7 March 2014

Inquiry into the Services Sector
New Zealand Productivity Commission
PO Box 8036
The Terrace
**WELLINGTON 6143**

**By post and email**

Email: info@productivity.govt.nz

Dear Sir/Madam

**RE: "BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR" SECOND INTERIM REPORT - "IMPROVING COMPETITION LAW"**

1. This submission on the New Zealand Productivity Commission's ("**Commission's**") January 2014 "*Boosting productivity in the services sector*" Second Interim Report ("**the Report**") is made by Russell McVeagh, with the input of a number of its clients, who include some of New Zealand's largest companies. This submission is specifically in relation to chapter 4 of the Report entitled "*Improving competition law*".

2. All enquiries on this submission may be directed to:

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3. We would be happy to meet with the Commission to discuss our submission further if that would assist.

**EXECUTIVE SUMMARY**

4. We agree that having carefully framed competition laws, including having a Commerce Act 1986 (the "**Commerce Act**") that appropriately strikes the balance between protecting competition without unduly increasing business compliance costs, is important to the efficient functioning of New Zealand's economy and the welfare of New Zealand's citizens.

5. Accordingly, we support debate on how best to ensure that the Commerce Act achieves that balance.

6. However, given the Commerce Act touches on every aspect of New Zealand's economy, and every business, it is vital that all affected stakeholders (not just those in the services sector) are given the opportunity to comment and submit, and that views are considered from all sides, before any recommendations are made on reforming the Commerce Act.

7. We are therefore surprised that the Commission's Report, which is in the context of a review of the services sector only, made specific recommendations for reform to the Commerce Act, namely that the section 36 market power prohibition moves from its existing counterfactual test or that it incorporates an "effects" based approach.

8. Even with the benefit of submissions on the Report, we doubt that the Commission could be in a position where it can confidently make robust recommendations, which have a necessary level of stakeholder support, to Government unless those recommendations are kept at a very high level. In particular, framing up an appropriate and workable "market power" prohibition is recognised worldwide as an inherently complex issue (see for example, Russell McVeagh's comparative analysis of different tests applied in key international regimes in "The Death Knell of the Counterfactual?").[1] Any reform that may be considered superficially appealing when analysed through the lens of the services sector could well be inappropriate when applied to all industries in New Zealand.

9. Our view is that the only appropriate forum for substantive consultation on reforms to competition law is through a dedicated consultation on potential reform of the Commerce Act that invites input from the full range of industry sectors and affected parties. By way of example, the Ministry of Business Innovation and Employment's ("**MBIE's**") (previously MED's) consultation on the Commerce (Cartels and Other Matters) Amendment Bill (the "**Cartels Bill**") has been referred to in international antitrust forums as a market leading consultation exercise, which generated a significant number of submissions from a range of different industry sectors.[2]

10. Accordingly, if the Commission's view is that productivity in the services sector could potentially be enhanced through reforms to the Commerce Act, the Commission's recommendation should simply be that a specific review of the aspects of the Commerce Act that the Commission identifies as being potentially problematic be undertaken, rather than the Commission making a specific recommendation in favour of a particular type of reform (eg a new effects based test) before it has had the opportunity to benefit from any consultation on the topic. That approach would ensure that:

    (a) The review starts on a level playing field in terms of problem identification - and that a "preferred position" does not skew the problem identification analysis at the outset; and

    (b) All business sectors, not just the services sector, would have sufficient time to consider the implications of any reform for business, and make substantive submissions on any proposals for reform.

11. If MBIE, as part of its competition policy function, were to manage that consultation process the Commission would, of course, be able to provide its

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[1] Sarah Keene, "*Death Knell of the Counterfactual? The 0867 Case",* Presentation to the Bright*Star Competition Law and Regulatory Review Conference 22 - 23 February 2010, available at: https://www.yumpu.com/en/document/view/12115358/death-knell-of-the-counterfactual-the-0867-case-russell-mcveagh

[2] MED started that reform process by issuing a 98 page Discussion Document that had a list of 35 questions for submitters, with those submissions being considered before a recommendation was made to Government (January 2010). The Ministry of Economic Development, "*Cartel Criminalisation- Discussion Document*", available at: http://www.med.govt.nz/business/competition-policy/cartel-criminalisation/discussion-document-cartel-criminalisation

views on the best means of achieving productivity gains through reforms to the Commerce Act.

12. This submission does not make any substantive comments on desirable reform (or otherwise) of the Commerce Act. The debate has simply not yet been adequately framed to allow informed feedback in that respect to be obtained.

**SECTION 36 OF THE COMMERCE ACT**

13. Reform of New Zealand's abuse of market power (monopolisation) provision would have far-reaching and significant consequences for all businesses, not just businesses in the "services sector" that are the subject of the Report.

14. While debate on whether New Zealand's market power provision is functioning in the most efficient manner possible is welcomed, it is essential that any recommendations for reform, on what is recognised internationally as an inherently complex area of law, are subject to widespread consultation and views from all stakeholders that would be affected (namely, businesses from all industry sectors, legal practitioners, economists and the New Zealand Commerce Commission (**"NZCC"**)).

15. Our concern with the Commission's recommendation on reforms to s 36 is that the Commission did not sufficiently engage or consult with the business community before making these relatively specific recommendations, and in particular businesses (including even those in the services sector in relation to reform of the market power provisions in the Commerce Act) were not aware that reform of section 36 was within the scope of the Commission's review.[3]

16. In particular, we are concerned that:

    (a) The Commission has reiterated the NZCC's (publicly expressed) views, which is naturally skewed towards a legal standard that may be more readily prosecuted - in effect more rather than less regulation. However, it does not follow that "more regulation" equals more competition. It will be important to balance the NZCC's perspective against the views from businesses that will have to deal with the increased compliance costs of additional regulation. Furthermore, we do not consider that the NZCC's "real life" experiences match the NZCC's commentary that section 36 as it stands is flawed:

        (i) It must be remembered that the NZCC was successful in the most recent section 36 prosecution that it has brought, achieving the highest penalty ever awarded under the Commerce Act ($12m) in its enforcement of that prohibition;[4] and

        (ii) The NZCC in 2013, while considering that there was a "strong argument" that SKY had the required anti-competitive purpose under s 36 based on "documents supplied by SKY, that suggest

[3] The Commission's question Q8.10 specifically asked about competition law issues that "meet the criteria set out in the terms of reference" which, on any interpretation, would be competition issues specifically related to services, not of mere general application. Only one submission, NZ Airports, in a single line, mentioned the Commerce Act's ability to deal with anti-competitive behaviour and that was caveated with "and/or that there are characteristics of the market that render sustainable competition difficult".

[4] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278.

> it had an anti-competitive purpose", chose not to bring proceedings (and, therefore, to not test the robustness of the existing s 36 prohibition) because of "other developments" in the market.[5] The evidence that the NZCC apparently had in that case would seem to have been the ideal testing ground for testing the appropriateness of New Zealand's purpose test. That the NZCC did not pursue that case says more about its enforcement priorities that it does about the ability of s 36 to capture pernicious conduct.

(b) Undue weight has been given to the presentation of Professor Gavil at the 2013 Competition Matters Conference (October 2013), when that was not the purpose of that presentation, and the emphasis provided to its conclusions lacks any critical analysis of the substance of the presentation. That presentation was delivered for the purposes of generating debate, by a highly respected US-based competition law professor, who explicitly did not, however, profess to having experience of New Zealand competition law. Accordingly, while Professor Gavil opined that New Zealand's s 36 approach diverged from Australia's, that was just one commentator's opinion.

The contrary opinion, held by the Supreme Court of New Zealand (which of course has significant experience and expertise in New Zealand law), is that New Zealand's current approach to s 36 is consistent with Australia's:[6]

> The survey we have undertaken of the principal authorities demonstrates a factor common to the reasoning of both the Privy Council and the High Court of Australia. It is important that the approach to the issue under consideration be broadly the same on both sides of the Tasman. Under agreements between the two countries competition law in New Zealand and Australia and associated enforcement provisions are increasingly being framed in a common way to address anti-competitive practices affecting trans-Tasman trade.53 All the relevant reasoning involves, either expressly or implicitly, consideration of what the dominant firm would have done in a competitive market; that is, in a market in which hypothetically it is not dominant.

The Commission significantly failed to adequately reflect the New Zealand Supreme Court's views in identifying divergence from Australian law as a reason to support its arguments for reform of s 36.

17. Further, while the Commission's report notes that "Australia and New Zealand stand apart from other countries in relying solely on purpose tests in their approaches to monopolisation", (again, relying on Professor Gavil's presentation), a cursory review of other antitrust regimes reveals there is at least one other jurisdiction in which a finding of illegal unilateral conduct requires a finding of an anti-competitive purpose. Canada's prohibition on "Abuse of Dominant Position" includes a list of prohibited "anti-competitive" acts, all of which require the finding that the defendant's purpose was to have a

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[5] New Zealand Commerce Commission, "*Investigation report on SKY TV contracts*", 8 October 2013.

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

negative effect on a competitor.[7] It is important that a full review of overseas approaches is considered before a recommendation is provided to Government.

18. Given the complexity of the issue, and the competing views from different sides of the debate, we consider that it is vital that before any specific recommendation on amending the Commerce Act's market power prohibitions are provided to Government that a transparent and rigorous consultation process is performed so that recommendations have legitimacy in the eyes of affected stakeholders.

**PRODUCTIVITY ENHANCING COLLABORATION**

19. Russell McVeagh made a number of submissions throughout MBIE's and the Commerce Select Committee's consultation process on the Cartels Bill.

20. While we do not support all of the changes that are intended to be introduced through the Cartels Bill, we consider that the length of time that it is taking for the Cartels Bill to be enacted, and the requirement to sensibly obtain advice on two separate regimes with no certainty as to when the collaborative activities regime will come into force when considering collaborations that will be of more than one year's duration, is generating significant inefficiencies and loss of productivity in the New Zealand economy. For example, businesses are considering whether to delay pro-competitive and efficiency enhancing collaborations and, if they proceed now, how to best structure arrangements to future proof them for the proposed regime (for example, the existing law has a separate regime for joint ventures operated through incorporated companies, but incorporation of a new company may add an unnecessary layer of formality and administrative cost if the proposed new regime will later apply).

21. We consider that resolving the applicable regulatory framework for pro-competitive collaboration, in circumstances where draft legislation has already been reported on at Select Committee, would be a significant "win" for productivity in the services sector, and other sectors. Having legislation languish in the House between the second and third readings is, in this context, plainly a negative outcome for productivity.

**IS THERE A CASE FOR MARKET STUDIES?**

22. Similar to any reform to the Commerce Act's market power prohibition, empowering the NZCC to conduct market studies would inevitably significantly increase the compliance costs of any businesses that were to be the subject of such market studies, in particular given the significant costs for businesses identified in the Commission's report: "*A company's external costs in a typical … Competition Commission investigation can be over £4m and internal costs over £2.5m*".[8]

23. Both the Australian Parliament and Australian Productivity Commission have in the past expressed concerns about the costs and benefits of these inquiries. The key factors of concern include the time taken, cost of running the process, reporting time, the fact the inquiries may not be required to consider relevant

[7] Section 78 and 79 Competition Act (R.S.C., 1985, c. C-34).

[8] OECD Policy Roundtables, Market studies, (2008b) at p.202, available at: http://www.oecd.org/regreform/sectors/41721965.pdf

policy options or make reasons for recommendations publicly transparent, and the difficulties of establishing the efficiency and effectiveness of such inquiries.[9]

24. For example, despite the significant time and cost involved in preparing the reports, prominent recent inquiries in Australia resulted in little material change for consumers. The ACCC's inquiry into petrol prices in 2007, for example, ultimately concluded that price changes were the result of international movements and that even if the recommendations of the report were implemented that there would be only marginal changes in pricing, most likely measured in cents per litre.[10] Similarly, the 2008 inquiry into the supermarket industry concluded that the market was workably competitive, and that there was nothing demonstrably wrong with the grocery supply chain.[11]

25. Market inquiries in the United Kingdom have been similarly prolonged, and subject to criticism for the amount of taxpayer resources that they consumed. In its review of the Office of Fair Trading's (**"OFT"**) power to instigate market inquiries (references) by the Competition Commission, the House of Commons noted that:[12]

> On setting the OFT's priorities for market inquiries, we consider the essential test is whether they are a sensible use of the public purse and provide value for money. Put another way, could the National Audit Office be satisfied that there is a clear cost benefit? Responding to an OFT market inquiry and a subsequent CC market investigation is extremely costly for the companies concerned. This is in terms of external advisor costs, and a great deal more in terms of the huge diversion of management and employee resources.

26. The House of Commons also noted in relation to the OFT's preliminary power to undertake market studies to inform this decision that:[13]

> In terms of market studies there is an equal need to ensure that they are value for money and priorities are set accordingly. Particularly in view of the OFT's admitted resource constraints there must be clear evidence that a market study is needed and will represent value for money and not just that it is an interesting market to study.

27. The most analogous NZCC investigation to a market inquiry, the NZCC's four year investigation the electricity sector,[14] was the single most expensive

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[9] Prices oversight - Parliament of Australia, citing the Australia Productivity Commission, March 2001a, op. cit. XXIII and 88p, available at: http://www.google.co.nz/url?q=http://www.aph.gov.au/parliamentary_business/committees/house_of_representatives_committees%3Furl%3Defpa/accc9900/chapter3.pdf&ei=RfMXU8shyZmSBZGFgdgC&sa=X&oi=unauthorizedredirect&ct=targetlink&ust=1394080333006506&usg=AFQjCNH6kkApMzq9BboQxLvkrFp1LvuDtw

[10] ACCC, "*Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol*", December 2007 at page vi.

[11] ACCC, "*Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*", at p.14-15.

[12] Great Britain: Parliament: House of Commons: Trade and Industry Committee, "*The Work of the Office of Fair Trading: Twelfth Report of Session 2006-07 - Report, Together with Formal Minutes, Oral and Written Evidence*" (Paperback) at page EV52

[13] Ibid

[14] The Commerce Commission investigated whether any participants in the wholesale or retail electricity markets may have breached Part 2 of the Commerce Act. The investigation was opened in late 2005 after a number of complaints about high electricity prices, large company profits, a perceived low level of competitive activity and allegations of anti-competitive conduct:

investigation in the NZCC's history, with the costs to the NZCC (let alone the businesses investigated) of that process understood to be in the millions[15] (which would not be out of line with the costs identified to be regularly incurred in the UK and Australian market investigation processes). There, too, the NZCC found no evidence of breaches of the Act, but issued one warning regarding a risk of a breach.

28. Accordingly, there would need to be a strong case that the benefits of NZCC market studies would outweigh the detriments before any such market studies are introduced. Our view is that, if there is a case for considering the introduction of such a power (which we doubt), then the appropriate forum for considering such a significant step, and before any recommendations are made, is for a specific consultation process that calls for submissions from all affected parties - not just those in the services sector.

**Russell McVeagh**
**7 March 2014**

http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2009/commercecommissionfindsthatelectri

[15] Commerce Commission Annual Report 2008/09, p15 notes that this was one of two significant unilateral conduct investigations closed in that year. In 08/09 unilateral conduct investigation expenditure was in excess of $2m and in 2007/08 it was $1.5m.