NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION TO THE COMMERCE SELECT COMMITTEE ON THE SUPPLEMENTARY ORDER PAPER AMENDING THE COMMERCE AMENDMENT BILL

SEPTEMBER 2000

1 Introduction and summary

1.1 This submission on Supplementary Order Paper No 37 amending the Commerce Amendment Bill is made by the New Zealand Business Roundtable (NZBR) an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that benefit New Zealand as a whole.

1.2 The NZBR has taken a close interest in Commerce Act issues because of the Commerce Act's pervasive influence on commercial decision making in New Zealand.

1.3 We presented a submission on the Commerce Amendment Bill to the Commerce Select Committee in July 1999 and this submission should be read in conjunction with the earlier one. Our submission opposed increasing the penalties for breaches of Part II of the Act.

1.4 Supplementary Order Paper No 37 amending the Commerce Amendment Bill proposes a number of major changes to the Commerce Act and to the role of the Commerce Commission. Our view is that changes to the Act should only be introduced if they are clearly shown to be necessary. Changes to the Act are inevitably costly because of the uncertainty that results. Changes also risk producing unexpected effects.

1.5 The main changes proposed in the Supplementary Order Paper and our comments on them are as follows:

(a) The title of the Commerce Act is to be replaced by a new purpose provision.

We believe that economic efficiency should be the objective of the Commerce Act. The proposed change does not explicitly endorse this objective, although it appears to represent a tentative step towards an efficiency objective.

(b) Clause 3 of the Commerce Amendment Bill, which widened the scope of section 30 of the principal Act, is to be removed.

We support the removal of this clause, which would have captured a number of practices that did not have an anti-competitive effect.

(c) The threshold in section 36 will be changed from 'dominant position' to a 'substantial degree of market power'.

We strongly oppose lowering the threshold to a substantial degree of market power. We believe that a 'high degree of market power' is the appropriate standard.

(d) The threshold applying to acquisitions is to be changed to a test of 'substantially lessening competition'.

We strongly oppose lowering the threshold because it will significantly increase the direct and indirect costs imposed by the Act. The change risks preventing mergers that would otherwise drive costs and prices down. It increases the scope for the Act itself to be used anti-competitively.

(e) The Commerce Commission will be given the power to issue 'cease and desist' orders.

We strongly oppose this proposal, which creates a conflict of interest for the Commission while markedly expanding its role. There is little justification for giving the Commission this power, and the benefits claimed are likely to be illusory. Concerns about court processes should be addressed by direct reform, although inevitably such processes will remain costly.

(f) The Commerce Commission will be exempt from the requirements to give undertakings for damages.

We oppose this change. We believe the requirement to give undertakings is a proper discipline on Commission actions and an incentive to ensure that the cases it takes are sound.

2 Purpose of the Act

2.1 The NZBR has long argued that economic efficiency should be the primary objective of the Commerce Act. An objective of economic efficiency focuses on ensuring that the mix of goods most preferred by consumers is produced at minimum cost. The efficiency approach aims to maximise the size of the economic cake.

2.2 The efficiency detriment from monopoly behaviour is the loss of welfare that results when consumers, in the face of monopoly prices, choose to buy substitute products that are more expensive to produce than the monopolist's product or are of lower quality. For a given level of consumer satisfaction, monopoly behaviour results in a waste of resources.

2.3 An efficiency standard puts equal weight on consumer and producer interests rather than arbitrarily favouring one over the other. Thus, the transfer of income from consumers to producers that is associated with monopoly pricing is not a detriment from an efficiency standard. Economics provides no way of determining whether one particular division of the gains from trade between consumers and producers is superior to another. It also recognises that consumers will only buy goods from producers if the benefits to them exceed the price they pay, even if this price includes an element of monopoly profit.

2.4 Under an efficiency standard, competition is valued to the extent that it achieves an efficient outcome – it is not valued as an end in itself.

2.5 Although Commerce Act decisions may affect the distribution of income, we do not believe that the government's income distribution objectives should be pursued through competition policy. The Commerce Act is not a transparent or effective means of achieving government's income distribution objectives. Income distribution objectives can be achieved more assuredly and efficiently through other mechanisms such as the tax and transfer system.

2.6 The Supplementary Order Paper proposes that the purpose of the Act be defined as being "to promote the efficient operation of markets through the promotion of competition for the long-term benefit of consumers". The proposed change appears to clarify that competition is not an objective in itself, but instead is the means to achieving the end of long-term consumer welfare. The new provision may result in the Commerce Commission and the courts placing more emphasis on achieving efficient outcomes over time. Defining the purpose of the Act as being "to promote the efficient operation of markets" without the rest of the proposed change would provide greater clarity that efficiency is the objective of the Act.

2.7 Economists would generally agree that a market is efficient if it maximises the sum of producer and consumer surplus over time. Consumers gain when producers, spurred by the prospect of earning profits, enter markets, undertake investments and innovate to produce the goods and services that consumers want. Market entry, investment and innovation by producers will be reduced (and consumer welfare harmed) if there is a substantial risk that the returns from such investment (including supernormal profits) are arbitrarily confiscated by actions taken under the Commerce Act.

2.8 We are concerned that the reference to the "long-term benefit of consumers" might be interpreted as introducing a distributional criterion. A distributional criterion would have a seriously detrimental impact on

efficiency and would be strongly opposed by the NZBR. However, as long as the relationship between producer surplus and long-term consumer welfare is recognised by the courts and the Commerce Commission, the proposed wording should not have this adverse effect.

3 Removal of clause widening scope of section 30

3.1 We support the removal of the clause widening section 30 to bid rigging, market allocation and output limitation agreements given the likely harm the changes would have imposed on many efficiency-enhancing business arrangements such as franchising.

4 Changes to thresholds in the Act

4.1 The Act uses thresholds to help eliminate from consideration those arrangements that are unlikely to create competition policy concerns. The thresholds should be set at a level that trades off the risk of allowing undesirable behaviour against the costs of administering the regime and the costs of deterring efficiency-enhancing behaviour.

4.2 The government has not established that the proposed changes in the thresholds in the Commerce Act would improve the trade-off between costs and benefits. The justifications for the proposed changes are weak. Most examples of problems with the current thresholds are based on worse case hypothetical situations which might (or might not) have resulted in an increase in collusion. There is little evidence that collusion is a problem in New Zealand.

4.3 In our view, any benefits from the proposed changes are hypothetical, yet the measures will without doubt add costs and uncertainties for businesses. Most large companies already devote substantial resources to ensuring compliance with New Zealand's laws, including the Commerce Act. Any tightening of the Commerce Act requirements will increase compliance costs. More stringent provisions will further encourage company executives to be risk averse – to forgo positive opportunities and investments because they risk breaching the uncertain provisions of the Act.

4.4 Our judgment is that a single threshold of high market power for trade practices, business acquisitions and the use of market power provisions (section 36) would best focus attention on those situations that cause the most concerns while limiting the costs of the Act. High market power was

the test developed by the courts using an economic interpretation of 'dominance'.

4.5 The proposed 'lessening of competition' threshold sets the standard for acquisitions too low. The lower threshold will lead to an increase in the number of business acquisitions scrutinised by the Commerce Commission, and increase the number of firms that are forced to seek authorisation. This will increase transaction costs (Commission fees, legal expenses and managerial resources), and deter some firms from pursuing acquisition opportunities. Firms will face greater uncertainty as to the legality of proposed transactions and efficiency-enhancing merger activity will be deterred. The lower threshold increases the opportunities for rivals to make anti-competitive use of the Commerce Act. Competitors often oppose mergers because improvements in the merged firm's efficiency result in it being a more vigorous competitor.

4.6 The change will impair opportunities for growth and rationalisation through business acquisitions. Given the importance of the threat and practice of takeover in ensuring that business assets are allocated to their most efficient use and that the costs of production are minimised, the negative effects on efficiency could be substantial.

4.7 The Business Acquisition Guidelines developed by the Commerce Commission for the existing Act have significantly reduced the uncertainties faced by businesses and their advisors in determining whether or not an acquisition might create competition concerns. The Australian Competition and Consumer Commission (ACCC) guidelines based on a lessening of competition standard provide firms with an extremely limited safe harbour. The reduced safe harbours will force most parties to seek clearance or authorisation, forgoing the substantial efficiency benefits that have been delivered by the voluntary notification regime.

4.8 We do not support the 'substantial degree of market power' standard that is proposed for section 36. Lowering the threshold would increase uncertainty for firms in concentrated markets, increase the possibility that innocent behaviour is wrongly challenged, increase the anti-competitive use of the Commerce Act to attack successful incumbent firms, and increase compliance costs. Given these increased risks and the absence of evidence that collusion is a real problem in New Zealand except in hypothetical circumstances, we conclude that section 36 should continue to focus on single firm behaviour.

5 Cease and desist powers

5.1 The Supplementary Order Paper proposes giving the Commerce Commission the power to issue cease and desist orders. We do not support this change, particularly given the weak justifications advanced for what is a major change in the Commission's role.[1]

5.2 The proposal for change appears to be based on concerns about the costs and delays associated with legal processes as well as concerns that the current powers are not sufficient to allow the Commission to stop anti-competitive actions in a timely manner.

5.3 In our view, problems with court processes should be dealt with directly. Progress has been made in improving court processes, and further options should be investigated more thoroughly. However, it seems inevitable that court processes will remain relatively costly.

5.4 The proposal to give the Commission cease and desist powers seems unlikely to reduce costs substantially. By replicating the judicial process within the Commission (which we believe is essential in the interests of natural justice), most of the hoped-for benefits of a lower cost system will be lost.

5.5 Many of the parties subject to a cease and desist order can be expected to immediately appeal that decision to the High Court. Given rights of appeal and the judicial review associated with the cease and desist orders, savings in time and cost will be minimal, if they exist at all. In fact, it is possible that the overall costs of litigation may be higher rather than lower.

5.6 The proposed change will result in the Commission both prosecuting and judging the merits of applications for cease and desist orders. This results in a conflict of interest for the Commission.

5.7 Some protection against the inherent conflict of interest that results from these joint roles is provided by the appointment of independent Commissioners, the provision for hearings, cross examination of witnesses and the right of appeal. However, it is not clear that this separation completely deals with the actual or perceived conflicts of interest.

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[1] The Commerce Commission suggests that this change is neither required nor desirable in the New Zealand situation. See Office of the Minister for Enterprise and Commerce, "Paper 4 – Improving Court Processes", paper addressed to the Chair, Cabinet Economic Committee, (undated), p 4.

5.8 The suggestion that the Commerce Commission needs cease and desist powers because it may not be able to obtain an injunction quickly enough to prevent anti-competitive behaviour does not appear to be true.

5.9 The ability of the Commission to apply for interim injunctions provides a strong safeguard against anti-competitive harm. In the majority of cases where an interim injunction could have been sought, the Commission has managed to achieve agreement through a deed with the affected parties.[2]

5.10 The Commissioners appointed to hear applications for cease and desist orders will not necessarily be judges but rather barristers or solicitors of at least 5 years' standing. These individuals are likely to have less experience and expertise than High Court judges. They will be involved in relatively few cases during any year. There is therefore a substantial risk that their decisions will be inferior to those made by High Court judges.

5.11 It is important also to note that while delays in court processes may sometimes work to the advantage of a dominant firm, competitors to a dominant firm also have incentives to use the judicial process to advance their own interests. By seeking and obtaining an injunction, a competitor may be able to impose costs on a dominant firm. Court actions can divert key managers and technical people from a primary focus on market opportunities and innovation. A wrongly imposed cease and desist order may impose substantial costs on an incumbent firm.

6 Commerce Commission undertakings for damages

6.1 Currently the Commerce Commission is required to give an undertaking for damages if it seeks an interim injunction from the courts. The government provides the Commerce Commission with an indemnity of up to a maximum liability of $40 million per case. The SOP proposes that the Commission be exempt from the requirement to give an undertaking, and that the court in determining whether to grant an injunction should not take this into account.

6.2 The NZBR opposes this change. The requirement for the Commission to give an undertaking as to damages provides it with strong incentives to ensure that its case is sound and that the risks of taking action are carefully considered. The requirement to give undertakings provides an important protection for firms subject to proceedings where the Commission's analysis

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[2] *Ibid*, p 4.

proves to be wrong. Although the requirement to give undertakings may result in the Commission taking a risk averse approach to interim injunctions (despite the indemnity provided by the government) we believe that a cautious approach is justified given the potential harm imposed by an interim injunction.