BELL GULLY

SUBMISSION ON DRAFT MISUSE OF MARKET POWER GUIDELINES

1. Introduction

1.1 Bell Gully is a leading competition law practice, advising major New Zealand and overseas companies on a range of issues, including misuse of market power and access issues. We welcome the opportunity to make submissions to the New Zealand Commerce Commission (**Commission**) on its draft Misuse of Market Power Guidelines (the **draft Guidelines**).

1.2 We would be happy to discuss our views further with the Commission. Please contact:

2. Assessment of the Guidelines

2.1 Bell Gully is grateful that the Commission is developing guidelines to prepare the business community for changes to section 36 of the Commerce Act (the **Act**) – there is a strong need for detailed guidance for businesses to adjust to what is a significant amendment to the law.

2.2 We understand the Commission must strike a balance between providing detailed guidance that offers businesses certainty and guidance that is over prescriptive that might risk enforcement errors. We appreciate this is not easy, but we do not believe the balance is quite right in the draft Guidelines.

2.3 Bell Gully considers the benefits of more detailed guidance significantly outweigh the risks in this context, for the following reasons.

(a) The amendment to section 36 is a significant change to the business landscape. We expect all of New Zealand's large firms will be required to undergo a fairly comprehensive review of their current business practices to ensure compliance with the new law. The stakes are high – non-compliance can lead to significant penalties and reputational damage.

(b) We have previously submitted to MBIE on our concerns of the potential overreach of the new law. Our primary concern is that the new section 36 may, *in practice*, place large firms under an obligation or "special responsibility" to ensure that their conduct does not adversely impact smaller (and possibly less efficient) competitors. Further, the boundaries of the new law are inherently uncertain, with firms now required to undertake a detailed assessment of the likely competitive effects of actions, whereas a more straightforward self-assessment was possible under the previous law.

2.4 We appreciate they are only draft Guidelines and that the Commission anticipates a process of engagement and refinement. However, we are concerned that, as they are presently drafted, the draft Guidelines would offer fairly limited real-world support for businesses. Business are likely to be left uncertain as to the Commission's view on certain conduct, and may rationally compete less vigorously as a result. Indeed, many types of business conduct that could potentially fall within the scope of section 36 also look very much like pro-competitive behaviour. Therefore, any steps that can be taken by the Commission to reduce the possibility that the new rule will restrict competition or innovation in New Zealand markets are strongly encouraged.

2.5 One way in which the Commission can seek to appropriately provide more certainty is to focus more on the economic underpinnings of various misuse of market theories of harm, and there are many analytical techniques from economics available to assist in this regard. On our read, the draft Guidelines portray as potentially unlawful conduct that would not meet misuse of market power or abuse of dominance standards as they are generally understood in most major antitrust jurisdictions. Focussing more on the economic underpinnings of anticompetitive conduct will provide a more objective measure and thus provide more certainty.

2.6 For example, the Commission's discussion of predatory pricing does not refer at all to the central concept of below cost pricing. By contrast, it is generally accepted that to be predatory, pricing must be below some relevant measure of cost.[1] Often the debate is precisely *which* measure of cost is the appropriate baseline. This choice may well depend on the facts of the case, but focussing on costs at least gives a meaningful metric against which to measure the reduced pricing.

Worked examples

2.7 We appreciate the Commission's efforts in drafting a number of worked examples in the draft Guidelines. However, we consider the worked examples would benefit from significantly more detail. Critically, many of the examples do not conclude on key issues, such as whether the hypothetical firm has substantial market power, or whether the Commission considers the particular conduct would contravene section 36 in the relevant scenario. Bell Gully encourages the Commission to add further detail to these examples and to reach firmer conclusions. A disclaimer that each example does not carry legal weight would limit the risk of over-reliance from businesses.[2]

2.8 By contrast, the Inland Revenue Department (**IRD**) has recently issued highly detailed 54 page guidance on the changes to the business continuity test.[3] Their guidance contains 15 worked examples, many of which are two to three pages long. Each example offers a definitive conclusion on the IRD's interpretation of each situation, making each highly valuable to New Zealand businesses.

2.9 Another example is the ASX's guidance note on continuous disclosure. It not only sets out the law but also refers to other sources, clarifies how the ASX will approach particular issues, and provides numerous examples.[4] In so doing, it assists listed entities to understand how to comply with their ASX listing rule obligations. Like section 36 guidance, the ASX guidance must similarly deal with nuances and difficult concepts, such as materiality and price sensitivity. We understand the ASX road tested proposed examples (and conclusions) with the market and adjusted its position in some cases. The outcome is a guidance note that is valuable to the business and adviser community, and which has contributed to greater certainty, less variability and lower compliance cost and risk across the market.

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[1] Rex Adhar *The Evolution of Competition Law in New Zealand* (Oxford University Press, Oxford, 2020) at 187: "predatory pricing does require below-cost pricing" citing *Commerce Commission v Port Nelson* [1993] 6 TCLR 406 (HC) at 538 and *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) at 572.

This position is also settled in Australia. See, for example CCH Commentary: *Australian Competition and Consumer Law Commentary*, 16 January 2019, "*In the past, Australian courts have acknowledged that predatory pricing is price cutting below some measure of cost without specifying what the appropriate measure of cost is.*"

[2] See, for example, the disclaimer at the beginning of the FMA's Guide to Financial Advice Provider license requirements and application kit, August 2022, (available here).

[3] Inland Revenue Department, *Loss carry-forward – continuity of business activities*, 28 October 2022 (available here).

[4] ADX Listing Rules: Guidance Note 8 "Continuous Disclosure: Listing Rules 3.1 – 3.1B", 28 February 2020 (available here).

3. Specific feedback on the draft Guidelines

Volume rebates

3.1 In the Residential Building Supplies Market Study draft report, the Commission suggested that some widely used volume rebate structures may breach the new section 36, and encouraged firms to review these structures:[5]

> *In addition, some rebate structures may breach the Commerce Act in some circumstances. From April 2023 changes to section 36 of the Commerce Act will prohibit firms with a substantial degree of market power from engaging in conduct that substantially lessens competition, regardless of whether they would have done the same thing if they did not have market power*
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> *Suppliers with substantial market [power], particularly those in highly concentrated markets, should review their rebate structures for compliance with the revised section 36 of the Commerce Act.*

3.2 In light of this indication from the Commission, specific guidance on volume-based rebates would be very useful for New Zealand businesses. The draft Guidelines discuss rebates at a high level, but do not specifically discuss the circumstances in which quantity-forcing rebates may harm competition, nor do they include any worked examples.

3.3 We consider guidance would be most useful in the context of share of wallet and tiered retroactive rebates, because:

(a) the Commission considers share of wallet and tiered retroactive rebates pose the greatest competition concerns;[6] and

(b) tiered retroactive rebates in particular are very common in New Zealand: they are a fairly standard way to recognise volumes, and are frequently driven by customers rather than suppliers.

3.4 Bell Gully would be happy to engage with the Commission with respect to common rebate structures, if this would be of assistance.

Predatory pricing

3.5 Bell Gully wishes to submit on two material elements of the draft Guidelines dealing with predatory pricing, being the:

(a) omission of the requirement that predatory pricing be below cost; and

(b) the Commission's view that recoupment is not necessarily an essential element of predatory pricing under the new section 36.[7]

3.6 We discuss each of these in turn below.

3.7 It is a settled principle of competition law that predatory pricing requires below cost-pricing.[8] However, the draft Guidelines do not state that below cost pricing is a requirement of

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[5] Residential Building Supplies Market Study draft report at paragraphs 9.90-9.91.

[6] Ibid at paragraph 7.49.3, where the Commission notes, *"Quantity-forcing rebate structures (both share of wallet and tiered retroactive rebates) appear most likely to have the potential to harm competition between suppliers, particularly when used by suppliers with substantial market power that have an assured supply base."*

[7] See the Draft Misuse of Market Power Guidelines at paragraph 112.

[8] *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) at 572

predatory pricing. Similarly, the worked example does not indicate that the pricing of "Company A" is below cost.[9]

3.8 In the interests of clarity, we recommend that the Commission confirms that below-cost pricing is recognised as a legal requirement for any claim of predatory pricing. If this omission was intentional, we encourage the Commission to provide a fulsome explanation of why it has adopted such an approach. From our perspective, it would be highly concerning to have an environment where the Commission purported to be able to challenge above cost pricing as predatory and thus anti-competitive. In fact, we believe the Commission should clearly set out its view on which measure of cost it considers will generally be appropriate, and how it proposes to measure that cost, e.g. in terms of over what period it would consider costs incremental, etc. From our perspective, only in exceptional circumstances should companies face predatory pricing allegations where they supply at prices above their average variable or incremental cost. Those circumstances should be, to the greatest extent possible, defined in the draft Guidelines.

3.9 Our concerns in relation to the cost issue are further amplified by the Commission's view that recoupment will no longer be an essential element of predatory pricing under the new section 36, although evidence of recoupment "may be evidence of a lessening of competition".[10]

3.10 We continue to see an intention / ability to recoup losses as an essential element to distinguish predatory pricing by firms with market power and competitive discounting. As explained by NERA (and the Privy Council, subsequent to *Port Nelson*), evidence of recoupment is important for economic analysis because it suggests a rational motive for the allegedly predatory conduct.[11]

3.11 We struggle to see an instance where price-cutting by a firm with market power could substantially lessen competition under section 36, unless that firm has either an intention or an ability to recoup its losses. We are of the view that the Commission should continue to view recoupment as the key difference between competitive discounting and anticompetitive pricing, as was emphasised by the Privy Council in *Carter Holt Harvey Building Products Group Ltd v Commerce Commission.* While the following statement was made in the context of an assessment of the former section 36, we see it as highly relevant to the assessment of whether particular pricing conduct amounts to an SLC:[12]

> *the importance that the ability to recoup losses by raising prices later without the fear of reprisals has in distinguishing between price cutting that is competitive and that which is anticompetitive.*

3.12 That is not to say that a straight increase in price post exit should be the only form of recoupment. The requisite recoupment may be more nuanced and could come in many different forms, including in markets outside of the market in which the pricing is examined. However expressed, we see the concept as a critical touchstone to distinguish pro-competitive price reductions from anticompetitive predatory pricing. If the Commission were to proceed on the basis that, in its view, recoupment is not required, then it is even more

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This position is also settled in Australia. See, for example CCH Commentary: *Australian Competition and Consumer Law Commentary*, 16 January 2019, "*In the past, Australian courts have acknowledged that predatory pricing is price cutting below some measure of cost without specifying what the appropriate measure of cost is."*

[9] See the worked example on page 25 of the Draft Misuse of Market Power Guidelines.

[10] The Draft Misuse of Market Power Guidelines at paragraph 112, citing *Port Nelson Ltd*, above n 8, at 571.

[11] NERA, *Some Economics of a "Misuse of Market Power",* 7 October 2017, at page 3.

[12] *Carter Hold Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, [2006] 1 NZLR 145 (PC) at 67.

important that the Guidelines provide substantial detail on what distinguishes lawful, competitive conduct from predatory conduct.

Anticompetitive purpose

3.13 At paragraph 60 of the draft Guidelines, the Commission discusses the section 36 purpose requirement. It notes that the purpose requirement will be satisfied "if one of the firm's *motivating purposes* is anticompetitive". In the interests of clarity, we favour using the wording of s 2(5) of the Act, that requires the anticompetitive purpose to be a "substantial purpose" of the conduct.

Assessment of pro-competitive effects

3.14 We agree with the Commission's assertion at paragraph 77 that the pro-competitive effects of conduct are relevant when assessing whether an SLC has occurred.[13] Given their importance to any section 36 assessment, we consider examples of pro-competitive effects / efficiencies should be provided in each section of the draft Guidelines addressing the various types of competitive harm.

3.15 For example, the importance of efficiencies in the context of exclusive dealing has been highlighted by New Zealand courts on a number of occasions. The High Court in *Fisher & Paykel* noted that the exclusive dealing arrangements in question *"prevent the twin evils of 'free riding' and 'switch-selling' of competitors' goods and allow F&P to deliver a superior product and service to consumers, more efficiently than would otherwise be the case."*[14] We consider the Commission should incorporate examples of pro-competitive effects such as these throughout the draft Guidelines.

Price squeeze

3.16 At paragraph 89, the draft Guidelines describe a price / margin squeeze as pricing by a vertically integrated firm with market power that "prevents *efficient* competitors from profitably operating in the downstream market", citing *Telecom Corporation of New Zealand Ltd v Commerce Commission*.[15] In that case, the Court of Appeal in fact defined a price squeeze as follows:[16]

> *A price squeeze occurs when a dominant vertically integrated supplier sets prices in the upstream wholesale market in a manner that prevents* ***equally or more efficient competitors*** *from profitably operating in the downstream retail market.*

3.17 We consider the draft Guidelines should be amended to reference "equally or more efficient" competitors. As they are currently drafted, the draft Guidelines may be interpreted as imposing a duty on firms with market power to price at levels that protects a potentially less efficient competitor in a downstream market. This is not consistent with generally accepted economic theory, that the price squeeze prohibition is designed only to protect those firms that are at least as efficient as the vertically integrated firm.[17]

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[13] See, for example, *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731 (HC) at 740 and 741.

[14] At 766.

[15] *Telecom Corporation of New Zealand v Commerce Commission* [2012] NZCA 278.

[16] At 2.

[17] See for example, Germain Gaudin and Despoina Mantzari "Margin Squeeze: An Above-Cost Predatory Pricing Approach" (2016) 12(1) Journal of Competition Law & Economics 151 at 169: "*Overall, from an economic perspective, only margin squeezes that exclude competitors who are at least as efficient as the integrated firm would harm competition and lower total surplus*." (available here).

3.18 In addition to amending this language, we recommend the draft Guidelines set out the measure of cost the Commission intends to use, and against what benchmark, in margin squeeze assessments. The European Commission's (**EC's**) equivalent guidance is clear that it will investigate instances of margin squeeze which do not "allow even an equally efficient competitor to trade profitably in the downstream market on a lasting basis".[18] The EC goes on to provide its favoured cost metric:[19]

> *In margin squeeze cases the benchmark which the Commission will generally rely on to determine the costs of an equally efficient competitor are the LRAIC [long-run average incremental cost] of the downstream division of the integrated dominant undertaking.*

3.19 We believe a similar level of guidance from the Commission is warranted. In the worked example on page 19, we also favour the Commission including reference to specific economic cost measures (e.g. LRAIC) and the appropriate test the Commission intends to use in future investigations.

Tying and bundling

3.20 Tying and bundling is a common and widespread business practice. The Commission notes at paragraph 108 that tying and bundling can "often be good for both consumers and suppliers, but sometimes…can harm competition." We consider it would be more accurate for the draft Guidelines to explain that tying and bundling are not harmful to competition except in a very limited set of circumstances.[20]

3.21 Current economic thinking accepts that, as a rule, tying and bundling are generally not harmful to competition, except in specific scenarios. In our view, the draft Guidelines do not adequately address this position. In fact, the draft Guidelines are silent on the framework which the Commission intends to apply in order to assess whether a tying or bundling strategy potentially has anticompetitive effects. The upshot is that the draft Guidelines offer limited benefit in this regard.

3.22 We urge the Commission to develop a clear framework or set of operational rules to help businesses differentiate harmful cases from normal commercial behaviour, including with regards to relevant economic analysis. To that end, we note that generally accepted economic theory suggests that a tying and bundling strategy may have anticompetitive effects *only* where there is evidence of each of the following:

(a) where a firm has market power in relation to one (or more) of the products in the bundle;

(b) the tying/bundling strategy impedes the ability of rival players to effectively compete; and

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See for example, Wen-Jey Tsay *The Over-Deterrence Risks of Price Squeeze Tests in Regulated Industries* (November 30, 2021) which states: "*Price squeezes are evaluated by the as-efficient competitor (AEC) test, which is the sum of the regulated input price, mm, and the downstream marginal cost of the vertically integrated monopolist.*" (available here)

[18] European Commission *Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* (2009) at 79 (available here).

[19] European Commission, above n 18.

[20] We note that Dr Amelia Fletcher *Economics for Competition Law 2010-2011, Module Two, Unit 5, Price Discrimination, discounts, tying and bundling* (informa, London, 2011), at 5-135 states: *"bundling is a common practice often driven by efficiency rationales and characterised by benign effects."*

See for example, Daniel Mandrescu "Tying and Bundling by Online Platforms – distinguishing between lawful expansion strategies and anti-competitive practices" (2021) 40 CLSR 2 at 3, in particular: "*Tying and bundling practices have also been found to produce various efficiencies such as ensuring product quality and reducing distribution and search costs that may even intensify competition and increase welfare*" (available here).

(c) the tying/bundling firm could subsequently raise price or lower quality, without the threat of re-expansion by its rivals.

3.23 As regards (b) and (c) above, we note that there are a range of techniques which can be employed[21] and the draft Guidelines would benefit from further detail in this regard.

Exclusive dealing example

3.24 We note that exclusive dealing "example 1" is broadly analogous to the *Fisher and Paykel* High Court decision.[22] In *Fisher and Paykel*, the High Court determined that the exclusive dealing clause (**EDC**) did not SLC, however the draft Guidelines suggest that example 1 may SLC.

3.25 Bell Gully considers the draft Guidelines should include much more detail as to how it would assess the competitive effects of this EDC. In particular, the EDC described in example 1 appears less likely to cause a competitive concern than the EDC described in *Fisher & Paykel*. Notably:

(a) Fisher and Paykel had an 80% share of the whiteware market, which is greater than the 60% market share in the example; [23] and

(b) the EDC in Fisher and Paykel restricted retailers from stocking or selling whiteware of any other distributor[24], whereas the example only restricts retailers from stocking more than 40% of their products from any other brand.

3.26 We additionally consider the Commission could include more detail in relation to:

(a) the pro-competitive justification advanced by Company A. The example only mentions the purpose of the EDC is to protect Company A's reputation as a supplier of "premium products", whereas *Fisher & Paykel* included discussion the purpose of the EDC to prevent "free riding" and "switch selling" of competitor goods;[25] and

(b) the theory of harm. The example focuses on whether the EDC forecloses competitors by denying them sufficient retail volumes, whereas *Fisher & Paykel* also discussed whether the EDC raised competitors' costs of obtaining adequate retail outlets or their cost of distribution.[26]

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[21] For example, the discount allocation test, whereby an "imputed" price for the component of the bundle which is also sold by a competing firm is calculated by subtracting the value of the bundled discount from the price the bundling firm sells that product for separately. The test is then to compare this imputed price to an appropriate measure of the bundling firm's cost for the component product in the bundle. See n 11.

[22] The Draft Misuse of Market Power Guidelines at page 20, in addition see *Fisher & Paykel Ltd,* above n 13.

[23] *Fisher & Paykel Ltd*, above n 13, at 731.

[24] At 734.

[25] At 766.

[26] At 753.