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COMPETITION · REGULATION · POLICY · STRATEGY

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Submission on draft Misuse of Market Power Guidelines

1. Thank you for the opportunity to submit on the draft Misuse of Market Power Guidelines (**Guidelines**). We welcome the detailed guidance and commend the Commerce Commission's (**Commission**) work in developing the draft. We commend the consistency of the Guidelines with similar guidelines and practice in Australia, consistent with legislative intent to harmonise New Zealand and Australian law as far as possible.

2. Matthews Law is a specialist competition law firm. We have previously submitted on misuse of market power issues including on MBIE's *Targeted Review of the Commerce Act* in 2016[1], *Review of section 36 of the Commerce Act and other matters*[2] in 2019, the Australia Government's *Options to Strengthen the Misuse of Market Power Law – Discussion Paper*[3] in 2016, and Parliament's *Commerce Amendment Bill*[4] in 2021. We regularly advise on section 36 matters. We have significant experience advising both access providers and access seekers, on the both demand-side and on the supply-side, with a focus on access pricing and refusals to supply.

3. Our submission recommends further commentary on the following areas:

   a. Conduct seeking to enforce intellectual property rights (**IPR**).

   b. Refusals to supply & access pricing.

   c. Demand-side theories of harm.

   d. Loyalty rebates & volume discounts.

   e. Purpose of substantially lessening competition in a market.

   f. Positive statements on permitted conduct.

Clarifying interaction with intellectual property rights (IPR)

4. The section 36 amendments include the repeal of the section 36(3) statutory IPR exception. While the application of this exception arguably may not have been clear, its removal highlights that conduct seeking to enforce IPR is a complex area where additional guidance is needed.

5. The interaction between IPR and competition law has long generated interest. IPR have unique characteristics. These include high fixed costs to develop often accompanied by low marginal costs to produce, a potential broad range of applications, ease of free-riding, ease of reproduction, and difficulties policing theft. Competition to develop IPR is critical in healthcare, bioscience, technology, and many other fields, and should be encouraged.

[1] Our submission: https://www.mbie.govt.nz/dmsdocument/2326-matthews-law-redacted-targeted-review-commerce-act-phase-one-submission-pdf
[2] Our submission: https://www.mbie.govt.nz/dmsdocument/7080-matthews-law-review-of-section-36-of-the-commerce-act-and-other-matters-submissionpdf
[3] Our submission: https://treasury.gov.au/sites/default/files/2019-03/C2015-061_Matthews_Law.pdf
[4] Our submission: https://www.parliament.nz/resource/en-NZ/53SCED_EVI_108304_ED573/2e23b7332e92515a441073ad855d6ff682f0f77a

6. These factors necessitate a more nuanced analysis and mean there will often be pro-competitive grounds for refusing supply.

7. The OECD's 2019 background note on *Licensing of IP Rights and Competition Law* recognised potential anti-competitive effects of reseals to license IP, but stressed: [5]

> *Imposing a duty to license can limit the value of legitimate IP rights, diminish the returns to innovation, work at odds with IP systems and, ultimately, stifle innovation (Shapiro and Teece, 1994, p. 158[41]; Shapiro, 1995, pp. 502-503[42]). Moreover, a number of the potentially procompetitive effects of IP and its licensing stem from the licensor's ability to limit the number of firms permitted to deal in the new technology. It is widely acknowledged that, as far as competition policy is concerned, the licensor should generally be free to refuse to license other firms, and to limit exploitation of the innovation either to itself or to its selected licensee(s) (OECD, 1989, p. 103[4]; OECD, 2004, pp. 39-40[11]).*

8. Competition analysis regarding enforcing IPR may therefore require greater consideration of dynamic efficiency given the role IPR may play regarding innovation, incentives, and long-term market outcomes.[6] This has impacts on the temporal aspects of market definition as well.

9. We **recommend** greater recognition of the pro-competitive (and competitively neutral) bases for refusing to supply IPR, and for setting supply prices and related conditions.

Clarifying the test for access pricing

10. Currently there is clear law for access pricing. The Privy Council in *Telecom v Clear Communications* held that the combination of the Efficient Component-Pricing Rule (**ECPR**) and Kahn's principle of comparative parity should be applied: "*the Baumol-Willig Rule itself **and** Dr. Kahn' s principle of comparative parity are designed to ensure that Clear and Telecom compete on a level playing field in the area in which they are to be competitors*".[7] [emphasis added] The Privy Council recognised that these tests were "*complementary* ".

11. While this judgment has been criticised, that may reflect a misunderstanding that it was intended that both tests be met, or not recognising the significance of competitive parity.

12. We submit that the starting point should be the requirement of **both** aspects. This should mean that any monopoly rents are captured at the monopoly level and calculation of any "opportunity cost" should not enable leveraging of monopoly rents into related (competitive) markets.[8]

13. We **recommended** this as the appropriate starting point for access pricing. It is consistent with an "equally efficient" competitor test. If the Commission has a different view or considers further modifications should be made to this two-part test, we recommend it does so. Particularly when the Guidelines indicate that a refusal to supply can include a constructive

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[5] *Licensing of IP Rights and Competition Law – Background Note* (OECD, 6 June 2019) at 31: https://one.oecd.org/document/DAF/COMP(2019)3/en/pdf

[6] See also *Competition Policy and Intellectual Property Rights* (OECD, Paris, 1989) at 10: https://www.oecd.org/regreform/sectors/2376247.pdf ("*long-run consumer welfare depends on the dynamic efficiency of the economy as well as its tendency towards allocative efficiency. Dynamic efficiency includes the invention and commercial introduction of new products and processes which enhance welfare both by increasing the quality of goods and by promoting growth through increased productive efficiency*").

[7] *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at 26.

[8] Despite access pricing issues being raised with government officials, the legislature did not amend the act to disapply the so-called Baumol-Willig rule (cf. Section 2 of schedule 1 (Designated services and specified services) subpart 1 – interpretation and application provisions of the Telecommunications Act 2001.

refusal to supply[9] and departures from an accepted methodology might be treated as falling in that category.

14. When considering unilateral market power, access pricing is one of the few areas, where there can be reasonably objective tests and greater clarity for all parties. (Arguably our comments here apply to some degree to *predatory pricing*[10] where there have been long-standing rebuttable presumptions offshore.) It seems a lost opportunity to fail to give such guidance.

15. In short, we **recommend** further guidance on applicable pricing methodologies, starting with existing case law and explaining any reasons for diverging. We also **recommend** consideration of rebuttable presumptions in other areas.

Providing further commentary on the analytical framework for demand-side theories of harm

16. The Guidelines recognise a firm can have substantial *purchasing* market power. The Commission could consider also providing further commentary on the analytical framework it might use to analyse demand-side theories of harm in the Guidelines, and whether anti-competitive effects on sellers will be analysed differently to effects on buyers.

17. For example, in the United States, the Department of Justice has affirmed "*Courts have long recognized that the antitrust laws are designed to protect both buyers and sellers of products and services*".[11]

18. We **recommend** further commentary on the analytical framework for demand-side theories of harm.

Distinguishing between loyalty rebates & volume discounts

19. The Guidelines do not seem to distinguish sufficiently between loyalty rebates and volume discounts.

20. Overseas regulators indicate volume discounts are less likely to raise concerns:

    a. The ACCC Guidelines state "*Unconditional rebates, which simply reduce the price of an item with no additional conditions based on the retailer* [ie volume discounts]*, likely only raise concerns of the reduce price amounts to predatory pricing*".[12] They also indicate anti-competitive effects are most likely to occur where a rebate is conditional on a retailer meeting certain targets.[13]

    b. The UK Competition and Markets Authority (**CMA**) has also adopted a clear approach to distinguish the two. In its view, "*rebates or discount schemes which pass cost savings from increased volumes on to a customer by offering the customer lower prices on further units*

[9] Relatedly, access providers often give reasons for refusing supply (capacity, technical, legal etc). In practice access seekers cannot assess if these are legitimate. The effect may the same as a constructive refusal. More guidance on this would assist.
[10] See, for example, Hovenkamp, Herbert J., "Predatory Pricing under the Areeda-Turner Test" (2015). *Faculty Scholarship at Penn Carey Law*. 1825.
https://scholarship.law.upenn.edu/faculty_scholarship/1825
[11] Department of Justice "*Justice Department Sues to Block Penguin Random House's Acquisition of Rival Publisher Simon & Schuster*" (2 November 2021): https://www.justice.gov/opa/pr/justicedepartment-sues-block-penguin-random-house-s-acquisition-rival-publisher-simon
[12] ACCC *Guidelines on misuse of market power* (August 2018): https://www.accc.gov.au/system/files/Updated%20Guidelines%20on%20Misuse%20of%20Market%20Power.pdf at [3.13].
[13] At [3.12].

once a particular volume has been purchased are, in general, unlikely to raise competition concerns even when they are offered by a dominant company".[14] However, "*certain rebates or discounts offered by a dominant company may be capable of restricting competition contrary to the Chapter II prohibition of the Act and/or Article 102 TFEU by having a loyalty-inducing or fidelity-building effect*".[15]

21. We **recommend** that the Guidelines are clarified to distinguish sufficiently between loyalty rebates and volume discounts.

Adding established case law regarding purpose

22. The section on purpose in the Guidelines does not include important, established case law on the meaning of "*purpose of substantially lessening of competition in a market*".

23. Glazebrook J in the Court of Appeal in *ANZCO* held "*the purpose that must be proved for ss 27 and 28* [ie under the SLC test] *is one that has, as an end in view, the substantial lessening of competition in a market. Where it is obvious that that could not be achieved if the provision or the covenant were implemented then, assessed objectively, the provision or the covenant cannot have that purpose"*.[16]

24. This was affirmed by the Court of Appeal in *Todd Pohokura*, which summarised the following principles on purpose under the SLC test:[17]

    (a) The test for assessing purpose is an objective one, but evidence of subjective purpose can be adduced and taken into account in assessing objective purpose.

    (b) Purpose is not the same as effect or likely effect. However, the purpose that must be proved for s 27 is one that has, as an end in view, the substantial lessening of competition in a market.

    (c) Where it is obvious that could not be achieved if the provision in question were implemented then, assessed objectively, the provision cannot have had that purpose.

    (d) There may be a role for subjective evidence of purpose. However, that would only be where such evidence exists, and it would be restricted to cases where it is "borderline" as to whether there might be an anti-competitive effect.

25. We note bare purpose can be difficult to reconcile with the Act's purpose of promoting competition. As stated by Glazebrook J "*In my view, the Commerce Act is designed to protect and promote competition. It regulates only those activities that threaten competition and is based on the premise that normally the market should be left to operate by itself. It would be inconsistent with such a philosophy to regulate wishful thinking that could in fact objectively have no anti-competitive effect. Where there is doubt, the market should be left alone.*".[18]

26. We **recommend** expanding the Guidelines to address the purpose element of the test.

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[14] Competition and Market Authority *Statement regarding the CMA's decision to close an investigation into a suspected breach of competition law in the pharmaceutical sector on the grounds of administrative priority (*CE/9855-14, 2015) at 2.
[15] Competition and Market Authority *Statement regarding the CMA's decision to close an investigation into a suspected breach of competition law in the pharmaceutical sector on the grounds of administrative priority (*CE/9855-14, 2015) at 2.
[16] *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA) at [257].
[17] *Todd Pohokura Ltd v Shell Exploration NZ Ltd* [2015] NZCA 71 at [256].
[18] *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA) at [262].

Positive statements on permitted conduct

27. We appreciate it is important for the Guidelines to highlight risk areas.

28. Equally the Guidelines should encourage vigorous competition for the long-term benefit of New Zealand consumers. The distinction between vigorous competition and anti-competitive unilateral conduct can often be unclear.

29. We commend the Guidelines for its clarity that section 36 "*does not prohibit a firm from charging high prices to end consumers*".

30. The ACCC Guidelines for example also include the following statements:

    a. "*Even if a firm has a substantial degree of market power, there is usually no obligation for it to deal with other firms.*"[19]

    b. "*Unconditional rebates, which simply reduce the price of an item with no additional conditions based on the retailer, likely only raise concerns of the reduce price amounts to predatory pricing.*"[20]

    c. "*The ACCC considers that the following conduct would not generally raise concerns: … c) responding to price competition with matching or more competitive (above cost) price offers d) responding efficiently to other forms of competition in the market such as product offerings and terms of supply*".[21]

31. We **recommend** including more statements on permissible or generally permissible conduct in the Guidelines to provide businesses greater clarity and encourage competitive conduct

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[19] Above, n 9, at [3.3].
[20] At [3.13].
[21] At [4.3].