



New Zealand Law Society

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Parts 4 and 4A of the Commerce Act

The Society's Commercial and Business Law Committee (the Committee) appreciates the opportunity to comment on the papers of the Cabinet Economic Development Committee on the reviews of Parts 4 and 4A of the Commerce Act. Reference to the Committee submissions is reference to the Committee submission dated 9 July 2007 (copy attached).

Criteria for when control may be imposed

The test for when control may be imposed outlined in Appendix B is substantially different to that proposed in the April 2007 Ministry of Economic Development (MED) discussion paper *Review of Regulatory Control Provisions under the Commerce Act 1986* (the Discussion Paper). The first part is as follows:

“1. *Goods or services in a market may be subject to regulation where:*

- *There is little or no competition and prospect of competition and there is substantial scope for the exercise of market power, taking into account the effectiveness of existing regulations or arrangements (including ownership arrangements);*
- *the benefits of regulation in meeting the objectives of the purpose statement clearly exceed the costs and risks of regulation.”*

The first limb combines the two options for the “competition test” presented in the Discussion Paper (ie limited competition or exercise of market power). The Commerce Commission, in its submission, supported reference to market power as being consistent with section 36.

However, it is not clear that the reference to substantial scope for market power (taking into account the effectiveness of existing regulations or arrangements) helps this limb of the test. If anything, it makes it more difficult and confusing to apply.

It is also inconsistent with the proposed purpose statement, which states that regulation is to be used when “*there is little or no competition and the prospect of little or no future competition*” (ie it does not refer to market power).

The Discussion Paper made a proposal to include an economic efficiency and net acquirer's benefit test. The second limb of the test in Appendix B builds on this by requiring a cost/benefit analysis with reference to all four outcomes in the purpose statement. This was proposed by the Commission, with the belief that including reference to only two competitive outcomes was "awkward".

The result is that when analysing whether control may be imposed, the Commission will need to consider whether regulation promotes:

1. incentives to invest;
2. incentives to improve efficiency;
3. sharing the benefits of efficiency gains with consumers, including through lower prices; and
4. limits on the ability to extract excessive profits.

It appears that analysis under the second limb would be the appropriate point to consider whether a substantial degree of market power can be exercised, together with any other matter relevant to the cost/benefit analysis. Similarly, this would include assessment of whether existing regulation or ownership arrangements act to prevent the exercise of market power.

The Committee submitted that benefits should "substantially" exceed costs under the cost/benefit test, but Appendix B has opted for the word "*clearly*". Given that the cost/benefit analysis is now more comprehensive than proposed in the Discussion Paper, and the Commission is required to undertake qualitative analysis, it is not clear that qualifying the test by use of the words "*substantially*" or "*clearly*" is necessary. They are difficult concepts to quantify under an already difficult test. The key issue is whether the benefits of regulation exceed costs.

Therefore, to provide legislative clarity and a more workable test in practice, the proposed test should be simplified as follows:

Goods or services in a market may be subject to regulation where:

- *there is little or no competition and prospect of competition in the market; and*
- *the benefits of regulation in promoting the outcomes sought under the purpose statement exceed the costs and risks of regulation.*

The Commission will also be required to undertake a qualitative analysis, as follows:

- “2. *In providing recommendations to the Minister, the Commission should undertake a qualitative analysis of all material long-term efficiency and distributional considerations.*

As part of this analysis, the Commission, should, as far as possible and practicable:

- a. quantify material effects on market efficiency;*

- b. *quantify material distributional and welfare consequences on suppliers and consumers;*
 - c. *assess the direct and indirect costs and risks of the forms of regulation considered, including administrative and compliance costs, transaction cost, and spill-over effects.*
3. *Any regulation should be the least intrusive necessary to meet the objectives of the purpose statement.....”*

Ultimately, this will leave the decision-makers with a great deal of discretion, both in terms of reaching a conclusion whether any particular form of regulation may be imposed, and whether it should be imposed. Nevertheless, the tests as proposed appear to strike a good balance between the favoured approaches of industry participants and the Commission, as submitted to MED. In particular, it is consistent with the Committee's submission that the test must strike a balance between:

1. Benefits of intervention and cost of doing so; and
2. Efficiency and other components that need to be taken into consideration in the decision to impose control.

Input methodologies

The Committee submitted that it does not matter whether the Minister or Commission formalises the input methodologies, *“as long as the consultation process for setting the input methodologies is robust, and submitters’ views are appropriately taken into account”*.

It is not apparent from Appendix B that the Commission will be required to consult and take into account submissions when establishing input methodologies. Appendix B states that the Commission may make amendments to input methodologies but *“must follow the processes specified above before setting the amended input methodology”*. It is not clear what that specified process is. The only express requirement is for the Commission to consult with interested parties every seven years, following initial promulgation of methodologies, on whether amendments are required.

The failure to refer expressly to a consultation process for input methodologies is likely an oversight, given that the Cabinet Paper on the regulatory regime for airports states that *“input methodologies developed by the Commission would be subject to industry consultation and merits review”*. Nevertheless, given the importance of input methodologies, clarity is required.

It is also not clear from Appendix B how the methodologies will be published. Consistent with other provisions in the Act, there should be a requirement for input methodologies to be notified in the Gazette.

Clarity is required in the consultation process for establishing input methodologies. In particular, it is important that the Commission is required to take submitters' views into account. Further, input methodologies should be published in the Gazette.

The Committee trusts that these comments are of assistance. If you have any further queries please contact the committee secretary Sarah Barker, by email sarah.barker@lawyers.org.nz or phone (04) 463 2967.

Yours sincerely

A handwritten signature in black ink, appearing to read "John Horner". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

John Horner
Convener, Commercial and Business Law Committee