



Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Secretariat,

The New Zealand Commerce Commission appreciates the opportunity to make the attached submission to the Competition Policy Review Panel.

Our comments address misuse of market power by a dominant firm and the proposed reforms in the draft report. We welcome the thorough review of section 46 conducted by the Panel and the draft recommendation proposed. We agree that an effects based approach is appropriate in assessing potential misuses of market power; however we have concerns about the proposed defences in the draft report.

We are available to respond to any questions in writing or by telephone and would welcome the opportunity for continued engagement in this review.

Yours sincerely,

A handwritten signature in blue ink that reads 'Mark Berry'.

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Summary of the Commerce Commission's submissions

1. We welcome the Panel's thorough review of section 46. In New Zealand the Productivity Commission recommended a review of section 36 of the Commerce Act 1986 following their inquiry into the services sector.¹ Further to that recommendation, the New Zealand Government has indicated a review of section 36 as part of its Business Growth Agenda.²
2. It is in the context of the proposed review of section 36 and the goal of a trans-Tasman single economic market that we comment on the draft recommendation of the Panel.
3. In broad terms the Commission's position can be summarised as follows:
 - 3.1 We support, in principle, the Panel's recommendation to reframe section 46 so as to focus on a whether a firm with substantial market power has engaged in conduct with the purpose, or that has the effect, or likely effect of substantially lessening competition.
 - 3.2 We agree with the Panel that the challenge is to frame a law that captures anti-competitive unilateral behaviour but does not constrain vigorous competitive conduct.
 - 3.3 We consider that 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. We consider that these arguments (or defences) can, and should, be captured in the round of a substantial lessening of competition test (as they are in other sections of the Commerce Act).
 - 3.4 To the extent that it is thought that these justifications cannot be considered in the round of a substantial lessening of competition test, then there may be room for a confined defence. But that defence should be clearly focussed on the particular firm's justification and pro-competitive rationale for the conduct; it should not be focussed on a hypothetical firm's hypothetical conduct abstracting completely from the effects of that conduct.
 - 3.5 If the Panel wishes to include a separate defence based on business justification, we suggest that rather than the proposed defence the Panel may like to consider the defence as currently expressed by the Federal Court of Appeal in Canada that:

a business justification must be a credible efficiency or pro-competitive rationale for the conduct in question, attributable to the respondent, which relates to and counterbalances the anti-competitive effects and/or subjective intent of the acts.^{3 4}

¹ www.productivity.govt.nz/sites/default/files/services-inquiry-final-report.pdf

² www.mble.govt.nz/what-we-do/business-growth-agenda

³ *Canada (Commissioner of Competition) v Canada Pipe Co.* 2006 FCA 233 at [73].

- 3.6 In terms of the currently proposed defence, we are concerned that the affirmative defence does not adequately sort the pro-competitive effects from the anti-competitive effects. We are particularly concerned about the 'rational business decision' limb; if this was retained, any change to the defence should not leave this as the only part of the defence.
- 3.7 The rational business decision limb, as currently worded, risks simply reintroducing the concepts that have made the counterfactual "taking advantage" test ill-suited to sorting conduct with pro-competitive effects and conduct with anti-competitive effects. There are two reasons that taking advantage has proven to be an inadequate filter:
- 3.7.1 it is absolute in that no matter what the impact of a firm's conduct on competition, if a firm without market power would have pursued that conduct no breach can occur; and,
- 3.7.2 the method by which it is applied – that is, the requirement of a consideration of a hypothetical world where all factors, apart from the firm-in-question's market power, are in place – is often difficult and unwieldy to apply in practice (particularly in comparison to a straightforward consideration of a whether a rational business justification is likely).
- 3.8 We are also unclear as to the need for the second limb of the defence. In our view, the substantial lessening of competition test is inherently focussed on the long-term effects of conduct in a market. We consider that all effects on competition (both pro and anti) should be captured within the main test as to whether the conduct had the effect, or likely effect of substantially lessening competition. Therefore a separate defence based on the effect of the conduct as being to benefit the long term interests of consumers appears to be unnecessary unless some different standard is being addressed.
- 3.9 Further, we consider that there is a risk that requiring the 'rational business decision' limb and the 'long term benefit to consumers' limb of the defence to both be satisfied means that any balancing of pro and anti-competitive effects undertaken as part of the second limb would not focus on actual pro-competitive effects of the conduct but instead focus on the type of hypothetical inquiry that occurs under the first limb. This type of inquiry may reveal only whether some efficiency might justify the same conduct by a firm absent market power.

We recognise the need for effective misuse of market power legislation

4. Being a small economy, New Zealand businesses face challenges in acquiring the scale to operate efficiently and compete effectively, especially in global markets. The

⁴ Canadian Competition Bureau "The Abuse of Dominance Provisions Enforcement Guidelines"
www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html

level of aggregation that may be tolerated in New Zealand markets may therefore be higher than in some larger economies.

5. Some argue that the need for increased scale requires a more relaxed attitude towards single firm conduct.⁵ We consider, as discussed in the relevant literature⁶, that a tolerance for higher market shares reinforces rather than dissipates the need for effective rules prohibiting anti-competitive practices by firms with substantial market power.
6. In New Zealand, misuse of market power is addressed under Part II of the Commerce Act, primarily in section 36. That provision prohibits a firm with a substantial degree of market power from taking advantage of that power for the purpose of preventing, deterring or excluding competition. Section 36(1), as drafted, is nearly identical to section 46(1) of the Australian Competition and Consumer Act 2010. While the Australian provision has undergone refinements in recent years, the core statutory provision is the same as in New Zealand.⁷
7. While the core statutory provisions are the same, the law – specifically the approach to taking advantage – is not. By adopting solely a counterfactual taking advantage test New Zealand's Supreme Court has decreased section 36's effectiveness as an enforcement tool. While the Commission believes that taking advantage in general does not effectively distinguish pro and anti-competitive conduct, the position in New Zealand is more extreme than in Australia. In Australia the courts (and now section 46(6A)) have been willing to consider alternative approaches to assessing taking advantage such as the 'materially facilitated' test⁸, or the 'direct inference' test,⁹ whereas in New Zealand the courts have highlighted that the only test to be considered is a counterfactual taking advantage test.¹⁰

We support the addition of an effects based test

8. We support, in principle, the panel's recommendation to reframe section 46 so as to focus on whether a firm with substantial market power has engaged in conduct with the purpose, or that has the effect, or likely effect of substantially lessening competition.
9. This recommendation recognises the underlying foundation of competition law is that what matters is the impact a firm's conduct may have on competition because of the benefits that competition bring to an economy.
10. This is true whether evaluating past conduct or undertaking prospective analysis of future conduct. As such, New Zealand's section 27, that addresses anti-competitive

⁵ Keene S, Irwin V, Fincham A "The 0867 case - death knell of the counterfactual?" (paper presented at the Bright*Star Competition Law and Regulatory Review Conference 2010) at 19.

⁶ Michal Gal *Competition Policy for Small Market Economies* (Harvard University Press, Cambridge, 2003) at 93.

⁷ Misuse of market power may also breach section 27 of the Commerce Act, if such practices involve agreements that have the purpose, effect or likely effect of substantially lessening competition in a market.

⁸ *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13, (2001) 205 CLR 1 at [51].

⁹ *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 197-198 per Deane J.

¹⁰ *Commerce Commission v Telecom Corp of New Zealand Ltd* [2010] NZSC 111 at [30].

agreements, (Australia's section 45) and New Zealand's section 47, that considers mergers, (Australia's section 50) both focus on purpose, effect and likely effect. The Commission sees no compelling reason why the focus in section 36 (Australia's section 46) should be different.

11. The focus in New Zealand is currently different because the counterfactual taking advantage test is the only inquiry with no assessment of the effect of the conduct on competition. It is for that reason that we also support the Panel's reframing of the primary prohibition to remove the "taking advantage of" language.¹¹

Concerns about the proposed scope of the defence

Pro-competitive conduct can, and should, be captured within the main provision

12. 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.
13. This would be consistent with the treatment of pro-competitive conduct in assessing potentially anti-competitive agreements and mergers under New Zealand legislation. For example section 27 (addressing potentially anti-competitive agreements) considers the "net" effect on competition, ie, it is necessary to balance the pro-competitive effects against the anti-competitive effects. We explained (and the High Court endorsed) the net approach in the exclusive dealing case, *Fisher & Paykel Ltd*.

It was ... submitted by the applicant that, in determining whether a practice substantially lessened competition in any market, both pro-competitive effects and anticompetitive effects had to be taken into account. Counsel opposing the application did not take issue with this submission. In the view of the Commission, should the circumstances make it appropriate, it is necessary to take into account all effects of the restrictive clause which is the subject of the inquiry in ascertaining whether the test in sec 27 is met. To take into account some effects on competition only would not be realistic. Further, sec 3(3) of the Act provides that 'all factors that affect competition in that market' must be taken into account, and it appears to embrace those factors which enhance competition as well as those which lessen it. If, for example, it could be shown that the net effect of the clause was to promote competition, then there can be no 'substantial lessening of competition' in terms of sec 27.¹²

14. Further to the way pro-competitive conduct is assessed in other provisions, we note that a survey of OECD countries¹³ on the treatment of efficiencies in competition legislation revealed a similar approach being undertaken in relation to the misuse of market power provisions that:

While in many jurisdictions (Canada, EU, US) legal provisions on abuse of a dominant position make no explicit allowance for an argument based on efficiency gains, legislation in some

¹¹ As previously discussed we recognise that in Australia the courts (and now section 46(6A)) have been willing to consider alternative approaches to assessing taking advantage.

¹² *Re Fisher & Paykel Ltd (No 2)* [1987] 1 NZBLC (Com) 104, 377 at [3.21].

¹³ OECD Policy Roundtable "The Role of Efficiency Claims in Antitrust Proceedings" 2012.

countries (Mexico, Republic of South Africa, Turkey) clearly allows dominant firms to bring forward efficiency claims. Despite lack of an explicit provision, a possibility to justify potentially anti-competitive conduct on efficiency grounds has been recognised by the EU and the US courts, as well as in soft-law instruments of the European Commission.¹⁴

15. In particular in relation to the US:

For single-firm conduct, efficiencies also may offer a pro-competitive justification for the conduct that is being evaluated. Various forms of unilateral conduct, including exclusive dealing, tying, and loyalty discounts, may have pro-competitive benefits, such as obtaining economies of scope, improved product quality or functionality, or lower prices for consumers. On the other hand, such conduct can also, in certain circumstances, harm competition. Accordingly, as with agreements, the Agencies, as well as U.S. courts, evaluate such conduct by considering both the anti-competitive effects and the pro-competitive justifications offered by the company.¹⁵

16. Further to this in relation to the European Union:

Even though the wording of Article 102 TFEU, which prohibits abuses of a dominant position, does not contain an efficiency defence, the Court of Justice of the European Union has recently confirmed that dominant companies have the opportunity to advance efficiency arguments in order to justify conduct which may otherwise be regarded as abusive.^{16 17}

17. We recognise that there may be a rational business justification for conduct that is not pro-competitive or efficiency driven (such as complying with other legislation) and that the Panel may wish to include a defence which captures such a rationale for anti-competitive conduct.

18. However, we consider that the first limb of the defence (whereby the primary prohibition would not apply if the conduct in question would be a rational business decision or strategy by a corporation that did not have a substantial degree of power in the market) would not necessarily capture these business justifications. Further, we are unclear as to the need for the second limb (whereby the primary prohibition would not apply if the effect or likely effect of the conduct is to benefit the long term interests of consumers). In our view, the substantial lessening of competition test in the main provision is inherently focussed on the long-term effects of conduct in a market.

The first limb of the defence and the counterfactual taking advantage test

19. As currently worded the first limb risks re-introducing the same counterfactual taking advantage test as interpreted by the courts from the current New Zealand legislation.¹⁸

¹⁴ OECD Policy Roundtable "The Role of Efficiency Claims in Antitrust Proceedings" 2012, at 8.

¹⁵ OECD Policy Roundtable "The Role of Efficiency Claims in Antitrust Proceedings" 2012, at 189.

¹⁶ Case C-209/10 Post Danmark [2012] ECR I-not yet reported, at [41].

¹⁷ OECD Policy Roundtable "The Role of Efficiency Claims in Antitrust Proceedings" 2012, at 89.

¹⁸ As previously discussed we recognise that in Australia the courts (and now section 46(6A)) have been willing to consider alternative approaches to assessing taking advantage.

20. The counterfactual taking advantage test 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.
21. By making this comparison the counterfactual taking advantage test makes the main focus a hypothetical inquiry into the conduct's possible efficiencies as opposed to the more important question of its actual effects, both pro- and anti-competitive, when practiced by the actual firm in question.
22. It trades an inquiry into actual efficiencies and actual motivations in a real world market for a hypothetical inquiry that reveals (assuming it can be effectively applied) only whether some efficiency might justify the conduct by some firm absent market power. It never asks whether the dominant firm's decision to undertake the conduct was in fact motivated by such a purpose and whether efficiencies were actually realised. And it never considers the anti-competitive effects in isolation, or in comparison to any realised efficiencies.^{19 20}
23. In this way the test acts as the only inquiry. If a firm can show a hypothetical firm would have carried out the conduct in a competitive market they will not breach the Act. This is the case even if the conduct has demonstrably adverse effect on the competitiveness of a market, with consequent adverse effects on consumers.
24. Moreover, putting aside these in-principle objections, we also consider that there are problems with applying the counterfactual taking advantage test in practice. For example, the first step in the test is to construct the hypothetically competitive market comparator. That construct is highly speculative. Further, assuming the identification of such a hypothetically competitive market, how reliably can a court predict how a firm would act in it?²¹
25. The courts have stated that the counterfactual taking advantage test is a test of causation – that is, there will only be a use of market power when the market power enables the conduct to be undertaken and the purpose to be achieved.²² It is argued by some that section 27 (section 45) and section 47 (section 50) also require a counterfactual analysis. That is true in the sense that a counterfactual is used to test for causation. However, the counterfactual enquiry in those sections is different. The enquiry in those sections is a comparison of effects – not of conduct. The

¹⁹ Gavil A "Imagining a Counterfactual Section 36: Rebalancing New Zealand's Competition Law Framework" (working draft paper, 2013).

²⁰ Cross J, Richards J, Stucke M, Waller S "Use of Dominance, Unlawful Conduct and Causation under Section 36 of the New Zealand Commerce Act 1986: A United States Perspective" New Zealand Business Law Quarterly, 2013; University of Tennessee Legal Studies Research Paper No. 208.

²¹ The Commission's submission to the Supreme Court in relation to *Commerce Commission v Telecom Corp of NZ Ltd* [2010] NZSC 111 noted four key difficulties with determining and applying the assumptions to be made in a counterfactual taking advantage test, at [3.29]. These were: a) determining the characteristics of the hypothetical non-dominant firm; b) determining the assumed structure of the hypothetical market; c) determining how competitive the hypothetical market should be; and d) determining how the hypothetical firm "would" have behaved.

²² *Commerce Commission v Telecom Corp of New Zealand Ltd*, [2010] NZSC 111 at [34].

counterfactual analysis, therefore, serves to clarify the statutory question of whether competition has been lessened as a result of the conduct under consideration.

26. Finally we note that the section 36 counterfactual taking advantage test appears to be unique in the world and is inconsistent with the otherwise common approach to judging single firm conduct. A survey of many of the members of the International Competition Network²³ found most jurisdictions apply a hybrid approach (between a formalistic, bright line approach, and an effects based approach) that combines a formalistic approach with varying degrees of analysis of effects, usually using rebuttable legal presumptions. The effects-based approach allows for an analysis of the circumstances in the particular case, and is therefore particularly suitable where neither economic theory nor empirical research predicts ex-ante a pro-competitive or exclusionary explanation for a certain type of conduct with a high degree of certainty.

The link between the first and second limbs of the defence

27. As already outlined, the current wording of the first limb of the defence appears to us to provide a complete defence to any conduct regardless of anti-competitive effect. The defence calls for no balancing of the business justification for the conduct against the effect of the conduct. It may be argued that by currently requiring the first and the second limb of the defence to be satisfied the overall defence does require this balancing to be undertaken.
28. However this does not reduce our concerns in relation to the re-introduction of the counterfactual taking advantage test within the first limb of the defence. This is because we consider that there is a risk that requiring the first and second limb of the defence to both be satisfied means any balancing of pro and anti-competitive effects undertaken as part of the second limb would not focus on actual pro-competitive effects of the conduct but instead focus on the type of hypothetical inquiry that occurs under the first limb. This type of inquiry may reveal only whether some efficiency might justify the same conduct by a firm absent market power.

The second limb of the defence and the link to the substantial lessening of competition test

29. We are unclear as to the need for the second limb of the defence. In our view, the substantial lessening of competition test is inherently focussed on the long-term effects of conduct in a market. Transitory or short term effects are unlikely to be considered to breach such a test. Moreover, as discussed above we consider that all effects on competition (both pro and anti) should be captured within the main test as to whether the conduct had the effect, or likely effect of substantially lessening competition. Therefore a separate defence based on the effect of the conduct as being to benefit the long term interests of consumers appears to be unnecessary unless some different standard is being addressed compared to the effect of a substantial lessening of competition test.

²³ International Competition Network (ICN) "Unilateral Conduct Workbook, Chapter 1: The Objectives and Principles of Unilateral Conduct Laws" (paper presented at the 11th Annual ICN Conference, Rio de Janeiro, Brazil, April 2012) at [33]-[34], [43] www.internationalcompetitionnetwork.org/uploads/library/doc827.pdf

An alternative defence based on business justification

30. If the Panel wishes to include a separate defence based on business justification given the ability to capture pro-competitive effects through the main provision, we suggest that rather than the proposed defence the Panel may like to consider the defence as currently expressed by the Federal Court of Appeal in Canada.

An additional factor in the determination of whether an act is anti-competitive is whether it was in furtherance of a legitimate business objective. A business justification is not a defence to an allegation that a firm has engaged in anti-competitive conduct, but rather an alternative explanation for the overriding purpose of that conduct, if and as required, that a firm can put forward where the Bureau believes that purpose to be anti-competitive. **For such purposes, proof of the existence of some legitimate business purpose underlying the conduct is not sufficient. Rather, the Federal Court of Appeal has said that "a business justification must be a credible efficiency or pro-competitive rationale for the conduct in question, attributable to the respondent, which relates to and counterbalances the anti-competitive effects and/or subjective intent of the acts."**^{24 25}

31. We note, as have others,²⁶ that the Federal Court of Appeal highlights the need for any legitimate business purpose for the conduct to counterbalance the anti-competitive effects.

²⁴ *Canada (Commissioner of Competition) v Canada Pipe Co.* 2006 FCA 233 at [73].

²⁵ Canadian Competition Bureau, "The Abuse of Dominance Provisions Enforcement Guidelines" www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html

²⁶ Stikeman Elliot LLP "2014 Competition Act and Commentary" at 122.