NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION ON THE *REVIEW OF THE COMPETITION THRESHOLDS IN THE COMMERCE ACT 1986 AND RELATED ISSUES*

MAY 1999

EXECUTIVE SUMMARY

- The New Zealand Business Roundtable (NZBR) has consistently argued that the objective of the Commerce Act should be efficiency, with competition desired as a means towards achieving this end.

- We have supported moving to a single competition threshold test that would apply to trade practices and business acquisitions. Business acquisitions and trade practices are part of a continuum of possible contractual arrangements rather than distinctly different forms. They should therefore be subject to the same regulatory rules. Adoption of a single threshold avoids different treatment of economically equivalent behaviour. Rules that bias the choice of commercial arrangement (eg vertical integration versus contracting) are likely to reduce efficiency.

- The NZBR believes that the single threshold should be the acquisition or strengthening of dominance, or an equivalent threshold stated in terms of market power.

- The NZBR does not support the proposal in the *Review of the Competition Thresholds in the Commerce Act 1986 and Related Issues* (the Review), published by the Ministry of Commerce, to amend section 47 so as to reduce the acquisition threshold to a 'lessening of competition' test.

- The Review's proposed change is based on the possibility that tacit collusion might be a problem which is not captured by the current structural threshold in section 47 or by the behavioural restrictions in section 27. However, the Review provides little evidence that tacit collusion is actually causing, or is likely to cause, significant inefficiency in New Zealand's economy. On the other hand, the direct and indirect costs of lowering the merger threshold are likely to be significant.

- The Review proposes changing the dominance standard in section 36 to a standard of 'substantial market power'. We do not support this proposed

change. We agree, however, that the inefficiency that is the concern of antitrust policy is the exercise of market power. The NZBR therefore supports changing the definition of dominance in the Act to ensure that the courts interpret it in terms of market power. Because nearly all firms have some degree of market power, it is necessary to define what degree of market power a firm must have before antitrust concerns are raised. We support the 'high market power' test developed by early court decisions.

- We do not oppose the proposed amendments to the price control provisions of the Act on the basis that there should be scope to apply different forms of price control. However, for the reasons set out in our submission on the December 1998 paper 'Electricity Industry Reform: Discussion Paper on the Operation of the Specific Thresholds for Electricity Line Businesses', we do not believe that a case has been made for introducing price controls on electricity supply.

1 INTRODUCTION

This submission on the *Review of the Competition Thresholds in the Commerce Act 1986 and Related Issues* (the Review), published by the Ministry of Commerce, is made by the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The NZBR has taken a close interest in Commerce Act issues because of the Commerce Act's pervasive influence on commercial decision-making in New Zealand.

The Review's main focus is on whether the current thresholds in the Commerce Act (the Act) for mergers and acquisitions are adequate to deal with the potential harm resulting from "collusion either explicit or tacit".[1] The Review suggests that the current merger and acquisition thresholds are too low and proposes amending section 47 to prohibit business acquisitions that "would have the effect, or be likely to have the effect, of substantially lessening competition in a market for goods and services". The Review also considers the judicial interpretation of dominance, use and purpose in section 36, concluding that the judicial interpretations of dominance have established a threshold that is too high. It considers options such as amending the section 36 threshold to "substantial degree of power in a market" to reduce the threshold. Finally, it proposes amendments to the price control provisions of the Act.

This submission comments on the Review. Section 2 briefly discusses how the current discussion document fails to meet the standards of good regulatory practice promoted by the government. Section 3 outlines what the objectives of the Commerce Act should be. In section 4 we comment on the Review's proposed change to the merger thresholds (section 47). Section 5 reviews the effectiveness of the section of the Commerce Act which controls the abuse of a dominant position (section 36). Section 6 comments briefly on the suggested changes to the price control provisions of the Act. Conclusions are presented in section 7.

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1 Review, p 3.

2 INTRODUCTION OF REGULATORY CHANGE

In our view, the Review prepared by the Ministry of Commerce does not meet the standards of good regulatory practice that the government has laid down. A useful framework for assessing proposed regulation is provided by the Regulatory Impact Statement requirements.

The first requirement for any Regulatory Impact Statement is that it should contain "a statement of the nature and magnitude of the problem and the need for government action". We do not believe that the Review demonstrates that there is in fact a problem that is large enough to warrant the proposed intervention. The Review fails to establish that the alleged problem is real as opposed to hypothetical.

In our view, any benefits from the proposed changes are uncertain, yet the proposed measures will without doubt add costs and uncertainties for businesses. Most large companies already devote substantial resources to ensuring compliance with New Zealand's laws, including the Commerce Act. Any tightening of the Commerce Act requirements will increase compliance costs. More stringent provisions will further encourage company executives to be risk averse – to forgo opportunities and investments that risk breaching the Act.

The Review does not satisfy other aspects of the Regulatory Impact Statement framework, which requires that the potential problem be stated in a way that does not pre-justify the proposed remedies, that there be proper identification of all feasible options, and that a proper analysis be undertaken of the costs and benefits of the proposed action. Asserting that the benefits exceed the costs does not amount to a demonstration that this would indeed be the case.

We consider that the Ministry of Commerce has fallen well short of the standards that it has been promoting for the analysis of regulatory issues by public sector agencies. We believe the State Services Commission should investigate its performance in this regard.

3 COMMERCE ACT OBJECTIVES

The Commerce Act's objective is to promote competition in markets in New Zealand. Competition is desired not as an end in itself but as a mechanism to enhance economic efficiency.

The government undertook a review of the Commerce Act between 1991 and 1993. That review made a number of recommendations with which the NZBR agreed. Following the earlier review, Cabinet agreed to amend section 3A of the Act to emphasise the importance of economic efficiency. This would be a useful clarification of the Act. However, the NZBR's preference is to amend the long title of the Act to reflect the efficiency objective more explicitly. For example, the long title could read "An Act to achieve efficiency through promoting competition within markets in New Zealand". The current review does not seek to clarify the efficiency focus of the Act and we submit that it should do so.

4 SECTION 47 AMENDMENT

4.1 Introduction

The NZBR has sought a review of the thresholds since 1993, and welcomes the Review's discussion. However, we disagree with the Review's conclusions.

4.2 Criteria for determining Commerce Act thresholds

The Act uses thresholds to help eliminate from consideration those arrangements that are unlikely to create competition policy concerns. The thresholds should be set at a level that trades off the risk of allowing undesirable behaviour against the costs of administering the regime and the costs of deterring efficiency-enhancing behaviour.

The Review sets out three criteria to use in determining the Act's thresholds:[2]

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2 *Ibid*, p 12.

- they must capture for scrutiny those activities likely to impose efficiency losses;
- they must not deter or prevent efficiency-enhancing behaviour; and
- they must minimise uncertainty and the costs of administration, compliance and enforcement.

These are all desirable criteria. However, the Review does not explicitly recognise that trade-offs must be made between them. The lower the threshold, the greater the number of arrangements that must be scrutinised by the Commission, the greater the costs of administration, compliance and enforcement, and the more efficiency-enhancing behaviour that will be prevented by the Act.

To determine the appropriate level of the thresholds it is necessary to consider what is the appropriate focus of antitrust policy. In our view, antitrust policy should focus on the exercise of market power, since it is this that can result in a loss of efficiency. The loss of welfare results when consumers, in the face of monopoly prices, choose to buy substitute products that are more expensive to produce than the monopolist's product, or are of lower quality. For a given level of consumer satisfaction, resources are wasted (this is termed allocative inefficiency). The ability of a firm to impose these efficiency losses depends on its market power.

Market power is generally defined as the ability of a firm (or group of firms acting together) to raise prices above the competitive level by restricting output. However, most firms have some market power which they can exercise because they sell differentiated products and therefore face a downward-sloping demand curve. Firms that face declining marginal costs would meet the definition of having market power even if their prices were not covering average costs.[3]

Thus it is necessary to define when the exercise of market power creates antitrust concerns – that is, what degree of market power, if possessed and exercised by a firm, might create problems. Possible options include 'substantial market power' (the Australian test and one of the options proposed for section 36 in the discussion

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3 See Hay (1992), p 813.

document), 'high market power' or 'very high market power'. Deciding which of these options best describes when market power gives rise to antitrust concerns is a matter of judgment. If the standard is set too low, too many firms will be subject to the Act's restrictions. Behaviour that is not anti-competitive may be challenged, and compliance costs will be raised unnecessarily. If the standard is set too high, then anti-competitive behaviour will go unchallenged.

Our judgment is that a single threshold of high market power for trade practices, business acquisitions and the use of a dominant position provisions would best focus attention on those firms that cause the most concern while limiting the costs of the Act. High market power was the test developed by the courts using an economic interpretation of 'dominance' and was used by most practitioners prior to the decision of the Court of Appeal in *Telecom* v *Commerce Commission*[4] in 1992.

The very high market power test - arguably the standard that derives from a dictionary definition of dominance - is likely to set the standard too high. Such a standard is questionable given that it was not derived from sound economic analysis of the level of market power that might result in antitrust concerns.

A standard of 'substantial market power', which has been interpreted by the courts as falling short of a dominance test, appears likely to set the standard too low. Similarly, a 'lessening of competition' standard, if interpreted in terms of market power, is also likely to set the standard too low.

4.3 The section 47 threshold

Reducing the section 47 threshold to 'substantially lessening competition' will lead to an increase in the scrutiny of business acquisitions by the Commerce Commission. This will increase transaction costs and is likely to deter some firms from pursuing acquisition opportunities. Firms will face increased transaction-specific costs (in terms of Commission fees, legal expenses and managerial resources). They will face greater uncertainty as to the legality of proposed

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[4] (1992), 3 NZLR 429.

transactions. The likely result is a reduction in opportunities for growth and rationalisation through business acquisitions.

The current dominance threshold, or an equivalent threshold interpreted in terms of market power, is unlikely to impede most firms when developing their business strategies.

In contrast, many firms in relatively concentrated industries will need to consider carefully whether acquisitions will lead to a substantial lessening of competition. The impact of the threshold reduction is very difficult to measure but it could significantly reduce business acquisition activity. Given the importance of the threat and practice of takeover in ensuring that business assets are allocated to their most efficient use and that the costs of production are minimised, the negative effects on efficiency could be substantial.

The Business Acquisition Guidelines that have been developed for the existing Act have significantly reduced the uncertainties faced by business and their advisors in determining whether or not an acquisition might create competition problems. The Guidelines would need to be revised if a substantial lessening of competition threshold were adopted. Revised guidelines are likely to be much more complex, in part because the 'acquisition of dominance' test gives firms an absolute standard against which to assess potential acquisitions whereas the proposed lessening of competition threshold will provide only a relative standard. Firms will need to judge whether the level of competition in a market will decline substantially from the status quo situation.

The Australian Competition and Consumer Commission (the ACCC) guidelines based on a 'lessening of competition' standard provide firms with an extremely narrow safe harbour. The Commission does not examine mergers where:

- the merged firms have less than 40 percent market share; and

- the four largest firms have less than 75 percent market share;

- or where the four largest firms have more than 75 percent market share, the merged firms have less than 15 percent market share.

The tightened safe harbours will force most parties to seek authorisation before proceeding with a business acquisition, forgoing the substantial efficiency benefits that have been delivered by the voluntary notification regime.

The NZBR believes that the current Review does not adequately weight the increase in uncertainty and compliance costs that will result if the threshold is changed. The proposed amendment to section 47 will have far-reaching implications for economic activity in New Zealand. Reducing the threshold for acquisition approval from dominance to substantial lessening of competition will increase uncertainty regarding whether a merger will be approved, increase compliance costs associated with the Commerce Act, increase the scope for the Act itself to be used anti-competitively and – potentially most importantly – increase the risk that efficiency-enhancing merger activity will be deterred. Although difficult to quantify, these costs are likely to be substantial. They are additional to the Commerce Commission's administrative costs emphasised by the Review.

4.4 Analysis of the benefit of lowering the threshold

The benefit identified by the Review from changing the merger threshold is a perceived reduction in "joint dominance". The Review comments that:

> This focus [of the current framework] on single firm dominance ignores any potential harm that may result from joint dominance in a market. Consequently it prevents mergers being scrutinized in terms of whether the resultant market structure will be conducive to collusion, whether explicit or tacit.[5]

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5 *Ibid*, p 13.

However, in August 1998 a senior Ministry of Commerce official commented that:

> [M]y view is that we have a problem in principle but not in practice. The Commerce Commission's advice to the Ministry is that there are no examples of acquisitions that they consider should have been halted but could not because of the dominance test in section 47. This indicates that section 47 is either flexible enough to deal with oligopolistic mergers or that oligopolistic mergers have generally not been a problem in New Zealand to date. If the latter is the case then the extra monitoring and business compliance costs associated with broadening the scope of section 47 could not be justified unless anticompetitive acquisitions started to slip through the net.[6]

The Review correctly notes that tacit collusion can arise in some oligopolistic industries. However, it illogically concludes from this proposition that "tight oligopolistic industries can be expected to exhibit a tendency toward the maximisation of collective profits." The Review's first statement about the theoretical possibility of tacit collusion implies nothing about its likely frequency. In many industries, oligopolistic or not, a preferable strategy for all firms "might be to increase price where the drop in revenue from the lost sales is less than the total rise in revenue achieved through the price increase."[7] However, in all but the most unusual circumstances firms fail to achieve such actions because individual firms have incentives to deviate from coordinated outcomes.

The Review diverges markedly from the Ministry of Commerce's previous assessments of the importance of tacit collusion without explaining adequately the reasons for its change of mind. Our view is that the Review overstates the potential for tacit collusion to cause significant inefficiency.

Courts in other jurisdictions have had difficulty assessing *ex post* whether tacit collusion has occurred and, if so, whether it has resulted in significant inefficiency. The Commerce Commission and the New Zealand courts are likely to find it even

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6 Connor (1998), p 16.

7 Review, p 14.

more difficult to assess whether a change in market structure will be likely to result in a significant efficiency loss due to tacit collusion. As a consequence, if the threshold is lowered significant resources will be used in attempting to forecast firm behaviour under the proposed structure. Worse, because of the difficulty of correctly predicting firm behaviour, the Commission and the courts are almost certain to prevent some efficiency-enhancing transactions from proceeding.

In the rest of this section we comment first on the Review's summary of theoretical models of tacit collusion and then on its empirical evidence that tacit collusion is a problem.

Review's analysis of the conditions required for tacit collusion

In making a case for changing the Act's threshold to a substantial lessening of competition, the Review relies heavily on work by Douglas Greer. Greer is critical of the Act's focus on efficiency. He criticises the current regime because:

> Even mergers creating monopoly are allowed if it can be shown that … the merger's detriments will likely be outweighed by efficiencies.[8]'

Greer's research is based on the outdated 'structure-conduct-performance" framework, in which market power is equated with market share and the constraints imposed by the threat of entry are ignored. Greer's 1989 research monograph, "Market Dominance and Anticompetitive Effect under New Zealand's Merger Policy", downplays the potential efficiency gains from mergers and only grudgingly admits that tacit collusion need not occur in highly concentrated markets:

> It must be acknowledged that in certain instances the evidence reveals effective competition in markets occupied by only two or three firms. However, these instances are relatively rare. Hence they can usually be explained by unusual circumstances.

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8 Review, p 13.

Greer's conclusion on the likelihood of tacit collusion in highly concentrated markets is the opposite to that reached by most economists. The Review notes in paragraph 11 that "it has been known for a long time that under certain structural conditions coordinating firms have incentives to deviate". This is misleading. In the last 10 years economists have developed models of firm behaviour in which tacit collusion *may* persist. The conditions required for tacit collusion are much stronger than mere market concentration. A more accurate research summary would state that "firms may attempt to coordinate but except in very unusual circumstances they will face overwhelming incentives to deviate".

Oliver Williamson summarises the consensus view on "joint dominance" as follows:

> It is naive to regard oligopolists as shared monopolists in any comprehensive sense – especially if they have differentiated products, have different cost experiences, are differently situated with respect to the market in terms of size, and plainly lack a machinery by which oligopolistic co-ordination, except of the most primitive sort, is accomplished and enforced.
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> Except, therefore, in highly concentrated industries producing homogeneous products, with nontrivial barriers to entry, and at a mature stage of development, oligopolistic interdependence is unlikely to pose antitrust issues for which dissolution is an appropriate remedy. In the usual oligopoly situation, efforts to achieve collusion are unlikely to be successful or, if they are, will require sufficient explicit communication that normal remedies against price fixing, including injunctions not to collude, will suffice.[9]

More recent analysis that draws on game theory gives greater credence to the possibility of tacit collusion than was given to it in the preceding 10 to 20 years. However, Viscusi, Vernon and Harrington, in summarising current economic thinking on tacit collusion, support Williamson's statement, commenting:

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9 Williamson (1975), p 246.

> While some economists view oligopolistic markets (autos, steel, aluminium and others) with concern and urge new legislation to deconcentrate such industries, a majority of economists do not. One reason for this lack of concern is the belief that tacit collusion is unlikely to be effective except in very unusual situations.[10]

Review's analysis of empirical evidence

In this section we discuss the Review's analysis of empirical evidence of tacit collusion.

The Review notes that Greer (1989) "cites a number of studies that illustrate the occurrence of co-ordinated behaviour".[11] Greer claims that Gribbon and Utton (1986) found that from 1960 to 1981, 18 out of 21 "concentrated oligopoly" industries priced non-competitively. In fact, Gribbon and Utton acknowledge that they find little evidence of collusion:

> [E]ffective collusion between firms in most markets had not proved possible, even though about half the sample was taken from a selection of industries most prone to collusion and where it had been common prior to the 1956 Restrictive Practices Act.[12]

Gribbon and Utton's sample covers only cases that were examined by competition authorities. Their study did not attempt to measure the mark-up of price over marginal cost directly, since this is extremely difficult. Instead, Gribbon and Utton's analysis uses accounting profits, which bear little relationship to economic performance, to measure "excessive profitability". This is one of the most heavily criticised aspects of the 'structure-conduct-performance' framework.[13]

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10 Viscusi, Vernon and Harrington (1995), p 132.

11 Review, p 16.

12 Gribbon and Utton (1986), p 271.

13 See, for example, Fisher and McGowan (1983).

Gribbon and Utton used accounting profits to measure accounting return on capital, averaged over five years. These were then averaged over all firms in three groups selected by the authors. These averages were compared with the average profits of publicly listed manufacturing companies. These 'multipliers' formed the basis for the claim that 18 of 21 industries were "pricing non-competitively". The analysis ignored differences in systematic risk between companies which affect the cost of capital required under standard financial models such as the capital asset pricing model.

In addition to the flawed accounting-based analysis, Gribbon and Utton use an outdated concept of barriers to entry that has been thoroughly discredited by academics and regulatory authorities. For example, they describe 'technical barriers to entry' as "substantial economies of scale, production based vertical integration, and large capital requirements by then current standards". This is in contrast to the Commerce Commission's discussion of barriers to entry in its Business Acquisition Guidelines, which state that:

> [F]or the purpose of considering this issue [the effectiveness of the threat of new entry in constraining the conduct of market participants], a barrier to entry is best defined as an additional or significantly increased cost or disadvantage that a new entrant must bear as a condition of entry.[14]

The Review's account of tacit collusion in the United States is inaccurate. In paragraph 19 the Review uses the ready-to-eat cereals market as an example of tacit collusion in the United States. The Review claims that price leadership facilitated the joint movement by the three largest cereal manufacturers to higher prices. This is misleading. The Federal Trade Commission (FTC)'s case against the three firms was dismissed.[15] The FTC's case was based on a "shared monopoly" theory. Viscusi, Vernon and Harrington summarise the decision as follows:

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14 Commission, Guidelines, p 20.

15 In re Kellogg Company, Docket No. 8883, Federal Trade Commission, 1981.

> The FTC charged that the companies had engaged "in certain independent acts and practices in order to achieve a highly concentrated, non-competitive market structure and shared monopoly power". As an example one of these acts was called brand proliferation. By introducing some 150 brands between 1950 and 1970, the companies were alleged to have left "no room" for new entrants. The FTC judge, however, saw brand proliferation as "nothing more than the introduction of new brands, which is a legitimate means of competition … . There is no evidence of a conspiracy or intent to deter new entry by means of new product introductions".

After considering other aspects of the firms' behaviour and rejecting them as not being illegal, the judge dismissed the complaint. Thus, the cereal case is a poor example to support a claim that tacit collusion is a major problem.

The Review states that "the effect of such oligopolistic coordination is parallel behaviour, such as parallel price movement, that approaches the results associated with explicit agreement to set prices, output levels, or other conditions of trade."[16] However, mere parallel pricing alone is insufficient evidence of tacit collusion to be considered an offence under the Sherman Act in the United States. Jonathan Baker's article cited in the Review works through a hypothetical example of coordination in the electrical equipment industry:

> In the example, the focal rule for co-ordination involves preserving the relative price differentials in the existing price book. The example assumes that the firms have developed a method of deterring secret discounts by monitoring and policing deviation, so that the only remaining co-ordination problem is the identification of the terms of the agreement. Under such circumstances, mere price leadership – one firm announcing that it is increasing prices by five percent – would be sufficient for the firm to identify the terms of a co-ordinated arrangement by making them focal, and thereby solve the remaining co-ordination difficulty.

16 Review, p 14.

> Even if the other firms follow by matching the five percent price rise, no agreement will be found under Sherman Act section 1 even though the industry environment is, by assumption, conducive to co-ordination. With no additional plus factors, the observed behaviour would be deemed mere parallel conduct. As emphasised in a recent opinion of the First Circuit, "[o]ne does not need an agreement to bring about … [a] follow-the-leader effect in a concentrated industry.[17]

Overall, the evidence presented does not suggest that tacit collusion is of sufficient concern to justify the changes proposed.

New Zealand evidence

The Review claims that "there is some industry specific research that tends to suggest that tacit collusion may occur in some markets, at least in ones for homogenous products".[18] The NZBR agrees that it is conceivable that tacit collusion might occur from time to time in a limited number of situations. It is more likely in homogenous goods markets than differentiated product markets, and where barriers to entry are high. However, the report provides only one inconclusive example of possible collusion in New Zealand.

The example provided relates to the retail petrol market. The Review cites a New Zealand Institute for Economic Research (NZIER) study that the market for petrol in New Zealand was not a competitive one, resulting in harm to both consumer welfare and industry efficiency.[19] The NZIER's estimate of the deadweight loss caused by the alleged collusion is approximately $1 million per annum.[20]

The complaint against the four petrol retailers appears to be that they charged the same price and it was "too high". In the United States this would be inadequate to

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17 Baker (1993), p 187.

18 Review, p 15.

19 NZIER (1996).

20 *Ibid,* p 16.

prove an offence under the Sherman Act. Parallel pricing alone is insufficient evidence of collusion. In Australia, the law is summarised as follows:

> In certain industries, it is the likely result of industry structure that there will be an acknowledged "price leader" and that others will "follow" the leader's price. This can be a feature of market structure and similar prices may occur even though there is no "contract, arrangement or understanding" between competitors. Conscious parallelism is not condemned under competition policy. In certain markets, it occurs notwithstanding the fact that each competitor in the market makes his individual marketing decision. Indeed price leadership and conscious parallelism in some market circumstances may well be the inevitable consequence of particular cost or demand phenomena in light of industry structure and product characteristics.[21]

The oil company behaviour may well fall within the "inevitable consequence" category.

The findings of the NZIER have been challenged in a report commissioned by Mobil New Zealand Limited and prepared by Graham Scott of the Law and Economics Consulting Group (the Scott Report). The Scott Report provides detailed criticisms of the NZIER's methodology and conclusions.[22] Yet the Review makes no mention of this report.

The entry of two new petrol retailers last year, despite the barriers to entry created by the Resource Management Act 1991, suggests that new entrants will respond to profitable opportunities, constraining any market power that incumbents might have.

Even if there were evidence of abuse of market power by the oil companies, the joint use of the Marsden oil refinery makes this an atypical industry situation. It certainly does not justify imposing restrictions on other industries.

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21 Australian Trade Practices Reporter, 1998, pp 3-320.

22 Scott, (1997).

The distinction between conscious parallelism and tacit collusion is a fine one, as the Review notes.[23] The Review comments that no behavioural mechanism currently exists for addressing tacit collusion. It rejects amending section 27, noting that:

> … the major risk of making such an amendment is the negative impact that this would have on commercial activity and thus economic growth. Coordinated behaviour is not inevitable in oligopolistic markets … . Where it is observed, uniform conduct may reflect a set of identical business responses, by a group of similarly situated competitors, to the same economic conditions.

If this conclusion is true – and indeed it seems likely – then it will be even more difficult to determine whether a merger will lead to tacit collusion. Yet the Review supports lowering the thresholds so that such analysis could be undertaken.

The Review provides no analysis of how the proposed amendment might improve efficiency or even competition. Based on the weak evidence of a tacit collusion problem, the difficulties in identifying instances of tacit collusion and the increased uncertainty and compliance costs that would result from changing the threshold, a logical conclusion would be that the optimal strategy is to leave the Act as it stands. Instead, the Review proposes lowering the threshold so that the Commission can take account of the potential for tacit collusion when approving mergers.

The Review does not explain how the difficulties of identifying tacit collusion that have been discussed above will be avoided by changing the merger threshold. Instead of having a specific fact situation on which to focus, Commissioners will need to consider whether tacit collusion is already occurring, the likelihood of tacit collusion under the proposed structure, and whether the difference represents a substantial lessening of competition. The major risks of amending section 27 identified by the Review are therefore amplified, not reduced, by the proposal to amend section 47.

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23 Review, p 19.

4.5 The Review's analysis of the costs of the proposed amendment

The authors of the Review appear to have decided that the threshold should be lowered before they discuss the costs of doing so:[24]

> Although using a broader threshold is likely to be of net benefit to the economy, a broader threshold will impose some costs on the economy.

The most difficult-to-quantify cost of lowering the threshold, but probably the most important, is the increased uncertainty surrounding merger approval. Faced with the costs of seeking Commission approval and the risk that authorisation will be withheld, some efficiency-enhancing mergers are unlikely to proceed. The application fees of $2,250 and $22,500 for clearances and authorisation are small compared with the opportunity costs of managers' time and the direct costs of legal and economic advice.

Uncertainty is likely to persist under the lower threshold unless the Commission develops clear guidelines about acceptable industry structures. In the absence of an ability to forecast accurately the increased likelihood of tacit collusion, such guidelines will probably rely on market share. A number of efficiency-enhancing mergers which breach the market-share guidelines will be unlikely to receive a clearance. Changing the threshold to one of substantial lessening of competition is therefore likely to catch more mergers in the authorisation process than those few that raise a real prospect of tacit collusion.

5 AMENDMENTS TO SECTION 36

5.1 Proposed change to the definition of dominance in section 36

To contravene section 36 a party must have a *dominant* position in a market, which it *uses* for the *purpose* of restricting, preventing, deterring or eliminating competition.

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24 Review, p 34.

The Review considers each of these aspects of section 36, and proposes possible changes. These are considered below.

Definition of dominant position

The Review suggests that developments in case law have resulted in a threshold for dominance that is too high. Initially, the courts interpreted dominant position in terms of the economic concept of high market power. More recently, the courts have reverted to a 'dictionary' definition of dominance concluding that the threshold is higher than high market power.

The Review proposes that 'dominance' be redefined in terms of market power. The NZBR supports changing the definition of dominance in the Commerce Act to ensure that it is interpreted in terms of market power. This could be achieved either by stating in the Act that dominance is a measure of market power, or by stating thresholds in the Act explicitly in terms of market power. However, the Review's Option 2 proposes a threshold of "substantial market power", which is likely to be interpreted as less than "high market power". As mentioned in Section 3.1, we support a threshold of high market power because it is likely to focus attention on the firms causing legitimate concern without broadening the scope of efficiency-enhancing activity covered by the Act.

A high market power test may allow some consideration of tacit collusion. However, we do not think that the threshold should be further lowered to extend the application of section 36. Our discussion of tacit collusion in section 3.2 of this submission concluded that there was little, if any, evidence that tacit collusion was a significant problem in New Zealand except possibly in a few exceptional circumstances. Even if tacit collusion were possible in some markets, the extreme difficulty of distinguishing between illegal and legal behaviour cautions against an activist antitrust approach. Extending section 36 to cover tacit collusion would increase uncertainty for firms in concentrated markets; extend the scope for the Act to be used anti-competitively; increase the possibility that innocent behaviour was wrongly challenged; and increase compliance costs. Given these increased risks and the absence of evidence that collusion is a problem except in exceptional

circumstances, we conclude that section 36 should continue to focus on single firm behaviour.

We agree with the Review that the use of section 27 to address section 36 concerns is undesirable.

Use and Purpose

The Review does not provide a strong case for changing either the 'use' or 'purpose' tests in section 36 or extending the definition of these.

We agree with the Review that it would be undesirable to substitute an 'effects' test for the 'purpose' test. An effects test would condemn behaviour that was efficiency-enhancing (as in the example given where a dominant firm increased output to better achieve economies of scale). It would increase uncertainty for dominant firms; expose them to opportunistic action under the Act; and increase the risk that behaviour that was not anti-competitive was condemned.

Section 36 and monopoly pricing

The harm that antitrust policy seeks to prevent is the allocative efficiency loss that results from monopoly pricing. Section 36 only indirectly targets this concern by focusing attention on a dominant firm's anti-competitive behaviour. The Review raises the issue of whether monopoly pricing should be directly targeted in section 36.

The Review concludes that monopoly pricing should not be proscribed in section 36 because that would impose on the courts a regulatory role that they are ill-suited to perform. We concur with this conclusion.

6 AMENDMENTS TO PRICE CONTROL PROVISIONS

6.1 Different price control approaches and Commerce Commission advice

The NZBR is not opposed to amending the price control provisions to allow for different price control approaches.

However, we are conscious of the substantial efficiency costs likely to be imposed by the imposition of price controls, and the difficulty of removing them once they are first imposed. This concern might be met by including in the price control provisions a sunset clause that would apply to any controls that are introduced.

We are happy for the Act to allow the minister to obtain advice from the Commerce Commission on the thresholds or criteria for the application of price control.

Redundancy of section 73 (a) and (b)

We support the removal of the redundant sections 73(a) and (b) from the Act.

Right of appeal

We do not think that the discussion document makes any case for changing the right of appeal as to the Commission's price control calculations and methodology.

Penalties

We do not think that the Ministry of Commerce has established that penalties under the Act are not adequate for price control or for other parts of the Act. We disagree with the proposed amendments to the Act relating to penalties that were announced in February 1999 for the reasons set out in our submission of March 1998 on the Ministry's discussion paper *Penalties, Remedies and Court Processes under the Commerce Act.*

7 CONCLUSIONS

The NZBR supports rationalisation of the thresholds in the Act to a single standard of 'dominance' (with a statement in the Act that dominance should be interpreted in terms of the economic concept of market power). Alternatively, the threshold for mergers, restrictive trade practices and monopolisation should be "high market power".

The NZBR does not consider that the Review presents a strong case for lowering the section 47 threshold. The Review has failed to identify the existence of significant inefficiency due to tacit collusion. The proposed remedy would have far-reaching effects. Uncertainty and compliance costs for firms would be significant. The difficulty of predicting whether tacit collusion may develop may lead the Commission to increase its reliance on naive concentration measures. The Commission has not identified any acquisition which should not have been approved but fell within the existing threshold.

We do not believe that the Review provides a strong case for changing either the 'use' or 'purpose' tests in section 36. However, we believe that the section 36 threshold of dominance should be interpreted in terms of market power and that 'high market power' best describes the level of market power likely to create competition concerns. The NZBR does not oppose the proposed changes to the price control provisions of the Act, other than the increased penalties and right of appeal provisions.

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