BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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1 April 2019

Competition and Consumer Policy
Ministry of Business, Innovation and Employment
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Email to: competition.policy@mbie.govt.nz

Dear Sir/Madam

Re: Review of Section 36 of the Commerce Act and Other Matters

I am writing to you regarding the Ministry of Business, Innovation & Employment (MBIE) Discussion Paper, *Review of Section 36 of the Commerce Act and Other matters* (referred to as 'the Discussion Paper').

While the Discussion Paper examines three main issues, we wish to concentrate our comments on the proposed change to section 36 (referred to as 's36').

Background

BusinessNZ has been substantially involved with the review of s36 over the last few years, including:

- Submission to the New Zealand Productivity Commission (NZPC) on the Services Sector report (2013/14).
- Submission to MBIE on their Issues Paper that included s36 (2015/16).
- Cross-submission in response to the Commerce Commission's (ComCom) supplementary submission (2016).

Therefore, an extensive process has already looked at the need (or otherwise) to amend s36.

An extreme response, without going through a proper policy process, will inevitably produce a sub-optimal and likely controversial outcome.

The usual suspects (part II)

Paragraph 34 of the Discussion Paper states: *"Around two-thirds of submitters on the Issues Paper – mostly large firms and the law firms that represent them – supported retaining the current test contained in section 36 of the Act…"*. This is very close to paragraph two of the ComCom supplementary submission which in relation to those submitters who do not support a change to s36, stated: *"Perhaps unsurprisingly, those resistant to reform are large business and the advisors that represent them".* As with the ComCom conclusion, BusinessNZ is concerned about this statement for a number of reasons.

First, our organisation represents a large number of businesses of every shape and size. There are some 70,000+ entities ranging from sole traders and SMEs, through to large businesses.

Second, of those who have previously submitted, very few submissions from small businesses supported any change, demonstrating the small-business community's lack of concern with existing s36. To the contrary, there were a number of industry associations representing a wide cross-section of the business community (from small to large businesses) opposing s36 change. In addition, regional and industry associations also submitted on the cross-submission process, moving even further away from the MBIE and ComCom argument that this is simply a case of large businesses looking after themselves.

Third, large businesses submitting is an inevitable response to the fact that the Government's desired s36 change would result in a prohibition particularly applicable to large businesses. The core of their objection is the suggestion the connection between a business's market power and the conduct to be prohibited should be abandoned (i.e. by removing the "taking advantage" limb) leaving large businesses potentially at risk, even if their (alleged) market power is not used.

Given the Government's desired change would lead to a prohibition applying to all large business conduct, irrespective of whether linked to market power or not, would see large businesses most directly affected, providing a legitimate basis for opposition to what is proposed.

Last, though a number of those resistant to changing s36 were large businesses, that does not make either their arguments or their concerns any less valid.

The expected process

Paragraph 36 of the Discussion Paper points out that as part of the earlier process: *"The previous Government considered the review in June 2017 and invited the Minister of Commerce and Consumer Affairs to report back to Cabinet by end of June 2018, on whether it is appropriate to proceed to a section 36 options paper".* Paragraph 37 then states: *"Following the change in Government, the current Minister of Commerce and Consumer Affairs has publicly committed to reviewing section 36 of the Commerce Act"*.

However, an important point has been omitted from this timeline, namely that the Minister asked officials to investigate further:

i. any further evidence of harm occurring;

ii. The costs and benefits of alternatives to the current formulation of s36 of the Commerce Act 1986;

iii. Any further developments in Australia on misuse of market power; and

iv. Recommendations as to whether to proceed to an options paper.

Points (i) and (ii) are key considerations when it comes to determining the paragraph (iv) recommendations, particularly as going through the current Discussion Paper, it appears there has been little further evidence of harm while the costs and benefits of the alternatives outlined are wholly inadequate (discussed below). Even point (iii) is questionable as Australia has had an effects-test regime only since August 2017. Consequently, the areas looked at have not advanced the cause for change.

Question 2 of the Discussion Document asks whether submitters can offer any new evidence on the costs and benefits of s36. Also, if they have submitted before, whether they have anything new or different to add to their views on the effectiveness of s36. For BusinessNZ, the short answer is no. There is no further evidence we can provide around the costs and benefits of s36. However, this should not be a surprise as it is unlikely most previous submitters will be able to provide new evidence given the comprehensive review and cross-submission process carried out only a relatively short time ago.

BusinessNZ does not intend to go through all the previous evidence provided from 2013 to 2016 both to the NZPC and to MBIE as our position is already very clear. Instead, we will pick up on a few points made in the Discussion Paper.

The game has changed?

Paragraph 45 of the Discussion Paper points out that since Australia changed its law to include an effects test, New Zealand is now the only country requiring a strict causal connection between market power and the conduct in question. MBIE then states *"Given New Zealand's size and remoteness, any variation from the global standard of an effects-based test should require a very high level of proof of superior outcomes"*. This is a flawed argument.

First, New Zealand's size and remoteness mean compliance with global standards is often not the best course of action. Instead, a system that works here can ensure a better outcome than one more suited to larger countries close to their trading partners. This view was touched on in the NZPC 2014 report on the Services Sector where, on page 73, it states: *"the review needs to acknowledge the small size of and limited competition in the New Zealand economy"*. At the time we pointed out that

government must be very sure not to penalise the New Zealand economy unnecessarily by reason of its scale.

Second, looking at the outcome of the corresponding Australian review - which plays a large part in MBIE's thinking - there was no overwhelming groundswell of support on that side of the Tasman for changing to an effects test. As paragraph 80 of the Discussion Paper points out, eighty-six submissions were received, with no clear indication that an effects test would be the best step forward.

Last, since the existing regime does not show any clear overall net cost to the economy, we are uncomfortable with the idea that because New Zealand is now different from other countries, suddenly it should follow suit. In no way is the premise that 'the game has changed' accepted. Therefore, a high level of proof should not be needed to retain what is currently a workable regime.

Problem definition – not based on evidence

The work MBIE has put into developing s36's problem definition is appreciated but there are concerns about what are 'certain', compared with 'possible', problems with the status quo.

Chapter 4 of the Discussion Paper outlines three main problems with s36, namely:

- The potential for wrong answers that could harm competition;
- Cost and complexity of enforcement; and
- Predictability for pro-competitive decision making.

BusinessNZ does not deny there might be potential problems with the existing s36 regime and has never stated that s36 has no deficiencies whatsoever. We would support justifiable measures to correct certain concerns but paragraph 78 provides a fundamental reason for not supporting the current proposed s36 change: *"However, the magnitude of these issues is not clear and they are difficult to quantify"*.

As stated in our 2016 letter to MBIE regarding the cross-submission process, it is important to keep in mind that much business community angst over the proposal to introduce an effects test is essentially due to the decision to identify and propose an extreme solution early on in the policy process – namely, making finding a solution the Issue's Paper's front and centre conclusion. Therefore, it should come as no surprise the business community does not want change when presented with an extreme option based on little evidence.

Had the process begun by making the case for change, followed by an attempt to assess in a logical fashion how far to move up the regulatory pyramid, the business community would have been prepared to have an in-depth discussion of alternative enforcement mechanisms. However, this is not how the consultation process has proceeded and therefore we are where we are.

Paragraph 80 of the Discussion Paper essentially repeats the point equating New Zealand's size and remoteness with the need for the high level of proof provided by an effects-based test. But it also states: *"if the status quo were an effects-based test, it would be impossible to show any benefit from changing to a test that relied on a strict causal connection between market power and conduct"*. This provides a very weak foundation for a policy change. What essentially MBIE means is that under an effects-test regime, there would be a significantly higher number of cases brought forward over time compared with the status quo. There is simply no way in which to verify that. And whether the cases brought forward, and the associated costs, would be justifiable would also be up for debate.

Last, we are also very disappointed with the statement in paragraph 81: *"although there is a lack of empirical evidence about the scale of the problem, it is our judgement that maintaining the status quo does not promote the long-term benefit of consumers. As such, it is no longer appropriate to wait for certainty about the costs and benefits of reform before recommending change"*. From our perspective, this is simply MBIE flying a white flag around proper policy process and instead adopting a 'damn the torpedoes' approach. Given the lack of evidence, the existence of any real problem and the need for change should not be assumed.

Costs and benefits of an effects-based test

Paragraphs 202 and 203 of the Discussion Paper outline the expected costs and benefits of an effects-based test. As acknowledged, the table addresses only the marginal costs and benefits of the option, arriving at a total monetised cost of $2.7 million (with private sector costs of only $0.6m based solely on the estimated cost of introducing a new system to replace a well-understood 30-year old prohibition). There are no values provided for the monetised benefits.

While we appreciate MBIE's attempt to undertake a cost-benefit analysis, the summary provides little or no indication of what the net cost/benefit to New Zealand would be. We would even go so far as to suggest this is not a proper cost-benefit analysis at all. Rather it is a simple check-list impact analysis.

The problem with viewing MBIE's analysis as a cost-benefit analysis, with almost all the data missing, is evident in paragraph 203 where it is pointed out that although the potential benefits are difficult to monetise, they *"only need to be greater than $2.7 million to make the changes worthwhile"*. This is simply not true. To say the total cost to the business community of introducing an effects-based test would simply be a one-off cost of $0.6 million is almost farcical for two primary reasons. First, there will not be a one-off transition cost for those businesses with a substantial degree of market power. Instead, there will the ongoing higher cost of both internal and external legal advice when any decision is made that might hint at the triggering of an effects test. This is because the effects-test sets the bar far higher than the current regime.

Also, for the wider-economy, there is no recognition of the future chilling effects on business behaviour, canvassed at length by us in both our original submission and in response to the 2016 ComCom letter and by other submitters.

Last, we would like to point out that it is stated under the list of benefits that businesses with a substantial degree of market power are, *"over time likely to benefit from greater certainty of rules around specific types of conduct"*. The problem with this assertion is that it fails to recognise that the certainty provided by a new policy is not automatically better than the status quo if the new policy is flawed. We doubt whether there will be greater certainty given the extreme nature of an effects-based test compared with the status quo.

Therefore, given the reasons outlined in both this and previous submissions, BusinessNZ recommends that an effects-based test should not be introduced into s36 of the Commerce Act.

Recommendation: That section 36 of the Commerce Act is not changed to provide for an effects-based test.

Thank you for the opportunity to comment, and we look forward to further discussions.

Kind regards,

Kirk Hope
Chief Executive
BusinessNZ