cost analysis views type I errors as more significant and costly than type II errors, as this could lead to under-enforcement. However, within the context of misuse of market power, type II errors are likely to more significant and costly, disrupting that conventional thinking. The point is that the approach should be openly debated and analysed.

3 If economic cogency was the defining factor, there would be no substantial market power threshold. All conduct that had the purpose or effect of substantially lessening competition would be captured, regardless of whether the impugned firm has substantial market power.

whether a firm has substantial market power. It should be recognised in the draft Guidelines that the two issues are to be assessed very differently.

27 At paragraph 39, the draft Guidelines indicate that market power will be non-transitory. It is unclear to me whether this requirement is really necessary in the context of misuse of market power analysis (as it would be in the case of, say, merger review). Transitory market power may be a serious issue in the New Zealand economy, and if so that is something section 36 ought to be able to address. This seems especially relevant given the Commission accepts (at paragraph 40 of the draft Guidelines) that more than one firm in a market may have market power.

28 At paragraph 69, the draft Guidelines state that counterfactual assessment is required. It is not clear to me that this is in fact correct as a matter of law. The key point should be that cogent economic analysis is needed. Counterfactual analysis is one way to make economic effects cogent, but this does not make it necessary. The undue, exclusive focus on counterfactual analysis as simply being 'required' also obscures that the Commission has failed to provide any meaningful explanatory link between the types of unilateral conduct being investigated and the use of counterfactual analysis. In my experience, this is the type of explanatory work that large firms and their advises expect from competition agency guidance.

29 Finally, the draft Guidelines should explicitly address intellectual property rights, and how use or misuse of intellectual property rights inter-relates with the new section 36. All property rights will presumably be treated as a potential source of market power, but whatever the intended approach the Commission should be transparent upfront. Currently, intellectual property rights are only addressed in passing in the draft Guidelines.