

# COMPETITION ALERT

## APRIL 2007

### THE REGULATOR RELEASED

*This Alert considers some of the key proposals in the Ministry of Economic Development's Discussion Document on its review of the regulatory control parts of the Commerce Act.*

The Ministry of Economic Development's ("MED") recent *Discussion Document*<sup>1</sup> reviewing the regulatory control provisions in the Commerce Act 1986 ("Act")<sup>2</sup> proposes to arm the Commerce Commission ("Commission") with a suite of new powers for regulating businesses and sectors with "natural monopoly" characteristics. However, at their widest, some of the MED's proposals would also extend beyond natural monopolies to subject pricing and profitability of many other businesses to regulatory scrutiny.

#### "Light-handed" regulation with broader reach

The MED proposes introducing more "light-handed" regulation options as an alternative to the existing single "heavy-handed" option of regulatory control. However, the MED then suggests that, because these light-handed options will not involve the same costs of regulation as regulatory control, there is no need for the statutory scheme to be so restrictive when it imposes these regulatory options.

At present, regulation (other than for electricity lines businesses) only occurs where:

- (a) competition is limited or likely to be lessened;
- (b) it is necessary or desirable to control the goods or services, in the interests of acquirers or suppliers; and
- (c) the Minister then agrees to make an order declaring control.

Criterion (b) involves an intensive cost/benefit analysis of the desirability of imposing control, which can take a considerable period of time to complete. Importantly, the Commission currently analyses each business within a sector individually before imposing control.

The *Discussion Document* proposes that:

- (a) the "competition" text in criterion (a) be amended; and
- (b) the cost/benefit analysis criterion be reduced to a qualitative analysis for "light-handed" regulatory options.

One of the competition tests proposed for criterion (a) is the "substantial degree of market power" test – the test currently found in s 36 of the Act (relating to taking advantage of market power for an anti-competitive purpose).

As a result, among the MED's current proposals is a suggestion that the Commission can recommend light-handed regulation of any firm with a substantial degree of market power without undertaking the current detailed quantitative analysis of the costs and benefits of regulating.

The rationale in the *Discussion Document* for the rigour of the cost/benefit analysis is the assertion that the "substantial degree of market power" test is "tougher" than the current test. No analysis is presented to support this assertion. There is very little New Zealand case

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1. <http://www.beehive.govt.nz/Documents/Files/final-discussion-document.pdf>.

2. A discussion document about the other part of the MED's Parts 4, 4A and 5 review, on the clearance and authorisation processes for business acquisitions and restrictive trade practices, is due for release next month.

*[A]mong the MED's current proposals is a suggestion that the Commission can recommend light-handed regulation of any firm with a substantial degree of market power without undertaking the current detailed quantitative analysis of the costs and benefits of regulating.*

*If "substantial degree of market power" becomes the relevant threshold for regulation, it seems likely not only to add to regulatory uncertainty, but also potentially to catch a number of firms that may have a high market share but, not being natural monopolies, are highly unlikely to be subject to regulation under the existing law.*

law on how to determine whether a firm meets the threshold of "a substantial degree of market power" in s 36 (most s 36 cases have involved clear monopolies rather than borderline cases). However, an Australian Federal Court decision<sup>3</sup> (overturned on appeal) put it as low as a 15% market share, due to lack of material market constraints. If "substantial degree of market power" becomes the relevant threshold for regulation, it seems likely not only to add to regulatory uncertainty, but also potentially to catch a number of firms that may have a high market share but, not being natural monopolies, are highly unlikely to be subject to regulation under the existing law (except to the extent they may use their position of market power with an anti-competitive purpose).

As an alternative competition test, the MED is considering a "little or no competition or prospect of competition in the relevant market" test. Quite what this concept means is also unclear, and, accordingly, also involves regulatory uncertainty without the backdrop of Australian precedents to draw on.

### What are the new light-handed regulatory options?

One is an information disclosure regime. The rationale for this form of regulation is that, if firms are forced to disclose revenues and costs, and therefore profit margins, they are less likely to price so as to earn monopolistic (super-normal) profits.

The other form of light-handed regulation proposed involves a negotiation/arbitration regime in which suppliers and customers can refer pricing disputes to an arbitrator, who will make a determination on the price that should be charged (similar to the old union "award" system). It is suggested that the Commission be given the power to develop the principles for implementing such a negotiation/arbitration regime (including pricing principles). Depending on how this is developed, it could amount to de facto price control and a departure from free market prices.

### Sector-wide regulation

A second key recommendation is the proposal to allow for "sector-wide" regulatory regimes where a sector exhibits "natural monopoly" characteristics. The power to impose sector wide regimes includes the power to subject an entire sector to regulatory control or a threshold-style regime, using a generic benchmarking analysis of the sector, rather than undertaking a detailed analysis of each business within that sector.

### Other proposals

Other proposals in the discussion document include:

- (a) creating a generic purpose statement for the regulatory control parts of the Act that regulate businesses with "natural monopoly" characteristics, to include reference to maintaining incentives to invest;
- (b) allowing merits review (rather than just judicial review) of certain decisions;
- (c) placing some legislative process around the setting of key inputs into regulatory control decisions (such as setting the formula for determining a firm's cost of capital); and
- (d) where regulatory control is contemplated, the form of control to be imposed should be considered at the same time as the decision as to whether control should be imposed.

### Submissions

There are a number of potentially wide-reaching consequences of the MED's current proposals.

If you are potentially affected, we recommend you contribute to the MED's consultation process. If you are uncertain as to whether or how these proposals may affect your business, please contact one of the contributors below.

Submissions on the *Discussion Document* close on **Friday 6 July 2007**.

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3. *ACCC v Universal Music Australia Pty Ltd* (2002) ATPR 41-855, [2001] FCA 1800.