MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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# Regulatory impact statement (process options)

## Targeted Review of the Commerce Act 1986: section 36 and the taking advantage of market power

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# Agency disclosure statement

This regulatory impact statement (RIS) has been prepared by the Ministry of Business, Innovation and Employment.

It provides an analysis of process options for the next steps to address problems with section 36 of the Commerce Act (the prohibition on the misuse of market power).

MBIE officials have examined the theory regarding prohibitions on the misuse of market power, evidence from past section 36 cases and extensive submissions and cross-submissions from public consultation.

Following advice from the Treasury, MBIE officials have chosen to present options for the next steps to take in the process of examining section 36 of the Commerce Act rather than regulatory options.

This is a somewhat unusual step, which has been taken because:

- the current lack of conclusive empirical evidence around the scale of the problem with the status quo does not lend itself to robust comparison between alternative options; while
- the apparent problems with section 36 and its importance for the long-term benefit of consumers in New Zealand (especially given our small domestic markets) suggest that the case for reform should not be summarily dismissed; and
- this area of competition law is notoriously complex, with extensive consultation highlighting the lack of agreement between stakeholders and indicating that there is no clear 'right' answer.

Rather than proposing alternative options now, MBIE recommends that further work be undertaken to seek empirical evidence of harm occurring to consumers under the current test, with a view to moving to an options paper later (for instance in 2018). This strikes a balance between (a) seeking further evidence in an effort to better inform decision making and (b) managing the risks of harm occurring or likely to occur under the status quo.

Due to the proposal to seek further evidence MBIE has consulted on the issues with section 36 articulated in this RIS but has not consulted on the process options set out in the RIS nor on the criteria by which they are assessed. It is envisaged that further consultation on an options paper (which would contain alternative options to the current provision and criteria for assessment) would be undertaken before recommending whether or not to change the provision.

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# List of Acronyms

| | |
|---|---|
| MBIE | Ministry of Business, Innovation and Employment |
| ACCC | Australian Competition and Consumer Commission |

# Executive summary

This regulatory impact statement (RIS) provides an analysis of process options for the next steps to address problems with section 36 of the Commerce Act, the prohibition on the misuse of market power ('section 36' or 'the provision').

**MBIE considers that there are three main problems with section 36**

- The potential for wrong answers that could harm competition and in particular, fail to deter or penalise some types of conduct that may undermine the long-term benefit of consumers (often referred to as 'false negatives').
- It involves costly and complex enforcement that reduces the incentive for businesses to comply with the law.
- It creates some unpredictability for day-to-day business decision making, reducing the incentive for businesses to vigorously compete.

**However, the scale of harm arising from the problems with section 36 is not clear**

MBIE has not been able to document evidence of false negatives (and therefore harm) actually occurring. MBIE officials have examined the theory regarding prohibitions on the misuse of market power, evidence from past section 36 cases and extensive submissions and cross-submissions from public consultation. We have not been able to identify historical instances of harm where cases have not been taken. This is due to the fact that historically the Commerce Commission has applied the existing law and not considered whether a different law would change the outcome of their assessment of a case.

This lack of documented evidence of the scale of harm occurring (or likely to occur) makes it difficult to compare the net benefits of alternative options with the status quo. In turn, this makes it hard for an informed decision to be made about whether or not to amend the provision. However, despite the lack of documented empirical evidence, there are scenarios where the current provision is unlikely to capture harmful behaviour. It is therefore plausible that harm has occurred or is occurring which has not been identified or recorded.

**Feedback from consultation was divided**

Consultation focused on suggested problems with section 36 and whether an alternative test (an 'effects test') would better promote the long-term benefit of consumers.

Submitters on the Issues Paper were divided on the nature and extent of the problems with section 36, as well as whether an alternative test would be better. This area of competition law is notoriously complex, with extensive consultation highlighting the lack of agreement between stakeholders and indicating that there is no clear 'right' answer.

**MBIE recommends seeking further evidence before moving to an options paper by the end of 2018**

MBIE recommends that further work be undertaken to seek empirical evidence of harm occurring to consumers under the current test, with a view to moving to an options paper later (for instance in 2018). This strikes a balance between (a) seeking further evidence in an effort to better inform decision making and (b) managing the risks of harm occurring or likely to occur under the status quo.

Seeking further evidence would involve monitoring potential or actual instances where the regime fails to adequately deter or penalise misuse of market power and, if possible in the time available, assessing the changes Australia is making to its equivalent provision and any subsequent behavioural changes or developments in its case law.

# 1 Background

1. The Commerce Act came into force on 1 May 1986. It protects competition in markets in New Zealand for the long-term benefit of consumers. One of the ways it achieves this is through prohibiting misuse of market power by powerful firms.

## The origins of the review

2. MBIE regularly reviews various aspects of competition law. In May 2014, the Productivity Commission set out a number of recommendations in a report entitled Boosting Productivity in the Services Sector. This included a recommendation to review the misuse of market power prohibition (section 36) of the Commerce Act. This RIS comprises one of MBIE's regular reviews of an aspect of competition law and addresses the Productivity Commission's recommendation.

## The review process to date

3. On 17 November 2015, MBIE released an Issues Paper seeking views on a number of Commerce Act issues, including whether New Zealand's current section 36 was functioning adequately. In total, 39 submissions were received. On 2 June 2016, the Commerce Commission ("the Commission") Chair sent the Minister of Commerce and Consumer Affairs a supplementary submission, which critiqued a number of points made by other submitters. In this context, it was considered appropriate to launch a cross-submission process. In total, 26 cross-submissions were received.

## Corresponding review in Australia

4. In December 2013, the Australian government announced a competition policy review to be undertaken by a panel led by Professor Ian Harper (the "Harper Panel"). The Harper Panel's final report covered a wide range of competition law and policy matters, including a chapter on Australia's prohibition on misuse of market power (section 46 of Australia's Competition and Consumer Act 2010).

5. On 11 December 2015, the Australian government issued a consultation document, soliciting views on the Harper Panel's recommendation to amend section 46.

6. Eighty-six submissions were received and these have been considered by MBIE. Of the submissions that were made public, those from economists and lawyers appeared to be roughly split on whether an effects test (which focuses on whether the conduct in question is likely to substantially lessen competition) should replace the current formulation of section 46 (which focuses on whether the conduct in question was in some way enabled by the firm's substantial market power). By contrast, large businesses overwhelmingly supported the status quo, while small businesses unanimously supported the move to an effects test.

7. Although the submissions on Australia's review of misuse of market power were not solicited by MBIE, MBIE has considered them due to the fact that the current Australian prohibition is similar to the current New Zealand prohibition.

8. On 16 March 2016 the Australian Government announced it would adopt an effects test for section 46. On 1 December 2016 the Australian Government introduced the Competition and Consumer Amendment (Misuse of Market Power) Bill 2016 into the House of Representatives. The Bill incorporates an effects test.

9. MBIE notes that no RIS was prepared to support the Australian decision to amend section 46, and that the Australian Office of Best Practice Regulation did not assess the Harper Panel report.

## The purpose of misuse of market power provisions in general

10. Misuse of market power provisions are targeted at firms with substantial market power. They prohibit such firms from undertaking certain types of exclusionary conduct i.e. anticompetitive conduct that prevents or deters rivals and potential rivals from competing. These provisions do this in order to protect competition itself, rather than individual competitors. Unlike ex ante sector-specific rules, which impose positive obligations on firms (what firms must do), misuse of market power prohibitions impose negative obligations (what firms must not do).

11. The two prevailing categories of exclusionary conduct that are typically prohibited are:

    a. predation: for example, where a powerful business lowers its prices for a sustained period of time to drive a competitor or competitors out of the market. This may be prohibited if these prices are below an appropriate measure of cost and the business has the ability to recoup its losses by increasing its prices later, without likely entry into the market by others; and

    b. raising rivals' costs, such as:

        i. Exclusive dealing – where a business has contracts with retailers or distributors that allow them only to sell its products. This may be prohibited if the arrangement denied a competitor access to an important distribution channel.

        ii. Refusal to deal – where a vertically-integrated business refuses to supply a competitor with an input or give the competitor access to infrastructure, which the competitor needs to be able to compete in downstream markets. For instance, the Cease and Desist Order against Northport Limited in 2006 was because "Northport had granted an exclusive licence to its own joint venture port services company, Northport Services Limited, and was making it uneconomic for other companies to marshal cargo at the port."

        iii. High access pricing (or margin squeeze) – the supply of a bottleneck input or infrastructure to a competitor at a high price may also be prohibited. A high price may be assessed relative to the selling price of the downstream product or service and, in general, a business must leave a sufficient margin for an efficient competitor to compete.

        iv. Tying – where a business only sells a product if the customer purchases it together with another product. For example, if a firm dominant in respect of one product market sells that product together with another product (in respect of which the firm is not dominant), competition for the latter product could be impeded if the combined price of the tied products is significantly less than the prices of the products when sold separately. For instance, the Commerce Commission's final investigation report into the tying of accommodation and dinners at The Hermitage, 2 July 2007 found that "The Hermitage would have introduced, and persisted with, a tying policy that reduced its profits, so that… the intended 'payoff' could only stem from the elimination or deterrence of the competitor."

12. The section below provides specific detail on New Zealand's misuse of market power provision.

# 2 Status quo and problem definition

## Status quo

### New Zealand's legislative provision

13. New Zealand's rule against anticompetitive exclusionary conduct is set out in section 36 of the Commerce Act ('section 36' or 'the provision'), which is enforced by the Commerce Commission or through private action. The rule is one of New Zealand's main prohibitions on anticompetitive unilateral conduct (the other being resale price maintenance). The Commerce Act also covers anticompetitive multilateral arrangements (such as price fixing and group boycotts) and anticompetitive mergers and acquisitions.

14. The persons subject to section 36 are those with a substantial degree of market power. The way the rule is framed is to prohibit those persons from "taking advantage" of their market power with the purpose of excluding competitors from the market.

15. More precisely, section 36(2) provides:

> "A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of (a) restricting the entry of a person into that or any other market; or (b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or (c) eliminating a person from that or any other market."[1]

16. The provision is used to sanction (or deter) such conduct as predatory pricing, refusal to deal, tying, and bundling.

17. The prohibition has three elements:

    a. a firm must have substantial market power;

    b. it must take advantage of that market power; and

    c. it must have at least one of the three exclusionary purposes listed.

18. The reference to a firm's purpose distinguishes between a straight exercise of market power (such as monopoly pricing) and the exercise of market power to impede competition. In fact, while the third element is framed in terms of 'purpose', case law has meant that this can be adduced through evidence of the likely effects of a firm's conduct.

19. There is no defence to section 36 other than to disprove one of the elements of the claim. The Commerce Commission's authorisation regime (under which, conduct that prima facie breaches the Commerce Act can be allowed) is not available in respect of conduct that will or is likely to breach section 36.

[1] In its original formulation (i.e. until 2001), section 36 of the Commerce Act applied to those in "a dominant position" in a market. The circumstances which triggered the prohibition were where the firm in question was "using" its dominant position. The courts have found that, despite Parliament's intention, the original and current formulations of section 36 are effectively identical in effect.

## Judicial interpretation of the 'taking advantage' requirement

20. The second element of section 36 is a requirement that a firm with substantial market power take advantage of that market power. This is known as a requirement for a 'causal connection' or 'causal nexus' between the market power and the conduct at issue (e.g. pricing in a predatory manner). The market power must have in some way contributed to the ability of the powerful firm to undertake the conduct.

21. In itself, the 'causal connection' requirement in section 36 does not make New Zealand an 'outlier' internationally. While a large number of jurisdictions (such as the US and the UK) do not require one, a number of other countries (Australia, France, Spain, Switzerland, Portugal, Greece etc.) do.[2] Many of the jurisdictions that do have a 'causal connection' requirement rely on a common sense approach to determining whether the causal connection exists. For instance, in Australia, section 46(6A) allows the courts to consider a variety of questions in determining whether a firm 'took advantage' of its market power; in France, the courts simply ask whether the firm in question could have undertaken the conduct in question without market power, and answer the question promptly on the basis of what logic suggests. This is where New Zealand (and to a lesser extent Australia) differs from other jurisdictions that have a 'causal connection' requirement.

22. In 1994 the Privy Council interpreted the requirement for a causal connection to require the plaintiff to construct a hypothetical market in which the defendant firm is without market power and demonstrate that in that hypothetical market the defendant would not have undertaken the conduct at issue. This detailed inquiry is known as the 'counterfactual test' or the 'comparative exercise'.

23. In 2008 the High Court stated:

> "A dominant firm does not use its dominance … if it acts as a non-dominant firm otherwise in the same position would have acted in a competitive market".[3]

24. In 2010 the Supreme Court cemented the requirement for section 36 cases to use the counterfactual test when it stated:

> "Anyone asserting a breach of section 36 must establish there has been the necessary actual use (taking advantage) of market power. To do so, it must be shown, on the balance of probabilities, that the firm in question would not have acted as it did in a workably competitive market, that is, if it had not been dominant."[4]

25. These judicial interpretations of the 'taking advantage' requirement are summarised in the following table:

| Judicial question | Answer | Legal consequence |
|---|---|---|
| What would the firm have done if it did not have substantial market power? | The firm would <u>still</u> have undertaken the conduct at issue | The firm has not taken advantage of its market power |
| | The firm would <u>not</u> have undertaken the conduct at issue | The firm has taken advantage of its market power |

[2] See, for example, the decisions of the French competition agency: (i) Decision 06-D-22 dated 21 July 2006 (NGK Spark Plugs) at [125]; and (ii) Decision no 05-D-70 dated 19 December 2005, at [250].
[3] *Commerce Commission v Telecom* (2008) 12 TCLR 168 at [55].
[4] *Commerce Commission v Telecom* (2010) 12 TCLR 843 at [34] per Blanchard and Tipping JJ.

## The provision in the context of New Zealand's small and remote economy

26. Officials have noted that New Zealand being a small and remote economy means that in any given market there are likely to be fewer players, and therefore more dominant players, than in the equivalent market abroad. However, the implications for misuse of market power provisions have not been well studied.

27. The likelihood that New Zealand markets have a greater proportion of dominant players than equivalent foreign markets suggests that getting the misuse of market power provision right is particularly important for our economy because: (a) a provision that favours false negatives[5] is likely to lead to greater harm for consumers in New Zealand than in larger markets and (b) a provision that favours false positives is likely to have a greater impact on businesses' confidence to engage in procompetitive behaviour than in larger markets.

28. Rather than leading us to weight any one criteria or option for reform higher than others, the likelihood that the impact of this provision is amplified in New Zealand merely suggests that it is an important one to get right. It is therefore desirable that there be a considerable degree of certainty and robust evidence about the problem with the status quo and the ranking of alternative options prior to recommending a decision to change or not change.

# Problem definition

29. MBIE considers that the current section 36 is unsatisfactory. This section articulates the state of the evidence on the problems with section 36.

## Nature of the problem

30. The current formulation of section 36 has been criticised for the choice, by the legislature, of a 'causal connection' requirement over a different approach (such as an effects test) and for the interpretation, by the judiciary, of a strict requirement to construct a hypothetical market.[6] The ruling of the Supreme Court in 2010 in the *0867* case cemented this judicial interpretation.[7] Criticism of the current test and its interpretation has been led by the Commerce Commission, the Australian Competition and Consumer Commission, and Consumer NZ.

31. The current formulation and interpretation of section 36 leads to three main problems:

    a. The potential for wrong answers that could harm competition and in particular, failing to deter or penalise some types of conduct that may undermine the long-term benefit of consumers (often referred to as 'false negatives').

    b. It involves costly and complex enforcement that reduces the incentive for businesses to comply with the law.

[5] A false negative in the context of this provision is a failure to deter or penalise some types of conduct that may undermine the long-term benefit of consumers. A false positive is the flipside of this – deterring or penalising conduct that would have been for the long-term benefit of consumers.

[6] For example, the Commerce Commission considers that "section 36 is not effective primarily because of the way the courts have interpreted the 'taking advantage' part of section 36": see letter from Dr Mark Berry to Minister Goldsmith dated 2 June 2016 (supplementary submission on the Issues Paper concerning the Targeted Review of the Commerce Act), at [4].

[7] *Commerce Commission v Telecom* (2010) 12 TCLR 843.

c. It creates some unpredictability for day-to-day business decision making, reducing the incentive for businesses to vigorously compete.

32. In particular, MBIE considers that section 36 in its current form does not fully meet the Commerce Act's purpose, i.e. it does not succeed in promoting competition in New Zealand markets for the long-term benefit of consumers, in large part due to the 'counterfactual' test used by the New Zealand courts to assess whether a firm has taken advantage of its substantial market power.

## Scale of the problem

33. Evidence for the three main problems with section 36 is provided below.

### The potential for wrong answers that could harm competition

34. At present, in order to distinguish harmful conduct from other conduct, section 36 relies on the 'take advantage' test. This requires a causal connection between the firm's market power and its conduct (the market power somehow enables the conduct). As explained above the courts have interpreted this to require a complex counterfactual test.

35. This interpretation has received criticism for failing to penalise certain types of conduct, including forms of exclusive dealing and refusal to deal where the firm's misuse of market power is profitable in the short run (as opposed to being predatory or involving significant profit sacrifice in the short run). There is a risk that the current test is leading to, or could lead to, false negatives (where the test fails to penalise or deter some types of conduct that might undermine the long-term benefits of consumers).

36. Exclusive dealing, for instance, frequently occurs in competitive markets as businesses seek to control the distribution of their products; it is therefore unlikely to be penalised under the counterfactual test. However, such conduct when carried out by a business with substantial market power could foreclose a large portion of the market and result in significant competition detriments, at worst eliminating all competitors from the market. In such a scenario (though we are not aware that this has eventuated in New Zealand), there would likely be a false negative under section 36.[8]

37. For instance, the Australian Competition and Consumer Commission's (ACCC) submission to the Australian Treasury in February 2016 during the review of their equivalent submission cited the following example:

> "*ACCC v Cement Australia* [2013] FCA 909: a firm with substantial market power in the South East Queensland cement market contracted all the available supply of a cement ingredient with the purpose of excluding and/or increasing costs of rivals. The Court held that the firm with substantial market power had not 'taken advantage' of market power because a small firm could have done the same. [However]…the Court found the contracts… had the purpose and effect of substantially lessening competition."[9]

38. The ACCC's submission to the Australian Treasury in February 2016 during the review of their equivalent provision also contained a number of hypothetical scenarios where the current Australian provision and its judicial interpretation (which is very similar to the New Zealand one) was unlikely to apply. One example was land banking by a firm with substantial market power to prevent new entrants entering a market. The ACCC considered that despite such conduct being designed to protect market power it was unlikely to constitute a breach of

[8] The plaintiff might nevertheless in some such cases be able to take a case based not on section 36 but on section 27 of the Commerce Act.
[9] ACCC, 2016, Options to strengthen the misuse of market power law, Submission to the Treasury.

section 46 because the land could also be purchased by firms without substantial market power).

39. In certain situations, refusal to deal might create a similar risk, since a firm without market power may have rational reasons for refusing to supply its product (e.g. where the buyer presents a credit risk). In situations where supply is necessary for competition and the conduct is profitable the counterfactual test may fail to penalise powerful firms when they refuse to supply other market participants.[10]

40. One US submitter to the Issues Paper of November 2015 also set out "several examples of conduct that have … resulted in findings of liability [abroad], but [where] the results might have been different had the conduct been judged under New Zealand's version of the counterfactual test".[11] This included Microsoft bundling its Internet browser and/or its media player into its operating system Windows (for example by excluding that product from the add/remove option).

41. Officials therefore conclude that there is some risk of false negatives under the current section 36 test. We temper this conclusion by noting that it may be overly simplistic to consider that whole categories of conduct (e.g. exclusive dealing and refusal to deal) would automatically be immune to a section 36 case: the Australian courts have indicated that counterfactual analysis must focus on the particular conduct in question, and not on forms or categories of conduct.[12]

42. Despite the clear argument that the current test does not capture all conduct that may undermine the long-term benefits of consumers, it has proved difficult to capture evidence of actual harm occurring. Administration of the Commerce Act (and the policy review) has focused on the existing provision and legal precedent, rather than potential (but undetected) competitive harm and market outcomes.

### Gravity of the problem

43. False negatives, to the extent that they occur, can have a significant negative impact on competition.

44. As one academic notes, false negatives "can amplify incentives to undertake harmful conduct for both the defendant and others, harming competition and consumers".[13] The International Competition Network has expressed this in the following economic terms:

> "The cost of under-enforcement is the risk of exclusion and the resulting reduction in competitive pressure faced by the dominant firm. Under-enforcement may also lead to a loss of dynamic efficiency flowing from competitors' lessened incentives to innovate and enter the market. It may furthermore result in redistribution of resources from consumers to producers, potentially inflated costs by dominant firms, and the inefficient devotion of resources to rent-seeking by firms that seek to obtain or maintain dominance… under-enforcement will tend to reduce the pressure on an incumbent monopolist to innovate, improve, or expand and reduce the possibilities for innovative competitors to enter and expand."[14]

[10] Nevertheless, competition law author Matt Sumpter notes that the Australian case of Queensland Wire "suggests that refusals to deal or supply are likely to be actionable under section 36 of the Commerce Act where [amongst other things] the facility or input is not practically duplicable by the firm seeking access [and] there are no close substitutes for the facility or input…" (Sumpter, M in 'New Zealand Competition Law and Policy', 2010, at [1013]).

[11] Andrew Gavil, submission on Issues Paper, at p.40.

[12] See, for example, *ACCC v Cement Australia Pty Limited* [2013] FCA 909 at [1903].

[13] Gavil [2015] at [1060].

[14] ICN Unilateral Conduct Workbook, Chapter 1: The Objectives and Principles of Unilateral Conduct Laws, 2012, at [45]-[46].

45. However, the benefit lost – or to put it another way, the damage done – by a false negative is highly case-dependant.

### Evidence from substantive cases

46. In an effort to determine how often the 'taking advantage' requirement has resulted in false negatives (failure to penalise conduct that undermined the long-term benefit of consumers), MBIE compiled the following list of substantive cases (i.e. cases that that have reached the courts to be decided on their merits) since the counterfactual test was introduced by the Privy Council in 1994.

| Case | Final judgment | Conduct | 'Take advantage' proven | Could have been proven |
|---|---|---|---|---|
| Data Tails | 2012 | Price squeeze | Yes | n/a |
| Turners & Growers | 2011 | Conditional refusal to deal | Yes | n/a |
| Port Nelson | 1996 | Tying | Yes | n/a |
| 0867 | 2010 | Other | No | Yes |
| BOP Electricity | 2007 | Refusal to deal + Raising rivals' costs | No | Yes |
| Carter Holt | 2004 | Predatory pricing | No | No |
| Telecom v Clear | 1994 | Price squeeze | No | No |

47. In five of the seven cases, the plaintiff either proved that the powerful firm 'took advantage' of its market power or, according to the court, could have proven that the powerful firm did so had it argued its case differently.[15] [16] These cases are therefore unlikely to be examples of false negatives.

48. This leaves two of the seven cases (*Carter Holt* and *Telecom v Clear*) where the causal connection requirement, in the form of the counterfactual test, led to a finding that section 36 had not been breached: a 'negative' result. The question is whether these were <u>false</u> negatives i.e. whether, despite being cleared under section 36, the conduct at issue nevertheless undermined the long-term benefit of consumers.

49. In the *Carter Holt* case, the court did not consider that precise question but it did consider the related issue of whether the conduct in question had substantially lessened, or was likely to substantially lessen, competition. It found that it did not.[17] For this reason, it is unlikely that the finding in this case represents a false negative.

50. In the *Telecom v Clear* case, the court did not consider whether the conduct undermined the long-term benefit of consumers or whether it substantially lessened competition. In this context, it is impossible to know whether the decision represents a false negative.

[15] *0867*: the Supreme Court at [47 et seq] acknowledged that the Commerce Commission could have proven that a non-dominant Telecom would not have introduced the 0867 scheme (i.e. that the real-world Telecom had taken advantage of its market power), had it put forward to the High Court evidence that, by doing so, the non-dominant Telecom (i) would have lost 'other revenues' associated with the customers who moved and (ii) might have lost the 'network effects' benefits of scale.

[16] BOP Electricity: the High Court at [453 et seq] considered that BOPE had acted obstructively by delaying negotiations with other players on meter access, making switching slower for its customers, and exaggerating to its customers the inconvenience of switching. It stated obiter that "if the Commission had pleaded the case on these grounds, BOPE would have been found to have taken advantage of its substantial market power".

[17] Carter Holt: HC at [292]: "though the '2 for 1' was a provision in an 'arrangement' or 'understanding' it was a provision that has not been proved to be likely to have had the effect of substantially lessening competition".

### Other evidence of wrong answers

51. It is difficult to determine the extent to which section 36 as currently drafted is leading to false negatives. The Commerce Commission, for instance, has not been able to indicate whether it has foregone investigations where it considered the long-term interests of consumers were being harmed, because it believed the conduct would not constitute taking advantage of market power (a 'false negative'). However, the Commission rightly argues that this would be difficult to do, given that all its analysis of past cases has been undertaken within the current legal framework for section 36.

### Conclusion on 'wrong answers'

52. It is clear that the current test is unlikely to capture certain examples of harmful conduct. However, the evidence presented to date does not give a feel for the scale of the problem and the harm actually occurring or likely to occur. This is at least in part due to the fact that section 36 cases are infrequent, resulting in relatively few data points to consider.

53. Of the four substantive court cases in which the plaintiff failed to prove the 'taking advantage' element of section 36 (i.e. negative outcomes), a "substantial lessening of competition" test was considered under section 27 in three of them: the *0867*, *BOP Electricity* and *Carter Holt* cases. No substantial lessening of competition was found, suggesting that these three cases were not *false* negative, section 36 outcomes.[18]

54. However, it has been raised by the Commission whether MBIE or anyone is in a position to determine if false negatives have occurred in the past. Analysis undertaken during previous section 36 cases (and Commission investigations that did not proceed to court) was not always looking at the effect the conduct has had on competition. Accordingly it cannot be conclusively asserted that there has *not* been a false negative in the past.

## Cost and complexity of enforcement affects the penalisation and deterrence of anticompetitive behaviour

### Nature of the problem

55. There is little doubting that a case under section 36 is costly and complex. While this is true of a case taken under other provisions of the Commerce Act, the counterfactual test adds an extra degree of complication to section 36 cases.

56. We are not concerned here with the time it might take a case to work its way through the court system: that is more a function of the courts generally than of anything particular to our prohibition on misuse of market power.

57. Rather, we are concerned with the resources that must be devoted to a section 36 case by the parties to it. In particular, a mandatory requirement to construct a hypothetical competitive market of at least two participants requires difficult assumptions to be made. These difficulties are compounded by the courts' observation that the analysis need not depend on realistic or practical assumptions, so that unrealistic scenarios are permitted.

58. In the Commerce Commission's view, the resulting outcome is that section 36 cases are highly uncertain, making it difficult for them as the regulator to determine whether to take these

[18] *0867*: High Court at [108]: "we do not accept that [introducing the 0867 scheme] was injurious to competition even in the short term"; *BOP Electricity*: High Court at [551]: "the no leasing policy did not have the effect, or the likely effect, of substantially lessening competition in the market"; *Carter Holt*: High Court at [292]: "though the '2 for 1' was a provision in an 'arrangement' or 'understanding' it was a provision that has not been proved to be likely to have had the effect of substantially lessening competition".

cases. The regulator has limited resources and these cases are not only complex, but are also lengthy and involve high costs, raising questions of enforcement priorities.

59. While not denying the complexity of section 36 cases, some submitters (including Air New Zealand and Bell Gully) claimed that the complexity is justifiable on the basis that such cases are "often factually complex".

### Gravity of the problem

60. Costly and complex enforcement can deter plaintiffs from taking their case to court. This is concerning as it may incentivise large firms to 'chance their arm' with conduct that is likely to breach section 36.

61. Cost and complexity can also drain the resources of defendants away from competing actively in the market.

### Conclusion on the 'cost and complexity of enforcement'

62. The situations in which section 36 cases arise can be factually complex. However, the counterfactual test can add significant additional cost and complexity to a section 36 case for both parties. This is because of its requirement to construct a hypothetical market in which no player has substantial market power. Such cost and complexity can reduce the risk of legal action and, accordingly, reduce the incentive on businesses to comply with the law.

## Predictability for procompetitive decision making

63. Any test for anticompetitive conduct necessarily involves an element of unpredictability and the current formulation of section 36 is no exception. However, predictability prior to conduct occurring is important in order to encourage a business to aggressively compete with its rivals without being deterred by concerns that its conduct will breach section 36.

### Nature of the problem

64. Submitters were divided on whether the status quo provides sufficient predictability.

65. The courts themselves suggest that the counterfactual test was developed specifically to help ensure predictability. As stated by the Privy Council, 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".[19]

66. Some submitters argued that the status quo has the advantage of a relatively simple thought experiment for businesses ('would we do this if we didn't have market power?') which, in the time-pressured environment of daily business decisions, offers a higher level of predictability to firms with substantial market power considering market conduct.

67. Large businesses consider that the courts have done this successfully. In their responses to the Issues Paper, Orion stated that the counterfactual test "delivers a known compliance standard that can be readily applied by firms with market power to assess commercial conduct," and Air New Zealand claimed that it "has found that the current section 36, and in particular the 'taking advantage' limb, relatively simple to apply to its own conduct and the conduct of its competitors".

68. Other stakeholders, however, differ in their view of the predictability of the test. The Commerce Commission, for instance, argues that the hypothetical nature of the competitive market a court must construct means there is an inherent uncertainty in the counterfactual

[19] *Telecom v Clear* [1995] 1 NZLR 385 (PC).

test. A firm cannot know for certain in advance what the hypothetical market the court will adopt will look like.

69. As the Commerce Commission noted in its supplementary submission on the Issues Paper, "business is… exposed to significant risks around how the Commission and the courts will undertake the hypothetical analysis required by the taking advantage test… The Commission's conclusion on this hypothetical analysis [in the Origin Pacific investigation][20] turned on a single adjustment to an assumption about seating capacity in this hypothetical scenario. This change was made late in the investigation. That this change was made so late and was so significant to the outcome tends to belie the purported certainty of the counterfactual test."[21]

70. In addition, in its cross-submission on the Issues Paper, Tompkins Wake considered that, even if the counterfactual test itself is predictable, there can be uncertainty in what approach an individual judge would take to the test (a blunt 'but for' approach or a more nuanced economic test).[22]

71. Officials' conclusion is that the courts' use of the counterfactual test can make it difficult for firms to accurately predict the outcome of any potential court case, like in the Origin Pacific investigation. This means that at the point when a business makes a decision regarding a particular course of action there is a degree of uncertainty regarding whether or not that conduct will breach section 36.

### Gravity of the problem

72. As the Privy Council has stressed, it is important that there be "some certainty" for a firm with market power about whether its proposed conduct will fall foul of section 36. A lack of certainty is concerning, as it may deter a firm from undertaking perfectly legitimate procompetitive conduct.

73. More broadly, the concept of limiting liability to predictable outcomes is a common one. This principle is recognised in, amongst other areas, tort law.[23] For example, 'nuisance' is a strict liability wrong,[24] yet the courts have limited nuisance liability to foreseeable (i.e. predictable) types of harm, as they consider it would be unjust to penalise a defendant for harm it could

[20] The Commerce Commission investigated whether Air New Zealand has used its substantial market power to deter Origin Pacific from introducing a direct Hamilton-Christchurch route in 2003. In a media statement dated 31 March 2006, the Commerce Commission announced that it had found that Air New Zealand had not taken advantage of its market power.

[21] Letter from Dr Mark Berry to Minister Goldsmith dated 2 June 2016 (supplementary submission on the Issues Paper concerning the Targeted Review of the Commerce Act), at [23].

[22] For example, in the Supreme Court in the *0867* case, the court declined to rely on a nuanced economic approach. It stated (at [23]): "While we agree that economic analysis is likely to be helpful in identifying the relevant features of the hypothetically competitive market, deciding what the firm in question would or would not have done in that market will often be best approached simply as a matter of practical business or commercial judgment." By contrast, the lead Court of Appeal judgment in the Data Tails case makes a serious and sustained effort to grapple with the economic (that is, market) impacts of the impugned behaviour. Tompkins Wake suggests that these two approaches are materially different and that it is impossible for a firm to know in advance which approach a court will adopt.

[23] Tort law, similar to section 36, is concerned with civil rather than criminal wrongs. A breach of section 36 is a civil wrong. Under section 80 of the Commerce Act, the liability for that breach is the payment of a civil, pecuniary penalty, following a trial using the civil standard of proof (and potentially exemplary damages under 82A).

[24] A strict liability wrong is one which imposes liability on the defendant without the need to prove fault, such as negligence or tortious intent. Nuisance imposes strict liability for harmful effects to land or land interests, rather than for harmful effects to competition.

not reasonably foresee.[25] The alternative is to risk "punishing the blameless" (i.e. false positives).

### Conclusion on 'unpredictability'

74. Any single principle-based test is likely to involve an element of unpredictability for businesses. The current formulation of section 36 is no exception: the use by the courts of the counterfactual test can make it difficult for firms to accurately predict the outcome of any potential court case.

75. MBIE is of the view that the status quo makes it somewhat difficult for businesses to predict whether their conduct is likely to breach section 36. However, MBIE does not consider this to be as significant as issue as some of the other problems with section 36, given that a number of the firms which this most affects believe that the status quo provides sufficient predictability.

## Conclusion

76. MBIE concludes that there are the following issues with the status quo:

    a. It is clear that certain examples of conduct might not be captured by the current test but officials have not been able to identify actual examples where the test has delivered wrong answers or failed to deter anticompetitive behaviour.

    b. It is also clear that the counterfactual test adopted by the courts increases the cost and complexity of enforcement, raising questions around the regulator's enforcement priorities and reducing the incentive on businesses to comply with the law.

    c. There is some evidence that the current test lacks predictability.

77. However, the magnitude of these issues is not clear and they are difficult to quantify – especially given the lack of real-life evidence for or against reform that has so far been brought to our attention. This lack of evidence on the scale of these issues makes it difficult to compare the net benefits of alternative options with the status quo.

78. MBIE officials are conscious that it can also be difficult to quantify the benefits of a law change in a complex area of competition law like this. Despite this, if the costs of maintaining the status quo are clearly high, it might not be appropriate to wait for certainty about benefits before recommending reform. If further evidence on the scale of the problems with section 36 could be obtained, this could strengthen the case for reform and enable a more robust comparison of the status quo against options to address the problems with the provision.

### Suggested next steps following from this conclusion

79. It is clear that there are problems with section 36 and that it is an important provision to get right in a small market like New Zealand. However, the current lack of conclusive empirical evidence for the scale of the problem with the status quo does not lend itself to conclusive comparison between alternative options. This area of competition law is also notoriously complex, with extensive consultation highlighting the lack of agreement between stakeholders and indicating that there is no clear 'right' answer.

[25] See, for example, *Cambridge Water Company Ltd v Eastern Counties Leather plc* [1994] 2 AC 264 (HL); adopted in New Zealand in *Hamilton v Papakura District Council* [2000] 1 NZLR (CA) / [2002] 3 NZLR 308 (PC). Under the 'eggshell skull' principle, however, if the type of harm is foreseeable, defendants can be liable for the full extent of the harm done, even if that extent was unforeseeable.

80. Given this, MBIE officials have chosen not to present alternative regulatory options to section 36 of the Commerce Act just yet. Instead, officials recommend seeking further evidence of the scale of the problems with section 36 in order to better inform the decision making process.

81. If officials were to ultimately recommend reform, the likely options would include an effects test. However, there is significant variation in how these are designed. It would therefore be desirable to release an options paper prior to making final decisions on section 36.

82. The rest of this RIS analyses the next steps in the process for reviewing section 36 and the pros and cons of moving to an options paper now versus seeking further evidence before moving to an options paper later.

# 3 Objectives and criteria for assessment of options

## Introduction

83. Given the lack of evidence around the scale of the problem with section 36, the question at hand is whether or not to proceed to an options paper and if so, when to do so. With this in mind, MBIE has identified a number of options for next steps in the process of the review of section 36. Together with the status quo, these options must be assessed against a given set of criteria.

84. In this section, MBIE sets out the criteria it has concluded should be used to assess the different options.

## Primary objective

85. The purpose statement of the Commerce Act 1986 is "to promote competition in markets for the long-term benefit of consumers within New Zealand." This is the primary objective of the review of section 36 and this RIS. The criteria below should all be read in the light of furthering this objective.

## Criteria

86. The decision on whether or not to proceed to an options paper (and if so, when) needs to weigh up the risk of harm occurring to consumers from the problems with section 36 against the likelihood of obtaining further evidence that would enable better informed decision making and result in a more effective and enduring test in the long run.

### Criterion 1: The risk of harm occurring to consumers

87. Officials consider that the risk of harm occurring to consumers is an appropriate criterion for assessing the various process options available to the review.

88. The problems identified with section 36 mean that there is a risk of harm occurring to consumers under the status quo, either because anticompetitive behaviour is not deterred or not litigated, or because procompetitive behaviour is inhibited.

89. MBIE is not aware of any positive evidence of the issues with section 36 leading to harm occurring to consumers but if there is harm, as some submitters contend, the criterion relates to the likelihood that any harm, or the circumstances that allow that harm to occur, would continue under the option considered.

90. MBIE considers that the risk of harm occurring to consumers is likely to increase with the length of time that lapses before a decision is made on whether or not to reform the provision.

## Criterion 2: Likelihood of obtaining further evidence to inform choice of options

91. There is a lack of empirical evidence on the scale of the problems with section 36, meaning that the scale of the potential harm from the provision is unclear. The lack of empirical evidence of harm occurring makes it hard to assess the cost of remaining with the status quo. In turn, this makes it hard to assess alternative options against the status quo.

92. As noted earlier, New Zealand markets can tend to have a greater proportion of dominant players than equivalent foreign markets. This makes it likely that the impact of the misuse of market power provision is amplified in New Zealand and suggests that it is an important one to get right. It is therefore desirable to obtain as much evidence as practicable about the problems with the status quo and the ranking of alternative options for regulatory reform prior to recommending whether to the change the provision.

93. In this context, officials consider that the likelihood of further evidence being uncovered that will inform the design and choice of regulatory options is an appropriate criterion for assessing the various process options available to the review from here.

94. Uncovering even a few actual examples of harmful behaviour that was not deterred or penalised is likely to be sufficient to provide some sense of the scale of the costs of remaining with the status quo. However, given the uncertainty regarding whether officials will be able to obtain further evidence, MBIE proposes moving to an options paper by the end of 2018, regardless of whether or not further evidence is uncovered.

# 4 Process options and assessment of impact

95. The lack of empirical evidence of harm occurring from the current section 36 makes it hard to assess the cost of remaining with the status quo. In turn, this makes it hard to assess alternative regulatory options against the status quo. At the same time, MBIE officials consider that the apparent problems with the provision and its importance for the long-term benefit of consumers in New Zealand suggest that the case for reform should not be summarily dismissed.

96. Following advice from the Treasury, MBIE officials have therefore chosen to present process options regarding the next steps in the review of section 36 rather than presenting options for changing section 36 at this point in time.

## Description of process options

97. MBIE officials have identified three main options for the process of the review from here:

    a. dismiss the case for reforming section 36 and remain with the status quo;

    b. move to an options paper; or

    c. Seek further empirical evidence with a view to moving to an options paper by the end of 2018.

98. These options are described in more detail below.

### Option A: Dismiss the case for reforming section 36 and remain with the status quo

99. Option A is to remain with the status quo. This option would not involve an options paper and implicitly assumes that there is no case for reform of section 36 of the Commerce Act at the present time.

### Option B: Proceed to an options paper

100. Option B is to proceed to an options paper, in which different options for addressing the problems with section 36 are set out for public comment.

### Option C: Seek further empirical evidence with a view to moving to an options paper later

101. Option C is to seek further empirical evidence of harm occurring and the costs and benefits of alternatives to the status quo with a view to moving to an options paper later, for instance by the end of 2018.

102. Under this option, MBIE could explore further sources of evidence, for example:

a. monitor (in line with Cabinet's initial expectations for regulatory stewardship from March 2013) potential or actual instances where the regime fails to adequately deter or penalise misuse of market power; and

b. if possible in the time available, assess the changes Australia is making to its equivalent provision and any subsequent behavioural changes or developments in its case law.

103. These potential further sources of evidence are discussed in more detail in the section entitled 'Implementation plan'.

# Assessment of process options against criteria

104. In this section, we assess the different options for action, against the criteria discussed in Chapter 2.

## Option A: Dismiss the case for reforming section 36 and remain with the status quo

### Assessment of option A against criterion 1: Risk of harm occurring to consumers

105. MBIE considers there to be a moderate risk of harm occurring (over the long run) if the case for reforming section 36 is dismissed and the status quo is retained. This follows from the fact that:

a. there are plausible scenarios where the current formulation and interpretation of section 36 would not capture behaviour that is harmful to consumers; and

b. the cost and complexity of enforcement raises questions regarding the regulator's enforcement priorities and reduces the incentive for businesses to comply with the law.

106. Therefore, the longer the status quo is retained, the higher the risk of harmful behaviour occurring that is not penalised or deterred.

107. While MBIE has not been able to document evidence of false negatives (and therefore harm) actually occurring at this point in time, it is feasible that misuse of market power that falls outside the test has occurred but not been identified or recorded by the Commission (due to the fact that the Commission's current mandate does not enable it to take enforcement action against this conduct). Even if harmful false negatives have not occurred, the problems that have been identified with the status quo make it possible that harm will occur at some point in the future. The longer reform of section 36 is delayed, the greater the risk that harm will occur.

108. Dismissing the case for reform may incentivise businesses to test the boundaries of the provision in the hope that the regulator may prioritise other more certain and less costly enforcement activities. In this way, option A is likely to imbed and even increase the current problems with the status quo.

109. The risk of some harm occurring is greater over the medium term than over the short term, leading MBIE to consider the risk of harm occurring under Option A to be greater than 'low'. However, there is no empirical evidence that harmful activities are currently occurring that are unpenalised or undeterred, leading MBIE to consider the risk to be lower than 'medium' or 'high'.

110. Given these considerations, MBIE's conclusion is that continuing with the status quo contains a moderate risk of harm occurring (between 'low' and 'medium').

### Assessment of option A against criterion 2: Likelihood of further evidence to inform choice of options for reform

111. If further evidence is not sought, then it is unlikely to be uncovered. For this reason, MBIE considers that there is a low likelihood of further evidence being uncovered in the near future to inform choice of options if the case for reforming section 36 is dismissed and the status quo is retained.

112. Remaining with the status quo would not preclude the consideration of new evidence that emerges (such as assessment of the changes Australia is making to its equivalent provision and any subsequent behavioural changes or developments in case law). However, this would constitute evidence regarding one of the alternative regulatory options and not the scale of the problem in New Zealand per se. To date, MBIE and the Commission's monitoring of the existing legal framework has not documented empirical evidence of false negatives occurring and it is unlikely that further evidence will be uncovered unless it is systematically sought out.

113. Given these considerations, MBIE's conclusion is that continuing with the status quo is unlikely to lead to further evidence that would inform the choice of options for reform.

## Option B: Proceed to an options paper

### Assessment of option B against criterion 1: Risk of harm occurring to consumers

114. MBIE considers that there is a low risk of harm occurring if an options paper is proceeded to.

115. Proceeding to an options paper is the fastest track for dealing with the problems with the status quo, thereby lowering the risk of harm occurring.

### Assessment of option B against criterion 2: Likelihood of further evidence to inform choice of options

116. MBIE considers that proceeding to an options paper would have a low likelihood of uncovering further empirical evidence to inform the choice of options versus the status quo.

117. An options paper would provide further scope for the public to give evidence regarding the pros and cons of potential solutions to the problems with section 36. However, it would be hard to robustly compare the pros and cons of these alternative options with the status quo unless more evidence regarding the costs of remaining with the status quo was uncovered during this additional consultation. MBIE considers this to be unlikely given that the extensive consultation and cross-submissions process undertaken on the Issues Paper in 2016 failed to uncover such evidence. Given the lengthy submission and cross-submission process, interested parties are likely to be suffering from consultation fatigue.

118. The difficulty comparing the pros and cons of alternative options with the status quo means that any decision recommended in the options paper would carry on the one hand a moderate risk of cementing the existing problems with section 36 and on the other hand a moderate risk of leading to even greater harm if an inferior alternative to the status quo is inadvertently chosen.

## Option C: Seek further empirical evidence with a view to moving to an options paper later (MBIE's preferred option)

### Assessment of option C against criterion 1: Risk of harm occurring to consumers

119. MBIE considers that there is a low to moderate risk of harm occurring if further empirical evidence is sought before moving to an options paper by the end of 2018.

120. Given that there is no documented evidence of false negatives actually occurring at this point in time, it is unlikely that a relatively short delay will significantly harm the process of competition or consumers.

121. Evidence of harm from cases finding breaches of section 36 is also quite case-specific. For instance, in the *Port Nelson* case,[26] the court imposed a pecuniary penalty of $300,000, while in the *Data Tails* case,[27] the court imposed a pecuniary penalty of $12 million.

122. However, there are problems that have been identified with section 36 and it is possible that harm will occur at some point in the future. The longer the delay, the greater the risk of harm occurring.

123. MBIE's conclusion is that seeking further empirical evidence with a view to moving to an options paper later contains a low to moderate risk of harm occurring, so long as the delay is not too great. Although a judgment call, MBIE's view is that moving to an options paper by the end of 2018 would not lead to a significant risk of harm occurring.

### Assessment of option C against criterion 2: Likelihood of further evidence to inform choice of options

124. MBIE considers that option C contains a low to moderate likelihood of uncovering further evidence to inform the choice of options.

125. If evidence is not sought (as under options A and B) there is little chance of it being uncovered. Option C would enable two main avenues for collecting further evidence:

    a. monitoring potential or actual instances where the regime fails to adequately deter or penalise misuse of market power;

    b. assessing the changes that Australia is making to its equivalent provision; and

126. Whether monitoring potential or actual instances where the regime fails to adequately deter or penalise misuse of market power would uncover meaningful evidence is uncertain. However, given that there is currently little documented empirical evidence to inform an assessment of the net benefits of changing the provision, MBIE considers that it is an avenue worth pursuing. Regardless of whether further evidence is uncovered, MBIE would recommend proceeding to an options paper by the end of 2018.

127. If possible in the time available, option C would allow MBIE to consider the changes Australia is making to its equivalent provision (section 46 of Australia's Competition and Consumer Act 2010) and any subsequent behavioural changes or developments in case law. Keeping an eye on Australian case law as it develops would also enable further analysis of any benefits from change and risks of false positives arising from an alternative test. Option C would enable officials to take these developments into account to a greater extent than option B.

[26] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 (High Court).
[27] *Commerce Commission v Telecom* CIV-2004-404-1333 (High Court).

128. However, it is likely that monitoring the development of case law in Australia would take a long time to deliver new evidence that can be used to determine the appropriateness of moving to an alternative section 36 test. To manage this, option C could involve officials taking developments in Australia into account to the extent possible in the time available, but not to tying to them as a condition for moving forward.

### Overall conclusion

129. MBIE considers that option C contains a greater likelihood of uncovering further evidence than options A and B. However, uncovering further meaningful evidence is by no means certain.

130. MBIE's conclusion is that there is a low to moderate likelihood of option C leading to further evidence that would inform the choice of options.

# 5 Consultation

## Public consultation

### Introduction

131. An Issues Paper was released on 17 November 2015. Submissions were due on 9 February 2016, and 39 submissions were received. The Issues Paper proposed criteria for assessing the adequacy of section 36, applied those criteria to section 36, and indicated at a high level the types of alternatives that might exist to replace section 36 (including the introduction of an 'effects test').

132. A cross-submission process was launched on 9 June 2016 so that stakeholders could critique the 39 submissions MBIE received, as well as some additional information provided by the Commerce Commission by letter dated 2 June 2016. Twenty-five responses were received by the deadline of 21 July 2016.

133. The Issues Paper sought submitters' comments on:

    a. what criteria should be used to assess the status quo and any options for change;

    b. whether, using these criteria:

        i. section 36 was performing adequately; and/or

        ii. an alternative test would perform better or worse.

### Comments on criteria for assessment

134. The Issues Paper proposed two criteria for assessment of options: "assuring the long-term benefit of consumers" and "simplicity". Submitters provided useful comments on the criteria originally proposed for retention.

135. In light of responses to the Issues Paper, MBIE refined the criteria against which section 36, and alternative approaches, would be assessed if the decision were made to move to an options paper. Note that because these criteria relate to alternative regulatory options they differ from the criteria used in this RIS (which relate to alternative routes for the process of the review).

136. This refinement of options criteria led to MBIE (1) noting that the purpose of the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand and (2) suggesting three main criteria to achieve this – to be used in an options paper if carried out in the future:

    a. minimise the risk of wrong answers that could harm competition;

    b. reduce the cost and complexity of enforcing cases in order to penalise and deter anticompetitive behaviour; and

    c. provide businesses with predictability for procompetitive decision making.

137. This RIS has described the problems with section 36 in the terms of these criteria.

138. In addition, MBIE noted two other elements worth considering, but which it does not consider to be determining factors in the assessment.

139. First, a number of submitters pointed to the issue of implementation costs, should any option for change be adopted. While a relevant consideration, this was not given full weight as to do so could unfairly favour the status quo.

140. Second, the Ministry of Foreign Affairs and Trade (MFAT) in particular supported consideration of alignment of section 36 with misuse of market power provisions in other jurisdictions. We agree that this is important, particularly with regard to our trans-Tasman commitment to consultation on and coordination of business law.[28] However, ultimately the issue is what would be best practice for New Zealand. We also note that some of the benefit of alignment (access to a greater amount of relevant case-law and academic analysis) has been taken into consideration under the 'predictability' criterion, inasmuch as more relevant case law makes it easier for firms to predict how the courts will assess their conduct. As a result, we have not given alignment full weight as a stand-alone criterion.

141. Alignment of section 36 with other provisions of the Commerce Act (such as sections 27 and 47) was not retained as a criterion. Submissions generally agreed that most competition law regimes treat multilateral conduct more harshly than unilateral conduct – having different results under different provisions is thus not unusual worldwide.

142. The small size and remoteness of the New Zealand economy was not retained as a criterion. Submitters held deeply divided views on this issue: some considered that it meant section 36 should be harsher on dominant firms, while others thought it meant section 36 should be more forgiving. In the end, officials concluded that the only conclusion that could be drawn with certainty was that the proportion of markets in New Zealand with a dominant player would be higher than in many larger, more connected economies, and that as a result the costs and benefits of any particular option would be magnified, relative to many foreign jurisdictions. Rather than leading us to weight any one criterion higher than others, the likelihood that the impact of this provision is amplified in New Zealand merely suggests that it is an important one to get right.

## Comments on section 36

### Does section 36 promote the long-term benefit of consumers i.e. by minimising the risk of wrong answers that could harm competition?

143. Parties in favour of reforming section 36 argued that the 'taking advantage' test was an inaccurate way to distinguish between conduct that undermined the long-term benefit of consumers and conduct that did not. The Commerce Commission, for example, argued that "a firm's conduct could pass the 'taking advantage' test even though it demonstrably damages the competitive process", 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". The ACCC gave examples of conduct that might pass the 'taking advantage' test, yet undermine consumer interests, including exclusive dealing arrangements

[28] In 2010, the New Zealand and Australian governments signed a Memorandum of Understanding ("MoU") which set out a number of principles to guide efforts to coordinate business law, with these principles subsequently being adopted in the Trans-Tasman Outcomes Framework. Under clause 8, the two Governments identified a number of principles to guide coordination efforts, including the principle that "measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner". Under clause 13, each Government committed to "keep the other Government informed of proposed reforms in the area of business law and … give the other the opportunity to be involved in the other's reform process at an early stage."

and refusals to deal. A firm stripped of its market power might well still undertake such behaviour without harming the process of competition, meaning that it will be rare for such conduct to be penalised under the current test. Yet such conduct could undermine the long-term interests of consumers if it were undertaken by a firm with substantial market power and it locked competitors out of the market.

144. Parties against reforming section 36 argued that there is no perfect test for unilateral misuse of market power, and that against this standard the current test was satisfactory. DLA Piper argued, for example, that "on balance, the existing test seems to provide a satisfactory basis for assessing unilateral conduct by a firm". Chorus argued that "the current test strikes the right balance". IAG similarly submitted that the 'take advantage' test "is the most appropriate test to ensure that the prohibitions on exclusionary conduct are correctly applied".

### Does section 36 provide businesses with sufficient predictability for procompetitive decision making?

145. Parties in favour of reforming section 36 argued that section 36, as drafted, did not provide predictability to firms when considering whether proposed conduct might breach the law. The Commerce Commission stated that "the inherent uncertainties involved in applying the test through ascertaining the counterfactual are well documented". It added that "to the extent that 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."

146. Parties against reforming section 36 argued, in contrast, that section 36 provided firms with a good measure of predictability. For instance, Chorus wrote that "section 36 provides the necessary commercial predictability that companies with market power can reasonably apply (i.e. it poses a reasonably straightforward compliance stand: "would we do this, as a matter of rational commercial judgment, in a competitive market")".

### Does section 36 minimise the cost and complexity of enforcing cases in order to penalise and deter anticompetitive behaviour?

147. Parties disagreed on whether, once an investigation into conduct begins or a court case is launched, section 36 as currently drafted minimised the cost and complexity involved.

148. The Commerce Commission argued that the task it faced in taking action under section 36 was far too complex, as a result of the need – under the counterfactual test – to imagine what a market would look like if a powerful firm was stripped of its market power.

149. Air New Zealand, in contrast, claimed that "[m]any submitters appear to confuse a (justifiably) high standard with a level of complexity." Bell Gully, for its part, argued that "[w]hile we acknowledge that the taking advantage element has its difficulties, in our view, a significant portion of this difficulty can be attributed to the often factually complex nature of the inquiry involved in situations where section 36 issues arise".

## Comments on the effects test

150. While it was not the place or purpose of the Issues Paper to consider the advantages and disadvantages of options for reform of section 36, MBIE did note a few potential options that it might consider if an options paper were proceeded to – with a view to helping shape the options if an options paper were proceeded to. Many of the submissions and cross-submissions focused on these issues of the formulation of the test under section 36 – and in particular the pros and cons of an effects test. It would be remiss not to mention these below.

If the decision is made to proceed to an options paper then these submissions will be used to help shape potential options.

### Would an effects test better promote the long-term benefit of consumers?

151. New Zealand's current section 36 is a conduct-type test, requiring a causal connection between the firm's market power and its conduct (the market power somehow enables the conduct). An effects test on the other hand would examine the effect that a firm's conduct has had on a market (rather than the conduct itself per se).

152. The ACCC argued that the effects test "has a demonstrated ability to effectively filter anticompetitive from benign or procompetitive conduct…". The Commerce Commission claimed that it "would, in our view, deter some conduct that is anticompetitive but would pass the [current] taking advantage test". In other words, it would reduce the risk of false negatives, for example by allowing (where it harms competition) the penalisation of conduct such as exclusive dealing and refusal to deal (which may be difficult to capture under the current test).

153. Tompkins Wake, however, noted that certain formulations of the effects test are themselves capable of generating false negatives. It argued that, if reform is appropriate, the "substantial lessening of competition formulation should be resisted to avoid the perverse result that harmful conduct in markets with little or no competition (because of the presence of a vastly dominant competitor) might fall outside the scope of section 36".

154. Proponents of the status quo further argued that an effects test would create a risk of overreach. In other words, it would increase the risk of false positives. Chorus, Bell Gully and DLA Piper all cited the example of discounting, with Chorus stating that "[i]f section 36 simply said that conduct that has the effect of [substantially] lessening competition is prohibited, then firms with market power might be deterred from discounting if the result would be that less efficient competitors would struggle to compete".

### Would an effects test be more (or less) predictable?

155. Submitters in favour of reforming section 36 claimed that an effects test is just as predictable as the current test. Firms contemplating market conduct will not be any less certain about whether that conduct infringes section 36. For the ACCC, a substantial lessening of competition test "… is a well-established and well understood test that is applied in the majority of other competition provisions of the Commerce Act, including anticompetitive agreements, covenants and acquisitions". The Commerce Commission echoed this sentiment, noting that "[o]ther parts of the Commerce Act [such as section 27 on anticompetitive arrangements and section 47 on mergers] already have [substantial lessening of competition] tests... Firms and their advisors are currently dealing with these and there is no suggestion they are impeding competitive conduct."

156. However, some submitters in favour of the status quo argued that the 'substantial lessening of competition' test can be less predictable than the current test. Chorus, for instance, points out that "[e]ven those jurisdictions that have an effects test often treat identical conduct differently. For example, in our November 2015 submission, we pointed to the divergent approaches in the US and EU to Google's prioritisation of its own services in search results".

157. Many submitters also argued that, even if MBIE concludes that the effects test is predictable, that predictability can only be arrived at after significant time and effort are expended. As Russell McVeagh writes, "[b]usinesses make decisions about their own unilateral conduct hundreds (if not thousands) of times per day. It is not possible to perform the same degree of competition analysis as it is for contractual arrangements with third parties, which typically

arise in a more structured way, following negotiations, and potentially with the input of legal counsel".

### Would an effects test better minimise cost and complexity?

158. In his original submission, Donal Curtin argued that an effects test would be "less complex and more timely" than the 'taking advantage' test.

159. Bell Gully, however, countered in its cross-submission that "[a]nalysis of whether conduct could 'substantially lessen competition' can be extraordinarily complex as it is an intensely fact-dependent exercise. In the merger context, the Commission itself can take up to 3 or 4 months to undertake an SLC analysis [i.e. analysis of whether there is a substantial lessening of competition]."

## Agency consultation

160. MBIE officials sought inter-agency comments on the Issues Paper before it was released, notably from Treasury, the Ministry of Foreign Affairs and Trade, the Commerce Commission, the Ministry of Transport, and the Ministry for Primary Industries. The Electricity Authority, the Gas Industry Company, and the Productivity Commission were also consulted.

161. MBIE also sought inter-agency comments from Treasury, the Ministry of Foreign Affairs and Trade, the Commerce Commission, the Ministry of Transport, and the Ministry for Primary Industries on its draft policy advice and on this RIS. The comments of the different agencies have been taken into account.

162. The Commerce Commission considers that section 36 is in urgent need of reform and supports moving to an options paper. The Commission notes that Option C which involves (i) gathering forward-looking complaints to the Commission and (ii) monitoring case law developments in Australia, once their new section 46 is enacted, could involve considerable time delay. It could be a matter of some years before the monitoring further informs the process. The Commission agrees with officials that an options paper should be proceeded to next year regardless of the evidence.

163. Two outstanding issues remain.

164. First, the Ministry of Foreign Affairs and Trade sought reassurance about section 36A of the Commerce Act and its Australian equivalent section 46A of the Competition and Consumer Act 2010. Section 36A is primarily concerned with the leveraging of market power in an Australian market, to obtain an uncompetitive outcome in a New Zealand market (although it has to be a New Zealand market for goods, or goods and services combined). As a hypothetical example, we could imagine a scenario where an Australian tomato supplier, which holds a substantial degree of market power in the Australian market for tomatoes, decides to sell tomatoes in New Zealand below cost, with a view to eliminating a New Zealand tomato supplier from the New Zealand market for tomatoes. Australia's section 46A would be concerned with the opposite scenario, where a New Zealand tomato supplier leveraged its market power in New Zealand to sell tomatoes in Australia below cost.

165. The Ministry of Foreign Affairs and Trade wished to know what implications there might be if Australia amended section 46A to use an effects test, while New Zealand retained section 36A with the current test. In response, MBIE notes that there is no provision in the exposure draft of the Australian bill amending section 46 that seeks to amend section 46A. Even if Australia does at some point amend its section 46A, MBIE notes that we have recommended that the government consider moving to an options paper at a point in the future, at which point any issues of non-alignment could be assessed.

166. Second, the Ministry for Primary Industries (MPI) supports the decision to build the evidence base and then proceed to an options paper but considers that the specific formulation of section 36 would be less relevant if the Commerce Act also provided for generic *ex-ante* procompetitive provisions that could act as constraints and/or incentives on firms to operate competitively.

167. By way of explanation, any formulation of the prohibition on misuse of market power, applied after potentially harmful anticompetitive conduct has already taken place, is likely to be very difficult to police and enforce in a timely manner. In MPI's view, relying solely on *ex-post* consideration of a firm's actions may not therefore be sufficient to meet the purpose of the Commerce Act of promoting competition for the long-term benefit of consumers. While industry-specific regulatory regimes could be considered as feasible alternatives, the high regulatory hurdle for introducing such regimes, combined with the ongoing costs and complexities of maintaining and enforcing them on a consistent basis, should not be underestimated. MPI notes also that it would not necessarily be appropriate or justifiable to impose industry-specific regulatory regimes on industries where the prevalence of dominant firms arises simply due to the small size of the New Zealand economy, rather than any underlying structural (natural monopoly like) characteristics. The absence of generic procompetitive provisions, combined with the high hurdle for introducing and maintaining industry-specific regulatory regimes, imposes significant (and perhaps unrealistic) pressure on section 36 to deal with the issues it was not designed to deal with, and therefore does not deal with effectively.

168. In sum, MPI considers that the findings on the current formulation of section 36 expose a potential risk to competition where conduct that is harmful to competition cannot be effectively curtailed either at the industry-specific level, or through section 36 of the Commerce Act. In this regard, MPI understands that MBIE is considering a broader response to promoting competition as part of the BGA. MPI considers that there is merit in progressing such work as soon as possible.

169. MBIE is satisfied that MPI's concerns can be addressed within the BGA competition workstream (if approved).

## Treasury comment

170. Treasury agrees that MBIE's policy review has not uncovered sufficient evidence for officials to be confident about how to address an identified problem. Treasury therefore agrees with the recommendation to continue to collect evidence about the implications for market conduct and economic outcomes before moving to an options paper—particularly given the polarised nature of responses to the public consultation about the scale of the problem and the uncertain relationship between anticompetitive conduct deterrence and actual market behaviour. The role of deterrence vis-à-vis underlying structural drivers of New Zealand competition intensity is also not yet well-understood. Given developments in Australia and the fact that the review did not outline a clear way forward, a proactive approach that keeps all options on the table (including an effects test) makes sense.

171. While it is unclear when or what may indicate a particular case for reform at this stage, the Treasury considers that a broader range of stakeholders could be engaged in the debate and their perspectives incorporated. This may require a focus on market outcomes and clearer salience of the issue for consumers, smaller firms, and potential entrants. While waiting to collect more evidence has a potential cost if the problem is driving anti-competitive outcomes, the preferred option in the RIS of moving to an options paper at the end of 2018 seems reasonable. Experience in Australia should also provide a useful comparator to assess the

relative benefits and risks of reform, although there is a risk this takes more time to emerge (i.e. through legal precedent).

# Submissions to Australia's recent review of misuse of market power

172. Although the submissions on Australia's review of misuse of market power were not solicited by MBIE, MBIE has considered them.

173. MBIE notes, first, that a large proportion of submissions to the Australian Review suggested that problems with the current prohibition in Australia are due to it not protecting small business. In MBIE's view, however, this is not the prohibition's purpose. Imbalance of bargaining power is better dealt with by other means e.g. industry codes of conduct, unconscionable conduct laws, fair trading rules, etc. In this regard, MBIE notes that the Harper Panel's final report did not accept the submissions suggesting that section 46 should protect competitors.

174. Nevertheless, a number of submissions focused on the more relevant issue of whether the 'take advantage' element of section 46 was an appropriate filter between conduct that harms the long-term benefit of consumers and conduct that does not. This relates to getting the right answer by avoiding false negatives and false positives.

175. A number of submitters argued that the current formulation of section 46 creates too great a risk of false negatives. RBB Economics stated, for example, that the current test "ignores the very different consequences that can flow from the same conduct undertaken by a large firm versus a small firm…"[29] MBIE acknowledges that the current formulation of the test creates a risk of false negatives. However, our analysis of past substantive court cases (see section 1) does not suggest any false negatives have occurred in actual cases taken by the Commission. In addition, ex ante regulation in the telecommunications, postal, electricity and gas sectors has reduced the risk of anticompetitive conduct in what had been the markets most at risk.

176. The ACCC also argued that concerns about false positives under an effects test were misplaced. It stated that "under an SLC [substantial lessening of competition] test, to damage competitors, even to the extent of competitors being forced out of business, is not in itself a basis to establish a 'lessening of competition' … The SLC [substantial lessening of competition] test targets conduct that prevents or impedes firms from competing on their merits".[30] MBIE notes in response that Professor Hilmer's review in 1993 concluded that a "substantial lessening of competition" test was "too broad a prohibition of unilateral conduct" which – unless the courts developed "a gloss" to the contrary – might "prohibit economically efficient conduct".[31] MBIE is not aware of such a gloss having been developed. MBIE also notes the view of Professors Stephen King and Graeme Samuel, former chair and commissioner at the ACCC respectively, who conclude that a substantial lessening of competition test "will capture poorly defined complaints about conduct that benefits consumers but harms inefficient competitors".[32]

# Other views

[29] RBB Economics submission to Australian Treasury at p.1.
[30] ACCC submission to Australian Treasury at p.6.
[31] Hilmer report at pp.70-71.
[32] Kin and Samuel submission to Australian Treasury at p.2.

## Previous Australian reviews

177. A number of reviews of Australian competition law preceded the Harper Panel's review, including a number that considered an effects test (although not necessarily the particular form of 'effects test' considered by the Harper Panel). We assume that none of these reviews were assessed by the Australian Office of Best Practice Regulation (or its equivalent, if any, at time).

178. The Blunt Committee of 1979 concluded that "removing the purpose element altogether could give the provision a very wide application and bring within its ambit much legitimate business conduct… It is only purposive misuse of market power and not inadvertent conduct … that should be at risk."[33]

179. The Griffiths Committee of 1989 rejected a proposal from the Trade Practices Commission to introduce an effects test. It concluded that "the bulk of the evidence suggests that no change to the section is required" and that "[i]n particular, the major proposals for reform suggested during the inquiry would not contribute to the achievement of any greater certainty in the law".[34]

180. The Cooney Committee of 1991 concluded that an effects test "would unduly widen the operation of the prohibition" and that it "would force corporations to evaluate the potential effect of their every action on their competitors and potential competitors".[35]

181. The Hilmer Committee of 1993 concluded that an effects test "would not, in the Committee's view, constitute an improvement on the current test" notably because it would be "too broad a prohibition of unilateral conduct".[36]

182. The Dawson Committee of 2003 concluded that an effects test "would be likely to extend the application of section 46 to legitimate business conduct and discourage competition".[37] It also suggested that comparison with European jurisdictions that apply the effects test is "difficult and unhelpful" because they apply "the higher threshold of market dominance".[38]

## New Zealand Productivity Commission

183. In its May 2014 report on boosting productivity in the services sector, the Productivity Commission concluded that "there are real and valid concerns with how the current law and jurisprudence on section 36 are operating", noting that the status quo "risks causing losses of dynamic efficiency through failing to identify some cases where firms use their market power to restrict the ability of other firms to innovate and compete". However, while it recommended as a result that section 36 be reviewed, it did not express a view on whether it should in fact be amended.

## Academic papers

184. Academic papers brought to our attention largely support reform of section 36. This includes Mark Berry (2001, 2005, 2013), Rex Ahdar (2008), Paul Scott (2011), Jeffery Cross et al. (2012), Katherine Kemp (2014) and Andrew Gavil (2015). These papers largely focus on the risk of false negatives under the 'taking advantage' element of the prohibition.

[33] Blunt report at [9.21]-[9.22].
[34] Griffiths report at [4.6.29].
[35] Cooney report at [5.64].
[36] Hilmer report at p.70.
[37] Dawson report at p.81.
[38] Dawson report at p.79.

185. Brent Fisse (2015) appears to have a more nuanced view on the reform of Australia's section 46, recognising the drawbacks of the 'take advantage' approach to misuse of market power, but noting several issues with the "substantial lessening of competition" approach. He writes, for example, that "[o]ne reason why the Harper Report proposals on section 46 are controversial is that no adequate proof of concept has been given".[39]

186. O'Donoghue and Padilla (2014), for their part, argue in favour of requiring a causal connection between market dominance and a firm's conduct.[40]

[39] See Fisse, B., 'The Australian Competition Policy review Final Report 2015: Sirens' Call or Lyre of Orpheus?', supra, at [31].

[40] See Robert O'Donoghue / Jorge Padilla in 'The Law and Economics of Article 102 TFEU', 2014, at section 5.4.1.

# 6 Conclusions and recommendations

187. The table below summarises MBIE's assessment of the three process options available to the review of section 36 against the criteria.

**Table: Summary of analysis of process options against criteria**

| | | Options | | |
|---|---|---|---|---|
| | | **A**<br>**Dismiss the case for reforming section 36 and remain with the status quo** | **B**<br>**Proceed to an options paper** | **C**<br>**Seek further empirical evidence with a view to moving to an options paper later** |
| **Criteria** | Risk of harm occurring | Moderate | Low | Low to moderate |
| | Likelihood of further evidence to inform choice of options | Low | Low | Low to moderate |

188. On the basis of its assessment and consideration of the (diametrically opposed) stakeholder views on the provision, MBIE considers that the best option is option C (seek further empirical evidence with a view to moving to an options paper later).

189. This follows from MBIE's view that there is a problem with section 36, (implying that options should be developed and tested) but that the uncertainty regarding the scale of the problem makes it difficult to assess the costs and benefits of alternative options against the status quo.

190. A delay while MBIE searches for further empirical evidence of the scale of harm occurring (or likely to occur) is unlikely to lead to significant harm occurring – provided that the delay is relatively short (e.g. one to two years). Option C also has the highest likelihood of generating further evidence to inform the choice of options in the future (although there is a possibility that further evidence will not be found).

# 7 Implementation plan

## Process for seeking further evidence

191. MBIE's recommended option (option C) involves seeking further empirical evidence with a view to moving to an options paper later. MBIE is in the process of exploring further sources of evidence.

### Monitoring potential or actual instances where the regime fails to adequately deter or penalise misuse of market power

192. To date, analysis of the problems the status quo creates in deterring and penalising certain types of misuse of market power has been limited to consideration of previous cases and hypothetical scenarios. While this has provided evidence for problems with the current provision, it has not been able to indicate the scale of harm occurring, or likely to occur, under the status quo. We have not been able to assess historical instances of harm where cases have not been taken.

193. For instance, the Commission has not been able to indicate whether the current formulation and interpretation of section 36 has led them to forego investigations where it considered the long-term interests of consumers were being harmed. The Commission reasons that because all its analysis of past cases has been undertaken within the current legal framework for section 36, they have not been able to consider whether harm has occurred outside the bounds of the existing legal test.

194. An alternative way of gaining empirical evidence would be to instead take a more forward looking monitoring approach where MBIE monitors (in line with Cabinet's initial expectations for regulatory stewardship from March 2013) competitive market outcomes with a view to detecting harm – for instance by endeavouring to record new instances, new cases or new complaints, where apparent misuse of market power is likely to be undeterred or lead to a false negative under the current test. If successful, this would give a better feel for the scale of the problem with section 36 and enable better analysis of alternative options against the status quo.

195. Whether this approach would uncover meaningful evidence is uncertain but given that there is currently little documented empirical evidence to inform an assessment of the net benefits of changing the provision, MBIE considers that it is an avenue worth pursuing. Regardless of whether further evidence is uncovered, MBIE would recommend proceeding to an options paper by the end of 2018.

### Assessing the changes in Australia

196. In Australia, a bill has been introduced which would move to an 'effects or purpose test'. Under an 'effects or purpose test' a firm with substantial market power would be in breach of section 46 (equivalent to New Zealand's section 36) if its conduct was likely to lead, or did actually lead, to a substantial lessening of competition, but also, and alternatively, if its purpose in undertaking the conduct was to substantially lessen competition (whether or not it

succeeded in doing so). This option reflects the recommendation of the Harper Panel in Australia.

197. The New Zealand and Australian governments have a commitment to consultation and coordination on competition laws as part of the Single Economic Market agenda, and have endorsed the principle that "measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner".

198. If possible in the time available, option C would allow MBIE to consider the changes Australia is making to its equivalent provision (section 46 of Australia's Competition and Consumer Act 2010) and any subsequent developments in case law. The New Zealand and Australian governments have a commitment to consultation and coordination on competition laws as part of the Single Economic Market agenda, and have endorsed the principle that "measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner". Keeping an eye on Australian case law as it develops would also enable further analysis of any benefits from change and risks of false positives arising from an alternative test. Option C would enable officials to take these developments into account to a greater extent than option B.

199. It may also be worth attempting to detect instances of behavioural change (e.g. business uncertainty or deterrence of anticompetitive or procompetitive behaviour) following the Australian decision. If successful, this would provide evidence regarding the extent to which the Australian provision deters conduct. However, such an assessment is difficult – particularly given the added complexity of assessing impacts on businesses in a different country.

200. It is likely that monitoring the development of case law in Australia would take a long time to deliver new evidence that can be used to determine the appropriateness of moving to an alternative section 36 test. To manage this, option C could involve officials taking developments in Australia into account to the extent possible in the time available, but not to tying to them as a condition for moving forward.

# Minimising implementation risks

## Negative stakeholder reaction

201. The review of section 36 has extended over a significant length of time, with stakeholders investing substantial effort into their submissions. A further delay may frustrate stakeholders, leading to public criticism and a loss of engagement.

202. However, the strongly opposing views on section 36 mean that all possible routes are open to criticism. Many stakeholders would criticise a decision to dismiss the case for reform. On the other hand, moving to an options paper now would make it difficult to assess the costs of the status quo and therefore the possible benefits of change – in this scenario the criticism could be levelled that the case had not been made for change.

203. Cabinet has previously been informed that the Issues Paper would be followed by an options paper. MBIE has also indicated as much to stakeholders. MBIE therefore considers that the best way to manage the risk is to seek further evidence with a view to proceeding to an options paper in the future.

## Difficulties uncovering further evidence

204. There is a risk that efforts to uncover further evidence (particularly of false negatives) will not succeed. However, given the current situation of uncertainty MBIE considers that it is worth

instating a forward looking monitoring arrangement to seek further evidence. MBIE will discuss ways to gather this evidence with the Commerce Commission.

### Length of the delay in collecting evidence from Australia

205. Finally, there is a risk that monitoring the development of case law in Australia will take a long time to deliver new evidence that can be used to determine the appropriateness of moving to an alternative section 36 test. If the changes to the Australian provision are an effective deterrent then there is unlikely to be much case law. For example, if MBIE had decided to monitor the application of section 46 in 2008, when section 46(6A) was introduced into Australia's prohibition, we would today (eight years later) have only one decided court case[41] on which to base our opinion (although there would be ACCC settlements to consider as well).

206. Attempting to detect instances of business uncertainty or deterrence of anticompetitive or procompetitive behaviour following the Australian decision would potentially provide faster information about the effectiveness of the change to the Australian provision. However, such an assessment would be difficult – particularly given the added complexity of assessing impacts on businesses in a different country.

207. With this in mind, MBIE intends to take these developments into account to the extent possible in the time available, but not to tie to them as a condition for moving forward.

# 8 Monitoring, evaluation and review

208. As noted in section 6 of this RIS, officials will seek further evidence of the scale of the problem with section 36 of the Commerce Act by endeavouring to compile a log book of instances of apparent harm and monitoring the Australian reforms.

209. Following an effort to obtain further evidence, MBIE proposes to proceed to an options paper by the end of 2018. Timing will depend on the nature of any evidence that is uncovered and whether it appears likely that further evidence will be found.

210. Any court judgments that raise significant questions about the status quo will be drawn to the attention of the Minister of Commerce and Consumer Affairs. Such a scenario could potentially trigger a re-assessment of when to proceed to an options paper.

[41] *ACCC v Pfizer* [2015] FCA 113.