

27 April 2021

**Submission to the Economic Development, Science and Innovation
Committee on the Commerce Amendment Bill**

- 1) The main change proposed in this Bill is the introduction of an 'effects test' in s.36 of the Commerce Act 1986. This is long overdue. Evidence of the ineffectiveness of the existing 'purpose test' has been accumulating for two decades now, and moving to an effects test is the absolute minimum change required to rescue s.36 from the dustbin of history. Hence I strongly support this particular change, and nothing in the remainder of this submission should be read as qualifying that support.
- 2) In proposing only this single change along with some minor tweaks elsewhere, while leaving untouched the overall scheme of the Commerce Act 1986, Parliament would be missing an important opportunity to bring New Zealand's antitrust legislation up to speed with unfolding developments in antitrust both here and overseas. The Act as it stands embodies several discredited doctrines of the Chicago School of competition law in the USA – in particular the unqualified adoption of "competition" as the sole means of promoting "long-term benefit of consumers" – a phrase which itself is virtually empty of real meaning if one's concern is actually the wellbeing of consumers within their lifetimes.
- 3) The MBIE disclosure statement¹ explains the proposed change thus: "this prohibition seeks to prevent firms with market power from harming the competitive process by maintaining or extending their market power in a way that limits the ability of other firms to compete, and in turn reduces the benefits to consumers and the economy associated with competition." By thus treating "the competitive process" as the sole possible victim of anticompetitive conduct, with reduced "benefit to consumers and the economy" as merely collateral damage, and with no reference to predatory conduct that leaves the competitive process intact while damaging the wider economy, the Bill perpetuates a myopic and excessively narrow frame of reference for antitrust.
- 4) One of the ways Government can protect the interests of actual consumers in the here-and-now would be to lean strongly against the tide of monopolistic and monopsonistic conduct that has been running across Western capitalist economies since the 1980s. This requires more than paying lip-service to the supposedly cure-all properties of competition in markets. What is required is some crisp, unequivocal legal text that courts and regulators can use to check abuses of market power.
- 5) I attach as an appendix to this submission an article that I published in the August 2020 issue of *Policy Quarterly* entitled "Why the Commerce Act 1986 is unfit for purpose"

¹ <http://disclosure.legislation.govt.nz/bill/government/2021/9> p.1.

in which I develop some criticisms of the Act as it stands, and point to some of the provisions in the Commerce Act 1975 that were (unwisely I suggest) dropped overboard when the present Act was passed to replace it. In particular

- a. The 1986 Act overrode the common law in relation to the pricing of essential facilities².
 - b. It originally imposed no explicit prohibition whatever on the taking of monopoly profits; then an amendment 2008 stating (for the first time) the “purpose” of Part IV only made matters worse, by writing into law that “excess profits” were to be only “limited”, not eliminated, by regulation. (That a monopolist’s profit is always limited by the extent of the market is elementary economics; “limitation” is completely different from restraint or prohibition, which ought properly to be the goal of Part IV.)
 - c. Regarding application of the public benefit test in mergers and applications for exemption, the Act continues to leave unchecked the neoliberal notion that transfers of wealth from poor to rich, or from consumers to producers, are of no concern so long as the transfers are within the New Zealand community
- 6) Given the failure of the Commerce Commission’s prevailing benefit test to rule out activities that worsen the distribution of income and/or wealth, it appears to me that Clause 19 of the Bill, opening the way for the Commerce Commission to authorise anti-competitive conduct that would otherwise fall foul of the amended s.36, should be either dropped or heavily amended to restrain the Commission from authorising conduct that contributes to New Zealand’s already deplorable record of worsening wealth inequality. The MBIE disclosure statement’s explanation that “the Commerce Commission is ... empowered to grant authorisation for conduct to which section 36 would or might apply if that conduct is in the public interest” leaves unresolved the definition of where the “public interest” lies, thereby leaving untouched the failure of past Commission deliberations to take full account of distributional consequences. At the very least there should be a requirement for any applicant for exemption under the proposed new S.58(5) to demonstrate that no adverse distributional consequences are likely to flow from authorised conduct.
- 7) The Committee should not assume that simply bringing s.36 into line with Australian legislation will solve the problem of the loopholes opened for monopolists by past application of the “purpose” test. A series of court decisions have laid down important precedents that judges may be reluctant to drop overboard simply in response to a change in the precise wording of the Act. In particular the so-called “counterfactual

² See the Court of Appeal judgment *Vector Ltd v Transpower New Zealand Ltd* - [1999] 3 NZLR 646 paragraphs 51-54 and 59-66, especially paragraph 59: “we are satisfied that there is no room for the operation of the common law doctrine in relation to the transmission of bulk electricity by Transpower to Vector. It is precluded by the effect of the Commerce Act and that is reinforced by the effect of the State-Owned Enterprises Act.”

test” could well be carried over into legal rulings under the amended s.36, in judging whether an alleged “effect” is in fact an effect to which s.36 applies.

- 8) In short, in my submission it would be a pity if Parliament does not seize this opportunity to change the basic scheme of the Commerce Act. Under this Bill the Act’s purpose statement remains a neoliberal hymn of praise to competition; the legitimisation of monopoly profit in s.52A(1)(d) is untouched; the intricate but inadequate Part 4 regulatory formulae stay unchanged; and the suppression of the common law continues (“swept under the mat” as the Appeal Court said in *Transpower v Vector*). The Committee would do well to review the current moves of the Biden administration in the USA towards a new era in antitrust, and to ensure that the New Zealand officials providing advice on this Bill are familiar with the recent literature in law³ and economics⁴.



Geoff Bertram
Senior Associate
Institute for Governance and Policy Studies
Victoria University of Wellington

³ E.g. H. Hovenkamp and F.S. Morton (2020) “Framing the Chicago School of antitrust analysis”, *University of Pennsylvania Law Review* 168(7): 1843-1878, June; L. Khan, (2018) “The New Brandeis Movement: America’s Antimonopoly Debate”, *Journal of European Competition Law and Practice* 9(3): 131-132; and J.B. Baker (2019) *The Antitrust Paradigm: restoring a competitive economy*, Cambridge, Mass: Harvard University Press

⁴ E.g. M. Glick, M. and G.A., Lozada (2021) *The erroneous foundations of Law and Economics*, Working Paper 149, New York: Institute for New Economic Thinking, https://www.ineteconomics.org/uploads/papers/WP_149-Glick-and-Lozada.pdf .

Why the Commerce Act 1986 is unfit for purpose

Abstract

New Zealand's Commerce Act 1986 overturned both common law consumer protections and previous legislation that had spelled out procedures for identifying and sanctioning the abuse of market power. Inspired by Chicago School doctrines and an anti-state philosophy, the legislation opened the way for three decades of monopoly profiteering, exploitation of the weakest consumer groups and anti-competitive conduct, while regulation has been absent or ineffective. In this article, key weaknesses in the 1986 legislation are examined, and some remedies suggested.

Keywords regulation, antitrust, market power, anti-competitive conduct, consumer surplus standard

As New Zealand's experiment with deregulation enters its fourth decade, documented cases of regulatory failure abound: leaky homes (Dyer, 2019), Pike River (Macfie, 2013; Royal Commission on the Pike River Coal Mine Tragedy, 2012), electricity excess profits (Bertram and Twaddle, 2005; Poletti, 2018; Wolak, 2009), finance company collapses (Lee, 2019), workplace

injuries and deaths (Armstrong, 2014). A common theme running through these failures is that the weakening of regulatory legal requirements in the 1980s and 1990s, under the rubric 'light-handed regulation', was accompanied by a hollowing-out of the public sector's regulatory capability. That was never a necessary combination.

One can imagine a strong state staying its regulatory hand, yet managing to deter abuses

of market power by the credible threat of firm regulatory action. But the particular ideological programme that drove New Zealand's deregulation was motivated as much by a quest to weaken the state as it was by a quest to reduce formal regulatory restraints on big business. That pairing of light-handed regulation and a radically weakened state was and is a recipe for regulatory failure. Experience with New Zealand's Commerce Act 1986 provides a good case study.

Background theory of the state

Writing in 1651, Thomas Hobbes argued the inescapable need for some governing authority to exercise sovereign power to restrain the predatory 'natural passions' of humankind:

the Lawes of Nature (*as Justice, Equity, Modesty, Mercy, and (in summe) doing to others, as wee would be done to,*) of themselves, without the terrour of some Power, to cause them to be observed, are contrary to our natural passions, that carry us to Partiality, Pride, Revenge and the like. And *Covenants, without the Sword, are but Words, and of no strength to secure a man at all.* (Hobbes, 1657, part II, ch.17, pp.223–4, latter emphasis added)

Hobbes, therefore, argued for a strong sovereign authority to establish and enforce rules to restrain unbridled greed and self-aggrandisement, and to impose norms of civilised behaviour. Economic historians such as North (1990, 1991) similarly emphasise the importance of strong, well-designed ‘rules of the game’ for the historical development of markets under the shelter of constructed institutions, such as property rights and sanctity of contract. The first of these means that some individual or group holds a legitimate exclusive claim over certain resources and the ability to gain from utilisation or sale of those resources. The second means that promises can be made and kept with certainty as to the outcome. Modern capitalism could not have developed without these basic legal and institutional pillars.

But, while necessary, rights of property and contract on their own could never suffice to secure Hobbes’s ‘justice, equity, modesty, mercy’. Other restraints on human greed, backed by credible enforcement, are equally needed. A century after Hobbes, alongside his argument that competitive markets could in principle harness human self-interest to serve the common good, Adam Smith recognised the need for a ‘statesman’ to implement a set of ‘duties of the sovereign’. Those duties included ‘administration of justice’ – ‘the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it’ (Smith, 1776, book IV, ch.ix). That meant an effective prohibition on the use of either political influence or outright coercion to secure economic benefit for a favoured group at the expense of the general population, and the means to enforce that prohibition (Rosenberg, 1960, p.559).

The Golden Rule – Hobbes’s ‘doing to others as we would be done to’ – is the basis for Rawls’ use of the conceptual device of a ‘veil of ignorance’ that strips all the particular powers, assets and attributes that any individual actually possesses, and then asks them to choose amongst possible social arrangements (Rawls, 1971). Rawls argues that placed in that position, the rational individual will opt to insure against the worst possible outcome, and hence will choose the institutions that best protect the most vulnerable, weakest members of society.

My central proposition in this article is that, if forced to undertake Rawls’ ‘veil of ignorance’ experiment, no rational person would choose the regulatory arrangements that were established in New Zealand during the 1980s and 1990s.

Three central elements in the Commerce Act 1986 are: (1) tolerance of monopolistic price-gouging; (2) an idealised notion of competition that leaves the victims of anti-competitive conduct without remedy; and (3) absence of concern about wealth transfers arising from the exercise of market power, whether from consumers to producers or from small firms to large ones. The next three sections consider how the act deals with these three big issues.

... protection of buyers of the service against price-gouging; recognition that the owner of the monopoly facility is entitled to recover their reasonable costs of operation, maintenance and repair (but no more) ...

Regulating monopolistic price-gouging

Protection of the weak against predation by the strong was a central theme in the English common law as codified by a contemporary of Hobbes, Lord Chief Justice Sir Matthew Hale. In a work entitled ‘De Portibus Maris’, Hale set out what has since been known as the ‘doctrine of prime necessity’ or ‘essential facilities doctrine’, in a clear example of a situation in which the power of the state ought to be used to check the behaviour of a monopolist.

In Hale’s port example, the owner of the only wharf and crane in a port that is relied on by many users to undertake their trading business is legally constrained to charge only reasonable rates for use of the facility, because it is ‘affected with a public purpose’. Hale puts it thus:

There cannot be taken arbitrary and excessive duties for cranage, wharfage, pesage &c., neither can they be enhanced to an immoderate rate, but the duties

must be reasonable and moderate ... For now the wharf and crane and other conveniences are affected with a public interest, and they cease to be *juris private* only ... But in that case the king may limit by his charter and license him [the wharf owner] to take reasonable tolls, though it be a new port or wharf, and made public; because he is to be at the charge to maintain and repair it, and find those conveniences that are fit for it, as cranes and weights. (Hale, 1787, pp.77–8)

There are three clear and distinct elements here: protection of buyers of the service against price-gouging; recognition that the owner of the monopoly facility is entitled to recover their reasonable costs

of operation, maintenance and repair (but no more); and protection of the process of competition by ensuring open access to all comers on equal terms. This section looks at the first two of these. The next section takes up the third.

In the United States, under the 1890 Sherman Act and the 1914 Clayton Act, regulation to limit essential facility pricing to reasonable levels was the subject of extensive litigation, culminating in a 1944 Supreme Court ruling on the crucial issue of how a monopoly firm’s fixed assets should be valued in calculating its reasonable costs (*Federal Power Commission v. Hope Natural Gas Co* 320 U.S. 591; Troxel, 1947, chs 10–17). Central to the *Hope* decision was the proposition that regulated utility rates should be set on the basis of the historic cost of prudently incurred investment. Investors in a monopoly business had the right to receive a ‘return on and of’ what they actually spent to set up the business, but no more. The resulting

pricing formula corresponds to Adam Smith's 'natural price' (Smith, 1976, book I, ch.7) and Alfred Marshall's 'normal price' (Marshall, 1936, book V, ch.3, section 4).

In New Zealand prior to 1986, this principle was built into the law on price-gouging. Section 54 of the Commerce Act 1975 commenced with the provision: '(1) Every person commits an offence against this Act who whether as principal or agent, and whether by himself or his agent, sells or agrees or offers to sell any goods or services at a price which is unreasonably high.' The section then went on to lay out in detail the procedures to be followed by a court in assessing when a price was unreasonably high.

... since 1986, any decision to regulate a profiteering monopolist has to be a political, not a judicial, one, made by the minister of the day ...

Echoing the US Supreme Court's *Hope* ruling, the standard basis for price setting by courts and tribunals administering New Zealand's Positive List of controlled private sector prices under the Commerce Act 1975 was recovery of operating costs, plus anything up to and including a fair return on and of the capital expenditure actually undertaken to install fixed assets ('original' or 'historic' cost). That upper limit on prices applied also to publicly owned monopoly utilities such as the New Zealand Electricity Division, the regional electricity supply authorities, the harbour boards, airport authorities, and the New Zealand Post Office as owner of the telecommunications system. (The difference between regulated private businesses and those state-owned utilities was that the latter opted not to recover a full commercial return on the historic cost of their fixed assets, in order to hold down the price of what were in those days considered essential services.)

In 1986, at the same time as the state-owned utilities were pushed towards profit-driven corporatisation and privatisation, the old legislation with its clear focus on consumer protection was repealed by the

Commerce Act 1986. The 1986 act made monopoly profiteering (price-gouging) legal except where the minister of commerce takes a political decision to regulate prices by means of an order in council under part IV. In doing so, it stripped away the common law right of redress for victims of price-gouging.

The Commerce Commission, referring to the profits of electricity generators, has crisply summed up the position: 'The exercise of market power to earn market power rents is not ... a contravention of the Commerce Act, but is a lawful, rational exploitation of the ability and incentives available to the generators' (Commerce Commission, 2009, p.6, para ii). The

commission's website is equally clear: 'Charging high prices to consumers is not illegal under section 36 of the Commerce Act' (Commerce Commission, 2019).

Two centuries of common law protection against profiteering were 'ousted' by the 1986 act. The 'doctrine of prime necessity' (or 'essential facilities doctrine'), derived from Hale, previously enabled the courts to determine the reasonableness of charges by the monopolist owner of an essential infrastructure facility, without access to which other parties could not operate. But the decision of the Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 established that the Commerce Act 1986 had removed this protection for parties seeking access to telecommunication networks.

Subsequent decisions of the *Court of Appeal*, in *Vector Ltd v Transpower New Zealand Ltd* [1999] 3 NZLR 646, *Metrowater v Gladwin* (2000) 6 NZBLC 102 and *Pacifica Shipping Ltd v Centreport Ltd* [2003] 1 NZLR 433, made this clear equally for the case of electricity transmission lines, water pipelines and wharf charges respectively. As Justice Tipping said in

delivering the Court of Appeal's decision in *Pacifica Shipping Ltd v Centreport Ltd*:

the doctrine of prime necessity was excluded by the Commerce Act. This conclusion was held to be reinforced by the State-Owned Enterprises Act 1986. The reason the doctrine is excluded is that the only price control available under current New Zealand law is that provided for in Part IV of the Commerce Act, and such control is available only when the conditions set out in Part IV are satisfied. (para 15)

Thus, since 1986, any decision to regulate a profiteering monopolist has to be a political, not a judicial, one, made by the minister of the day, subject to lobbying financed by the monopoly profits of the big business interests threatened with regulation. Even the decision to investigate, as distinct from regulate, was stripped from the Commerce Commission in 1986 and was not restored until October 2018 when a new part 3A was added to the Commerce Act, over vocal opposition from ACT (Seymour, 2018).

The 1986 act, in short, shifted the job of identifying and checking monopoly abuse from courts and tribunals to the minister of commerce. Procedures are informal, rules of evidence are not applied, and officials and the minister are subjected to intense lobbying away from either public gaze or the discipline of a judicial forum. It's easy to get the impression that the regulatory machinery in part IV of the Commerce Act was set up to fail as a credible deterrent to abuse of market power.

As of mid-2020, just four industries have their prices regulated under part IV: electricity networks, gas pipelines, telecommunications networks and (less directly) airports. The regulatory proceedings are complex and highly technical, which renders them largely inaccessible to outsiders. The principled simplicity of Adam Smith's natural price, and the *Hope* principle of allowing no more than fair return on and of the original cost of fixed assets, lie buried under a mountain of submissions, litigation, impenetrable spreadsheets and arbitrary asset valuations.

In the case of electricity networks, the weakest consumers – households – currently pay hundreds of millions of dollars each year in excess of what could have been allowable under New Zealand's previous price-setting rules under the Commerce Act 1975 (Bertram and Terry, 2000; Bertram, 2006b, 2013, 2014, 2018). Those excess payments are pure rents, sustaining inflated asset valuations established during the sector's unregulated¹ wild west period, 1994–2002, and locked in by a compliant Commerce Commission in 2002 (Bertram and Twaddle, 2005).

Corporate capture of the regulatory apparatus was given extra scope by the Commerce Amendment Act 2008, which explicitly confirmed that excess profits are legal (by requiring them to be only 'limited', not eliminated, in section 52A of the amended act), while simultaneously providing for a right of appeal on the merits against Commerce Commission decisions (ss52Z, 52ZA). The appeal right is limited to parties that have participated in hearings on the decision to be appealed, immediately ruling out ordinary consumers who lack the resources or the representatives to participate continuously in Commerce Commission hearings. The appeals process enables deep-pocketed monopoly interests to hold the commission itself to ransom, given the commission's limited budget.

Following the 2008 legislation, the giant monopolies in airports, gas pipelines and electricity networks promptly mounted a joint appeal against the commission's 'input methodologies'. The large electricity networks argued (among numerous other complaints) that their asset valuations were too low, so their regulated prices should rise. The asset-valuation arguments which they laid before the court resurrected propositions spawned in US litigation following the long-discredited 1898 *Smyth v Ames* decision (171 U.S. 361) and conclusively rejected in the 1944 *Hope* decision. Clearly aware of this, the High Court asked what had happened to the original, historic cost asset valuations of the electricity network assets, and heard that:

The MED [Ministry of Economic Development] and subsequently the Commission took an ODV [Optimised

Deprivation Value] approach for two basic reasons:

- (a) because of a lack of reliable historic cost information, and
 - (b) because they considered that an ODV approach mimics outcomes in competitive markets.
- (*Wellington International Airport and Ors v Commerce Commission*, [2013] NZHC 3289 at para 428)

That alleged 'lack of reliable historic cost information' came at the end of 15 years of intensely prescriptive information disclosure which had been the promised crown jewel of

litigation trump card applies not only to price regulation; it has worked even more powerfully to entrench anti-competitive conduct, the subject of the next section.

Protecting the process of competition?

Until 1986, the Commerce Act 1975 had spelled out explicitly several types of anti-competitive conduct that were prohibited, including price collusion (s27), resale price maintenance (s28), tied bundling (s50) and refusal to deal (s23). In addition, there was provision in part III of the act for monopolists' market conduct in general to be investigated, and penalties or remedies

[The] explicitly prescriptive approach [of the Commerce Act 1975] was dumped overboard in 1986 in favour of a light-handed approach.

light-handed regulation. Detailed financial statements of electricity networks published annually in the *Gazette* until 2008, with strongly supportive audit statements from New Zealand's top accountancy firms, contained continuously tracked historic cost asset values, grounded in the pre-1994 books of the electricity networks. The proposition that they were not 'reliable' and hence could be set aside does not qualify to be described even as a fig leaf.

The ministry and the commission basically sold small consumers down the river. Having done so, the commission has, since 2013, defended the network asset valuations as its 'line in the sand' that cannot be revisited. The effect is to put a floor under network prices at the monopoly level established as of 2002, continuously adjusted upward for inflation.

In 2018 a ministerial inquiry, relying on the commission's own calculations, meekly reported that 'we found nothing to suggest grid operator Transpower or distributors are making excessive profits' (Dean et al., 2018, pp.5, 53–5). The lesson for regulated monopolists was clear: regulatory capture works under New Zealand's prevailing law, and the Commerce Commission can be broken by the credible threat of costly litigation. That

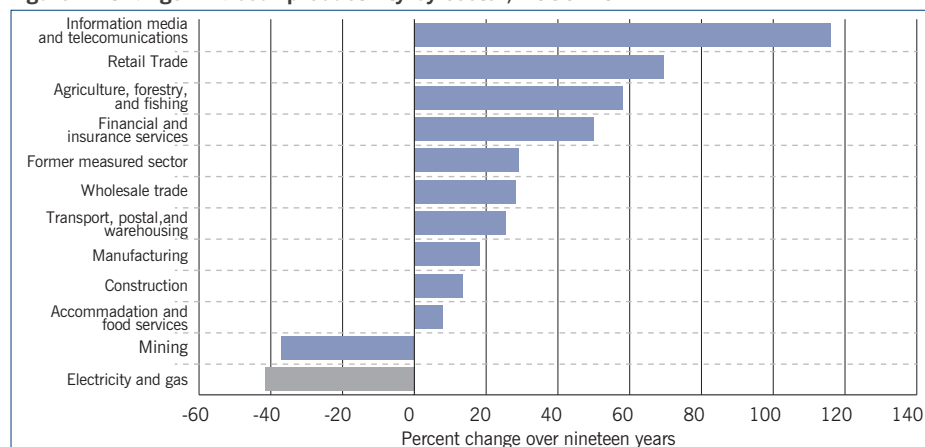
imposed. This explicitly prescriptive approach was dumped overboard in 1986 in favour of a light-handed approach.

It could reasonably have been expected that the Commerce Act 1986 would stand or fall on the effectiveness of its provisions against anti-competitive conduct. In practice it fell. To understand why, one has to bear in mind that the drafting of the legislation was heavily influenced by Chicago School writers, such as Stigler (1971), Posner (1976) and, most directly, Bork (1978).

A standard refrain in antitrust debate is that the goal is 'protection of the process of competition, not of competitors'. The obvious difficulty with this proposition is that protecting the process of competition by stopping a dominant firm from trampling on its competitors must inescapably be of benefit to, and provide a degree of protection to, those competitors, just as controls on price-gouging will benefit consumers. Regulation that delivers no benefit to anyone is difficult to justify.

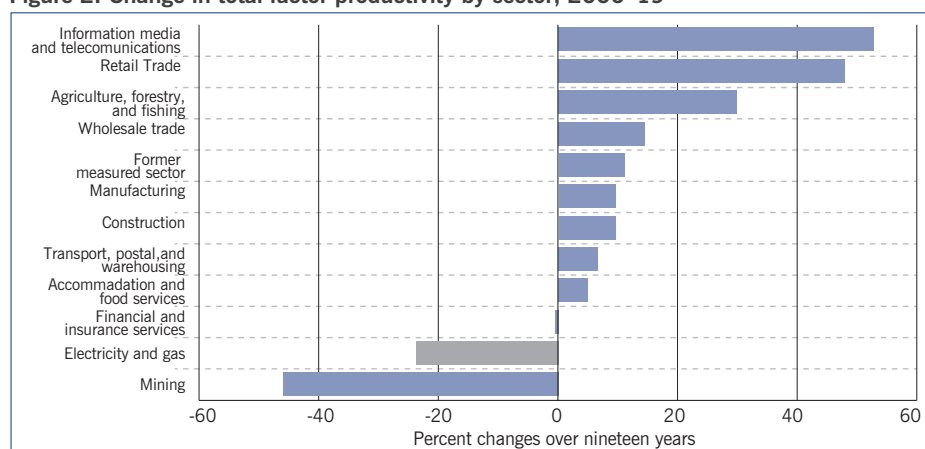
In the hands of Chicago adherents the rule 'protect competition, not competitors' became the argument that any regulatory intervention that benefits any competitor or competitors at the expense of an incumbent firm is a distortion of the

Figure 1: Change in labour productivity by sector, 2000–19



Source: Statistics New Zealand, 2020

Figure 2: Change in total factor productivity by sector, 2000–19



Source: Statistics New Zealand, 2020

optimal market outcome. (The Chicago approach is well characterised and critiqued in Hovenkamp, 2019 and Hovenkamp and Morton, 2020.)

Whatever real-world firms were doing could, in Chicago terms, be characterised as just the normal process of competition at work. That in turn meant that virtually any conduct by a firm with power in a market could be defended. Section 36 of the Commerce Act 1986 was where this approach to conduct in a market was encoded. As originally worded, that section read:

36. Use of dominant position in a market – (1) No person who has a dominant position in a market shall use that position for the purpose of –
- (a) Restricting the entry of any person into that or any other market; or
 - (b) Preventing or deterring any person from engaging in competitive conduct in that or any other market; or

- (c) Eliminating any person from that or any other market.

In applying the original section 36, the courts used a threefold test: (1) market dominance had to be proved, accompanied by (2) ‘use’ of that dominance, and (3) use had to be for an anti-competitive purpose, as distinct from merely a desire to compete vigorously as any firm is supposed to do. This imposed a burden of proof that simply overwhelmed attempts by private parties and the Commerce Commission to rein in conduct that was transparently anti-competitive in its effects but could not be proven to flow from an anti-competitive purpose (see cases discussed by, for example, Coull, 1998; Farmer, 1994; Berry, 2006; Sumpter, 2012; Ahdar, 2009; Bertram, 2006a).

In *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 a clear-cut example of what the textbooks call ‘raising rivals’ costs’ was found entirely legal under the 1986 wording. The Privy Council framed the issue as a counterfactual test: ‘In their

Lordships’ view it cannot be said that a person in a dominant market position “uses” that position for the purposes of s36 if he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted’; and further, ‘a monopolist is entitled, like everyone else, to compete with its competitors: if it is not permitted to do so it would be holding an umbrella over inefficient competitors’.

The same counterfactual test was crucial in a further Privy Council decision, *Carter Holt Harvey v Commerce Commission* [2006] 1 NZLR 145, which cleared Carter Holt Harvey of what (on any common-sense view of the facts – see Bertram, 2006a) amounted to predatory pricing and exclusionary bundling, on the basis that Carter Holt Harvey was merely competing vigorously. That outcome would surely have been different under section 50 of the old Commerce Act 1975.

Rather than clearing up the mess, an amendment to section 36 in 2001 just fiddled with the wording, replacing ‘dominant position’ with ‘substantial degree of market power’ and replacing ‘use’ by ‘take advantage of’. This did not fix the basic problem. The way section 36 of the Commerce Act 1986 is framed means a virtually complete absence of any check on predatory and anti-competitive behaviour so long as the courts stay with the counterfactual test – and that test seems to be what Parliament intended, given that Parliament has not removed it in the 34 years since the act was passed. The law still says that all firms, even those with ‘a substantial degree of market power’, are permitted to act in what they judge to be their commercial best interests, regardless of the effect on smaller competitors. What their ‘purpose’ may be cannot be known by outsiders, nor reliably inferred from their conduct. Only in 2019 did a tentative official proposal emerge to change ‘purpose’ into ‘effect’ (Ministry of Business, Innovation and Employment, 2019). Parliament is yet to pick this up.

Meantime, ‘New Zealand is the only country with modern competition law that requires an anti-competitive purpose and does not consider the effects of the conduct’ (MintnerEllisonRuddWatts, 2019). The Commerce Commission puts it this way:

‘a business with a substantial degree of market power can compete in the same way as a business which does not have market power’ (Commerce Commission, 2019). A former commission member says of section 36 that ‘its design allows anti-competitive behaviour to slip through’ (Curtin, 2016, p.13).

In 2015, the manifest inadequacy of section 36 was highlighted at a Commerce Commission conference: ‘Reliance on the counterfactual test ... will fail to condemn conduct that warrants prohibition, *precisely because it fails to attribute any significance to the dominant firm’s market power*’ (Gavil, 2015, p.1046, emphasis added).

Notwithstanding decades of criticism of section 36, officials in the Ministry of Business, Innovation and Employment have continued to give pride of place to the ‘efficiency’ defence of monopoly.

Striving to acquire market power is what encourages innovation, and firms should not be punished when they achieve it. Nor, having acquired market power, should they be prevented from innovating further. Consumers benefit from increased productivity and innovation. (Ministry of Business, Innovation and Employment, 2015 p.15)

Of the sectors in the New Zealand economy with which this author is familiar, the outstanding case study of ‘striving to acquire market power’ and then using it is the electricity sector. Having been left either completely unregulated (in the case of generation and retail) or only nominally ‘regulated’ (transmission and distribution) for over three decades, the sector’s total factor productivity in 2019 was 16% below 1986. Its capital productivity was down 35%. Figures 1 and 2 show the sector’s productivity performance compared with the rest of the economy since 2000, as electricity profits boomed, price-gouging of residential consumers roared on and competitive entry was foreclosed.²

Wealth distribution: benefits and detriments
Part 5 of the Commerce Act 1986 empowers the Commerce Commission to grant or withhold authorisation for mergers or restrictive practices that would otherwise be prohibited as anti-competitive. Section

67(3)(a) provides that ‘if it is satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted [the Commission may] grant an authorisation for the acquisition’. But how is ‘benefit to the public’ to be judged? No definition is provided in the act.

Suppose that merging two firms improves the efficiency of production while conferring increased market power. If the lower costs are passed on to consumers via lower price, consumers gain but not the firm’s owners. This is commonly described as the ‘consumer surplus

By leaving undefined what was meant by ‘benefit to the public’, the Commerce Act 1986 opened the way for business lobbyists ...

standard’. If all the gain goes to the shareholders of the merged firm via monopoly pricing, then consumers are left worse off but society as a whole benefits from the increased surplus in production. That is the ‘total surplus standard’.

A consumer surplus standard approves only those mergers that leave consumers better off – a test recognisably related to Rawls’ proposition that the interests of the worst off must be paramount. The total surplus standard allows market power to be exercised and the merging firms’ profits increased, even if no benefits flow to consumers.

The Chicago School position has always been that efficiencies on their own are sufficient justification for a merger, regardless of what happens to the welfare of consumers – in other words, the pure total surplus standard. It was Bork (1978) who produced the most extreme statement of the so-called ‘efficiencies defence for mergers’.

Bork did not use the term ‘consumer welfare’ in the same way that most people use it today. For Bork, ‘consumer welfare’ referred to the sum of the welfare, or surplus, enjoyed by both consumers and producers. Bork

referred to consumer welfare as ‘merely another term for the wealth of the nation.’ A large part of the welfare that emerges from Bork’s model accrues to producers rather than consumers. (Hovenkamp, 2019, p.65)

By leaving undefined what was meant by ‘benefit to the public’, the Commerce Act 1986 opened the way for business lobbyists and local Chicago School adherents to capture the regulatory process by adopting Bork’s framing. That capture involved enshrining the total surplus standard in the Commerce Commission’s authorisation

procedures (Easton, 1989, Ministry of Commerce, 1991; Pickford, 1993; Bertram, 2004a, 2004c). Thereafter, wealth transfers from New Zealand consumers to monopolist producers were treated as of no consequence in merger cases.

The argument for allowing mergers on efficiency grounds has always been that in a very small open economy such as New Zealand’s, optimally sized firms will tend to be large relative to the local market, and hence to have greater market power. Achieving that optimal scale ought not, the argument goes, be checked by any requirement to make consumer welfare paramount (Evans, 2004). But if there are genuine efficiency gains, a requirement to share them with consumers can always be mandated as a condition of the merger (Lande, 1982).

More fundamentally, the proposition that deregulating large industry would unleash dynamic gains so great that, after trickling down, they would leave everyone better off has failed.

Bork and the Chicagoans ... expected that relaxing antitrust rules would enable firms to achieve greater efficiencies. ... The Chicagoans lost

their bet. Since the implementation of antitrust deregulation, market power has widened, without accompanying long-term gains in consumer welfare. Instead, economic dynamism and the rate of productivity growth have been declining ... Whatever efficiency gains the Chicago-inspired changes may have achieved have not compensated for the market-power effects of the antitrust deregulation they sought. (Baker, 2019, p.2)

Hovenkamp and Morton bluntly describe the Chicago School attack on antitrust as 'one of the most complete cases of regulatory capture in economic history' (Hovenkamp and Morton, 2020, p.40).

Thinking about a blueprint

In thinking about how to replace the Commerce Act 1986 with something more in line with the principles laid down by Hobbes, Smith and Rawls, it pays to look in two directions. First, one needs to look back at what was thrown away to clear space for the new act. That means revisiting the Commerce Act 1975, with its blunt prohibition of profiteering, its quick-response provisions for inquiring into possible cases of abuse of market power, and its specific penalties. Then one needs to look outwards, at legislation and practices in other countries, and the global literature on competition law.

There are some bottom lines that need to be drawn, going back to the earlier discussion of Hobbes's image of the

covenant and the sword. Protection of the weak against the strong requires both a clear covenant and a sharp sword. New Zealand's 1986 transformation of its competition law offered neither.

First, the interests of New Zealand consumers need to be placed explicitly at the centre of the law as the overriding goal to which other goals are subsidiary. This would follow the recommendations of many legal scholars (see, for example, Baker, 2019; Hovenkamp and Morton, 2020).

Second, the taking of excess profits needs to be declared illegal, reviving the crisp clarity of section 54 of the Commerce Act 1975. 'Excess profit', in turn, needs to be defined as any return that yields more than some limit over a normal profit, except where clear evidence can be presented to justify a greater return. That would put the burden of proof where it belongs – on the profit taker – instead of on the aggrieved party as at present.

Third, forms of anti-competitive conduct that are proscribed need to be specified and some criteria laid down for detecting them. This involves a move away from the Commerce Act 1986's reliance on a generic, loophole-ridden principle in section 36.

Fourth, the sword must be empowered to enforce the covenant more stringently than has been possible for either the courts or the Commerce Commission over the past three decades. Among other things, that means that a repurposed Commerce Commission will need to be ensured a litigation budget that is always at least equal to that of big business, making the

full resources of the state available to underwrite legal action against deep-pocketed monopolists. The ability of the powerful to intimidate the organs of governmental authority simply by using their monopolistic gains to fund drawn-out, wasteful litigation has to end. Cases must be genuinely decided on the merits, not on the relative wealth of the parties.

Fifth, the weak and powerless need a champion. The New Zealand state abdicated that role in the 1980s, and its regulatory agencies have been too often cowed by the big business lobby. Parliament has been mostly missing in action; but in an electoral democracy that is where change should happen. The Commerce Act is only one of a number of 1980s laws that need radical rethinking.

Putting ourselves behind Rawls' veil, the hope is that reasonable people can agree on a policy menu to arrest New Zealand's slide from a 20th-century mixed capitalist economy towards a new feudalism, with entrenched dynastic wealth drawn from market power and a dominant rentier class.

1 From 1994 to 2003 the only regulatory requirement placed on lines companies was information disclosure under a 'light-handed' regime that involved no action whatever by the authorities in response to the revealed conduct. I do not regard this as meaningful regulation. See Bertram, 1999 and Bertram, 2006b, pp.212–13, 226–30.

2 The published data are for the wider sector 'electricity, gas and water'. Statistics New Zealand has, on request, produced the narrower data for 'electricity and gas' used in Figures 1 and 2. Greater disaggregation was not allowed; but the 'gas' component includes only the transmission and reticulation part of the gas sector, excluding gas production and sale. Electricity therefore dominates the results.

References

- Ahdar, R.T. (2009) 'The unfulfilled promise of New Zealand's monopolisation law: symptoms and solutions', *Competition and Consumer Law Journal*, 16 (3), March, pp.291–313
- Armstrong, H. (2014) 'Your life for the job: New Zealand rail safety 1974–2000', in New Zealand Fabian Society, *Flawed Theory – Failed Practice: light-handed regulation in New Zealand*, Wellington: New Zealand Fabian Society
- Baker, J.B. (2019) *The Antitrust Paradigm: restoring a competitive economy*, Cambridge, Mass: Harvard University Press
- Berry, M. (2006) 'Competition law', *New Zealand Law Review*, 2006 (3), pp.599–620
- Bertram, G. (1999) 'Light-handed disciplines on the market power of network owners: New Zealand's Pipeline Access Code and Gas Industry Information Disclosure Regulations', *Victoria Economic Commentaries*, 16 (1), pp.101–27
- Bertram, G. (2004a) 'Economic, legal and political theory in relation to the New Zealand Commerce Commission's public benefit test', paper presented to the fourth annual Competition Law and Regulation Review conference, Wellington, February, http://www.geoffbertram.com/fileadmin/publications/Public_benefits_paper_Sept_2003.pdf
- Bertram, G. (2004b) 'Deregulation and monopoly profits in New Zealand's gas and electricity industries', *Energy Studies Review*, 12 (2), pp.208–27
- Bertram, G. (2004c) 'What's wrong with New Zealand's public benefit test?', *New Zealand Economic Papers*, 38 (2), pp.265–77
- Bertram, G. (2006a) 'Exclusionary bundling, predatory pricing, and section 36: Carter Holt Harvey Products Group Ltd v Commerce Commission', *Waikato Law Review*, 14, pp.17–33
- Bertram, G. (2006b) 'Restructuring of the New Zealand electricity sector, 1984–2005', in F.P. Sioshansi and W. Pfaffenberger (eds), *International Experience in Restructured Electricity Markets: what works, what does not, and why?*, Amsterdam: Elsevier
- Bertram, G. (2013) 'Weak regulation, rising margins, and asset revaluations: New Zealand's failing experiment in electricity reform', in F.P. Sioshansi (ed.), *Evolution of Global Electricity Markets: new paradigms, new challenges, new approaches*, Amsterdam: Elsevier Academic Press

- Bertram, G. (2014) 'Light-handed regulation of the energy sectors', in New Zealand Fabian Society, *Flawed Theory – Failed Practice: light-handed regulation in New Zealand*, Wellington: New Zealand Fabian Society
- Bertram, G. (2018) 'Submission in response to first report of the review panel: distributors' profits', submission to Electricity Price Review, September, <http://www.geoffbertram.com/fileadmin/publications/Bertram%20Submission%20on%20distributor%20profits.pdf>
- Bertram, G. and S. Terry (2000) *Lining Up the Charges: electricity line charges and ODV*, Wellington: Simon Terry Associates
- Bertram, G. and D. Twaddle (2005) 'Price-cost margins and profit rates in New Zealand electricity distribution networks since 1994: the cost of light handed regulation', *Journal of Regulatory Economics*, 27 (3), pp.281–307
- Bork, R.H. (1978) *The Antitrust Paradox: a policy at war with itself*, New York: Basic Books
- Buchanan, J.M., R.D. Tollison and G. Tullock (eds) (1980) *Toward a Theory of the Rent Seeking Society*, Texas: A&M Press
- Caygill, D., S. Wakefield and S. Kelly (2000) *Inquiry into the Electricity Industry: report to the minister of energy*, Wellington
- Commerce Commission (1997) *Guidelines to the Analysis of Public Benefits and Detriments*, October 1994 (revised December 1997), Wellington
- Commerce Commission (2009) *Investigation Report: Commerce Act 1986 s.27, s.30 and s.36 electricity investigation*
- Commerce Commission (2019) 'Taking advantage of market power', <https://comcom.govt.nz/business/avoiding-anti-competitive-behaviour/taking-advantage-of-market-power>
- Coull, D. (1998) 'Predatory conduct under the Commerce Act 1986', *Victoria University of Wellington Law Review*, 28 (4), September, pp.649–82
- Curtin, D. (2016) 'Abuse of market power: the end of "make-believe" analysis', paper presented to the New Zealand Association of Economists conference, Auckland, 30 June, <https://www.nzae.org.nz/wp-content/uploads/2016/10/Donal-Curtin>
- Dean, M., S. Chetwin, J. Hancock, P. Harris, A. Herrington, S. Roberts, J. Small and L. Wilson (2018) *Electricity Price Review, Hikohiko te Uira: first report for discussion*, <https://www.mbie.govt.nz/assets/5ba1054036/first-report-electricity-price-review.pdf>
- Dyer, P. (2019) *Rottenomics: the story of New Zealand's leaky buildings disaster*, Auckland: Bateman Books
- Easton, B.H. (1989) 'The public interest in competition policy', in A. Bollard (ed.), *The Economics of the Commerce Act*, NZIER research monograph 52, October
- Evans, L.T. (2004) 'The efficiency test under competition law and regulation in the small distant open economy that is New Zealand', *New Zealand Economic Papers*, 38 (2), pp.241–64
- Evans, L. and N. Quigley (2011) 'Compensation for takings of private property rights and the rule of law', in R. Ekins (ed.), *Modern Challenges to the Rule of Law*, Wellington: LexisNexis
- Farmer, J. (1994) 'Competition law', *New Zealand Recent Law Review*, 1994 (4), pp.364–75
- Gavil, A.I. (2015) 'Imagining a counterfactual section 36: rebalancing New Zealand's competition law framework', *Victoria University of Wellington Law Review*, 456 (4), December, pp.1043–80
- Hale, M. (1787) 'De Portibus Maris', part II of *A Treatise Relative to the Maritime Law of England in Three Parts*
- Hobbes, T. (1651) *Leviathan*, 1968 edn, ed. C.B. Macpherson, London: Pelican
- Hovenkamp, H.J. (2019) 'Is antitrust's consumer welfare principle imperilled?', *Journal of Corporate Law*, 45 (1), pp.65–94
- Hovenkamp, H.J. and F.S. Morton (2020, forthcoming) 'Framing the Chicago School of antitrust analysis', *University of Pennsylvania Law Review*
- Huang, C.C. (2011) 'The constitution and takings of private property', *New Zealand Universities Law Review*, 24, pp.621–48
- Land, J., J. Owens and L. Cejnar (2010) 'The meaning of "competition"', *New Zealand Universities Law Review*, 24 (1), June
- Lande, R.H. (1982) 'Wealth transfers as the original and primary concern of antitrust: the efficiency interpretation challenged', *Hastings Law Journal*, 34, pp.65–151
- Lee, C. (2019) *The Billion Dollar Bonfire: how Allan Hubbard and the government destroyed South Canterbury Finance*, Paraparaumu: PRL Books
- Macfie, R. (2013) *Tragedy at Pike River: how and why 29 men died*, Wellington: Awa Press
- Marshall, A. (1936) *Principles of Economics*, 8th edn, London: Macmillan
- Ministry of Business, Innovation and Employment (2015) *Targeted Review of the Commerce Act 1986: issues paper*, <https://www.mbie.govt.nz/assets/2f9d8ba3f3/targeted-review-commerce-act-1986-issues-paper.pdf>
- Ministry of Business, Innovation and Employment (2019) *Discussion Paper: review of section 36 of the Commerce Act and other matters*, January, <https://www.mbie.govt.nz/dmsdocument/4325-discussion-paper-review-of-section-36-of-the-commerce-act-and-other-matters>
- Ministry of Commerce (1991) *Review of the Commerce Act 1986: discussion document*, Wellington: Competition Policy and Business Law Division, December
- MintnerEllisonRuddWatts (2019) 'Section 36 of the Commerce Act back in the spotlight', <https://minterellison.co.nz/our-view/section-36-of-the-commerce-act-back-in-the-spotlight>
- North, D.C. (1990) *Institutions, Institutional Change, and Economic Performance*, Cambridge: Cambridge University Press
- North, D.C. (1991) 'Institutions', *Journal of Economic Perspectives*, 5 (1), pp.97–112
- Pickford, M. (1993) 'The evaluation of public benefit and detriment under the Commerce Act 1986', *New Zealand Economic Papers*, 27 (2), pp.209–31
- Poletti, S.A. (2018) 'Market power in the NZ wholesale market 2010–2016', working paper University of Auckland Business School, <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/energy-centre/reports/Market%20Power%20in%20the%20NZ%20wholesale%20market%202010-2016.pdf>
- Posner, R.A. (1976) *Antitrust Law*, Chicago: University of Chicago Press
- Rawls, J. (1971) *A Theory of Justice*, Cambridge, Mass: Harvard University Press
- Rosenberg, N. (1960) 'Some institutional aspects of the wealth of nations', *Journal of Political Economy*, 68 (6), pp.557–70
- Royal Commission on the Pike River Coal Mine Tragedy (2012) *Final Report*, Wellington: Department of Internal Affairs, <https://pikerver.royalcommission.govt.nz/Final-Report>
- Scott, P.G. (2018) 'Legitimate business rationale and section 36 of the Commerce Act 1986', *Waikato Law Review: Taumauri*, 26, December, pp.96–116
- Seymour, D. (2018) 'Market studies are business-bashing', *Scoop*, 3 December
- Smith, A. (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1976 edn, ed. R.H. Campbell and A.S. Skinner, Oxford: Clarendon Press
- Statistics New Zealand (2020) *Productivity statistics: 1978–2019*, <https://www.stats.govt.nz/assets/Uploads/Productivity-statistics/Productivity-statistics-19782019/Download-data/productivity-statistics-1978-2019-inputs-and-outputs-by-industry.xlsx>
- Stigler, G.J. (1971) 'The theory of economic regulation', *Bell Journal of Economics and Management Science*, 2 (1), Spring, pp.3–21
- Sumpter, M. (2012) 'Competition law', *New Zealand Law Review*, 2012 (1), pp.113–40
- Troxel, E. (1947) *Economics of Public Utilities*, New York: Rinehart and Co
- Tullock, G. (1989) *The Economics of Special Privilege and Rent Seeking*, KluwerAcademic Publishers
- Wolak, F. (2009) *An Assessment of the Performance of the New Zealand Wholesale Electricity Market (public version): report to the Commerce Commission*, <http://www.comcom.govt.nz/investigation-reports/>