



Boosting productivity in the services sector: 2nd interim report

Comment | Productivity Commission

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Introduction

1. Thank you for the opportunity to comment on the Commission's services sector second interim report (**the report**).
2. We support the Commission's focus on productivity improvements that can be achieved through use of ICT. As set out in the first report, adoption of ICT in New Zealand can deliver significant opportunities for growth.
3. The ICT sector is highly competitive with a number of New Zealand providers offering a range of services and prices. There are low barriers to entry and, increasingly, offshore providers are offering cloud and other services in to the domestic market. Accordingly, the Commission is likely to add most by focusing on demand side factors that might be slowing the uptake of ICT services.
4. While the draft report covers a number of matters, we've limited our comments here to the Commission's proposals to review section 36 of the Commerce Act and to develop an industry system that would enable customers to access emails after they have switched broadband providers.

Consumer's ability to receive emails when changing service provider

5. The Commission, in referring to a submission, notes that customer use of an ISP provided email address may create a barrier to switching broadband service provider. The Commission proposes that the TCF should develop guidelines for a system that would enable customers to access emails after they have switched providers.
6. The Commission provides no analysis of the costs or benefits of such a system. Nor does it posit any theory for why this system would increase sector productivity. We believe care needs to be taken in intervening or requiring industry solutions in competitive markets as, by their nature, initiatives that are not driven by the competitive process create unintended incentives and risk distorting the market.
7. While portability solutions undoubtedly deliver some benefits to end-users, they are typically very complex and costly for industry participants, requiring close coordination, and systems interoperability, between market participants. The introduction of number portability into fixed and mobile telecommunications markets provides sobering evidence of this. The implementation costs of that system alone were in excess of \$100million.
8. In a market where the majority of email addresses are provided by multinationals that are not based in New Zealand, and that utilise email servers that are not based in New Zealand, the co-ordination and interoperability challenges would be significant. As such, there needs to be very clear and material benefits, and very clear evidence of a competition problem before interventions such as this should be considered.

9. We believe there is considerable evidence to suggest that the opposite is true. Customers increasingly use email services that are separate from their ISP. Further, modern email services make it easier for consumers to use and integrate multiple email accounts into a single mailbox across multiple devices. Accordingly, while individual customers may be impacted by current service limitations, there is likely to be no material overall market impact.
10. Further, the broadband market is already highly competitive and customers have access to multitude email providers at little, or no, cost. The Commerce Commission monitors telecommunications markets and, in its latest report, noted that NZ broadband growth was some of the highest in the OECD and that the retail broadband market is one of the most competitive telecommunications markets in New Zealand.¹ Similarly, the Government's 2013 Telecommunications Act review discussion paper referenced an increasing competitive broadband market with falling prices.² These observations are consistent with our experience - the broadband market is one of the most competitive markets we operate in.
11. There have also been a number of industry initiatives which seek to ensure consumers have appropriate information to make market choices and seek redress when things go wrong. To this end, the TCF has developed Codes on broadband product disclosure, international mobile roaming and customer complaints and dispute resolutions codes amongst others.³
12. It's difficult to envisage any material competition benefits from the proposed system given an already highly competitive broadband market and specific TCF consumer information standards. As noted in the draft report, consumers are increasingly using email services that are separate from their ISP and the number of impacted customers is likely to be small. There is nothing in the draft report to suggest the ability to access emails when changing providers is holding back broadband provider competition or services sector productivity.

Competition reform

13. The Commission also recommends that the Government review section 36 of the Commerce Act, which prohibits a firm from using a substantial degree of market power for an anti-competitive *purpose*.
14. As the Commission notes in the report, this is a contentious area. A large number of cases relating to alleged abuses of dominant positions, throughout the world, have been appealed to

¹ See the latest annual monitoring report here <http://www.comcom.govt.nz/dmsdocument/10043>

² See <http://www.med.govt.nz/sectors-industries/technology-communication/pdf-docs-library/communications/review-of-the-telecommunications-act-2001/Review-Telco-Act-2001-discussion-document.pdf>

³ <http://www.tcf.org.nz/content/ab04bbff-97fa-41d9-8def-b16f39687999.html>

the highest courts in their respective jurisdictions. Distinguishing between legitimate commercial behaviour and abuses of market power has always been a difficult area of competition law. The Commerce Act has a significant impact on market behaviour and it must strike the right balance between deterring anti-competitive conduct and promoting beneficial competitive activity. Accordingly, changes to the legal policy and the way the law is applied in this respect should not be made lightly.

15. In the New Zealand context, section 36 has been tested by the Courts and firms are currently operating within a relatively settled framework. Further, the application of section 36 has recently been considered by both Parliament (as part of the initial Commerce Amendment Bill) and the Supreme Court (who considered the counterfactual based framework in *Commerce Commission v Telecom* [2010] (the 0867 case)). We do not believe that second interim report raises additional services sector productivity concerns that would justify further inquiry and uncertainty.

Anti-competitive purpose

16. The section 36 purpose-based test is not unique. A purpose-based test is used in Australia and, in part, in Canada, and in other jurisdictions. The Supreme Court specifically acknowledged that the NZ and Australian law on use of market power (section 36) is the same.⁴
17. We consider that a purpose-based test likely provides the correct balance for New Zealand market conditions. As noted by the Commission, in a small economy such as ours, market structure may appear more concentrated than in larger economies, particularly for industries that require significant investment and scale. This means that theoretical findings of market power increases in a number of sectors. But being dominant or having theoretical market power is never itself unlawful or necessarily bad for competition. Large firms are often well placed to deliver benefits of innovation and scale economies to consumers. A purpose-based test provides the right check on their conduct to ensure that it remains consistent with what would be expected in a workably competitive market.

Analysis under a purpose-based test

18. Criticism of the New Zealand approach to section 36 appears to have been largely centred on the challenges presented by the counterfactual test. The counterfactual test was developed by the Privy Council in the *Telecom v Clear* [1995] and *Carter Holt Harvey v Commerce Commission* [2004] cases as a conceptual way to identify use of market power. The test was further considered in 0867 where the New Zealand Supreme Court had the opportunity to change the

⁴ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2011] 1 NZLR 577 at [31]

approach to the law (using the counterfactual) in New Zealand, but found good reasons not to do so.

19. The Supreme Court left in place the counterfactual framework, finding that the “comparative” test espoused in the counterfactual is consistent with the tests applied by the courts in Australia and remains the appropriate test for New Zealand. The Supreme Court rejected the Commerce Commission’s argument that the Australian cases represented a different approach. It acknowledged the importance of maintaining consistency between the New Zealand and Australian approaches in this regard. Going further, the judgment also noted that adopting a range of tests for New Zealand would make the application of section 36 unpredictable for firms and their advisers. We think that the value of such relative certainty for businesses remains important for large firms to be able to innovate and operate effectively.

Policy change requires sound evidential basis of likely net benefits

20. The Commission has proposed the possible inclusion of an “effects-based” test into section 36. However, a proposed effects-based test, rather than simply establishing a different conceptual framework, shifts the balance between prohibiting use of market power and promoting beneficial competitive behaviour. In the absence of any evidence to the contrary, it is equally possible (and we believe more likely) that the proposed change will undermine rather than promote productivity, innovation or efficiency in New Zealand.
21. Further, firms are operating in a relatively settled framework. Any changes would result in an extended, contentious and uncertain period as revised settings are implemented and tested. In addition to the impact on competitive activity, the uncertainty created by these proposed changes would increase compliance costs by large firms. Such firms would be required, by necessity, to conduct competitive/economic analysis on the market impacts of their initiatives to ensure they are not at risk of detrimentally affecting competitors. The small size of the market means that, in practice, the compliance overhead will apply to smaller firms in the New Zealand market than would be the case in larger overseas markets.
22. As yet, there has been little consideration of quantitative evidence of the effect of current settings on markets, competitive behaviour and consumers. The section 36 debate, to date, appears to be driven by concerns over perceived difficulties in demonstrating a breach of section 36 and the fact that this results in false negatives. However, proposed alternatives, on the face of it, may also simply increase the likelihood of false positives. False negatives and false positives will arise irrespective of the current law or any amended policy implemented in amendments to section 36.
23. Any amendment to section 36, however, should be justifiable by a reduction to the total welfare cost of regulation – in essence by minimising the harm caused to competition by an excess of false negatives on the one hand, and the harm caused to producers and consumers by an excess of false positives on the other. While it is important to understand how best to improve accuracy identifying situations where firms take advantage of market power for anti-competitive

purposes, it is just as important to ensure that regulatory policy settings do not impose an excessive social cost.

24. The second interim report does not assess the impact of current competition law settings on services sector productivity. As noted above, any debate around changes to the Commerce Act will be contentious and likely costly. The Commission can best contribute to that debate by, through this study, identifying empirical evidence of the effect of competition law settings on sector productivity. Sound evidence based regulation, whether retaining the status quo or amending it, will potentially contribute the most to New Zealand's productivity performance.

END