

Speech to Wellington District Law Society

Law Practitioners Seminar Series

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Kensington Swan, 89 The Terrace, Wellington

Introduction

Good afternoon and thank you, Hayden, for your warm introduction. I am delighted to be here today as part of the Wellington District Law Society Law Practitioners Seminar Series..

The Commission's role is to foster competition, and today I will be speaking about the benefits that competition offers, what we are doing, and what we intend doing in the areas of Commerce, Fair Trading and Consumer Credit Law. I will also touch briefly on our economic regulatory responsibilities and how, where there is little or no competition, the Commission aims to foster the outcomes over time that could be expected from competitive markets.

In talking about Commerce, Fair Trading and Consumer Credit laws, it is important to remember that these laws impact the lives of every New Zealander. We all, as consumers, have a right to purchase goods and services without deception, businesses have the right to compete on a level playing field, and when we borrow money for a car, house or appliance, we have the right to know and understand exactly what we are signing up for.

So I want to talk a little about all of these areas, today, and particularly focus on the areas where we are taking enforcement action. I will also give you a glimpse of what lies ahead, as the Commission has recently been re-prioritising its enforcement focus and has some new regulatory responsibilities, and briefly look at the implications for competition from the global downturn.

Competition

Competition is the basic underpinning of a market economy. The OECD Secretary General Angel Gurría, said, “Greater competition can boost a country’s growth and productivity. Conversely, restricting competition harms economic performance and delays development.”

We all understand the basic principle that customers vote with their feet. Those businesses that best meet customer demand – with competitive prices, and quality goods and services – will thrive. While those that don’t, fail. In this way a competitive market is self-regulating. Consumers, and those businesses who ‘deliver the goods’, benefit.

Consumers benefit from the pressure to lower prices and raise quality. Successful businesses, too, come out better off. This is because competition encourages productivity by creating incentives to work smarter. A competition-focused economy is also more attractive to foreign direct investment, because it is one in which businesses are likely to succeed or fail on their merits.

A competitive market place is a tough testing ground where businesses must constantly strive to be the best. However, there will always be firms that look for an easy way out. Those businesses come to our attention for collusion, abuse of market power or misleading customers.

What the Commission is doing to encourage competition

This year, the Commission has set ourselves the task of reviewing our major litigation portfolio to assess what further action we can take to ensure that cases proceed to full trial, only where no alternative forms of resolution are available.

Full defendant trials absorb considerable resources and the Commission wants to ensure that its resources are used to best effect. Seeking to use a wider range of interventions to resolve some cases more readily, is one avenue we can pursue to achieve this.

Cartels

Cartels remain a major focus of our competition work. Cartels are widely considered to be the most harmful of anti-competitive practices. They have an immediate impact on downstream businesses that rely on the cartel for necessary inputs, but, also consumers of the final product suffer by having to pay higher prices.

The success of our cartel leniency programme has led to more cases coming to our attention. Cartel enforcement work now takes up significant resources. In many cases applications for immunity are received from parties who are subject to high profile cartel investigations in other jurisdictions. They file leniency applications here at the same time that they file them with other anti-trust authorities.

The Commission currently has 11 active cartel investigations. They impact on a range of industries, including electricity (the gas insulated switchgear cartel), air cargo, freight forwarders, and cardboard manufacturing. Seven of the 11 cases originated through the leniency programme, proving how successful it has been.

We have recently closed two cartel cases. The Commission reached an administrative settlement where an elevator company alleged that one of its sales managers had been approached by an employee of a competitor to engage in price fixing. A formal warning was given both to the company from which the approach had been made and to the employee in question. In relation to the fine papers cartel, the Commission discontinued proceedings after obtaining information from an overseas regulator which had not been available when proceedings were commenced.

This illustrates the value of effective international co-operation and information sharing, as the Commission may never have initiated proceedings if that information had been available at the outset.

Of the remaining active cartel cases, seven are ongoing investigations, while the other four are currently in litigation or have been approved for litigation.

Major investigations are continuing in two large and complex international price fixing cartels in the air cargo and freight forwarding markets, as well as for an Australasian cartel investigation in the cardboard market. A decision on whether to take civil proceedings in the air cargo case will be taken by mid-December.

The Commission takes compliance with its section 98 notices seriously as these notices are an extremely important investigative tool. The Commission considers that parties who believe they have a viable defence would be well advised to engage with the Commission's investigation rather than resorting to expensive and time consuming litigation. As the High Court and Court of Appeal have noted in the recent AstraZeneca proceedings, an investigative body like the Commission should not be prevented from investigating because an alleged defence or statutory exemption is raised at the outset.

As is the case for most areas of modern business, the Commission faces increasing complexity in its work. An illustration is provided by the Commission's action against the New Zealand credit card industry over the fees the banks agree between themselves for dealing with credit card transactions. This case now involves some 11 defendants, including Visa and MasterCard with international transactions totalling some \$28.2 billion in 2007. The case will be heard in the second half of 2009.

Can we be more effective in our enforcement work? The answer is that we can, with the right tools. We are reviewing our Leniency and Co-operation policies, which can be effective in identifying the existence of cartels.

In this review we are taking account of the equivalent programmes of our major trading partners and the recommendations of the International Competition Network. The draft of the new policy will be circulated for public comment early in the New Year. Our experience with other draft Commission policies has been that the legal profession has come forward with a number of valuable suggestions, and I am sure this will be case for the Leniency Policy review also.

Many cartel cases will be resolved through in-court settlements. We encourage this, where appropriate, as there are often methods of more speedy resolution than proceeding to trial and appeal. The Commission is now signalling that it is seeking to use a wider range of interventions to resolve some cases more quickly, and freeing resources for new investigations.

The Commerce Commission (International Co-operation and Fees) Bill was introduced into Parliament in September this year, but had not had its first reading before Parliament was dissolved prior to the election. The bill, as introduced, provides for greater co-operation between us and our overseas counterparts, particularly the Australian Competition and Consumer Commission (ACCC). The bill would allow us to share information acquired from our own investigations with other regulatory bodies, even where that information would otherwise be confidential. It also permits the Commission to exercise statutory information gathering powers to assist its overseas counterparts. We expect reciprocal arrangements could provide us with information from overseas regulators that would assist our cartel investigations.

The Commission is also aware of the limitations of a financial penalty regime such as ours when dealing with international cartels.

The scale on which many cartels are operating, means that fines of the magnitude we are imposing might be seen just as a cost of doing business, and not as a deterrent.

A range of studies shows that for effective deterrence financial penalties need to be a significant percentage of turnover, even up to 150%.

But this approach remains risky because, if followed, it could lead to bankruptcy and more concentrated markets.

Internationally, there appear to be two approaches to deterring cartel behaviour. Some jurisdictions have significantly increased financial penalties, as in the EU, with penalties of €1.3 billion in its car glass cartel case. Some other jurisdictions have moved to criminal sanctions, as has the UK, following the approach of the United States. Criminalisation is promoted by agencies such as the OECD and the US Department of Justice as the most effective way to address the significant economic harm caused. I also note that the Australians are shortly due to introduce a Bill criminalising cartel behaviour. This will enable the courts to impose a 10 year sentence on individuals found guilty of participating in a cartel.

Section 36: Investigations and Review

I want to turn now to section 36 of the Commerce Act, which deals with anti-competitive conduct by market participants with substantial market power. Ensuring that companies have a fair opportunity to conduct business in a market, and are not kept out or forced out by a business with substantial market power, is crucial to competitive markets.

The effectiveness of section 36 as a tool for preventing unilateral anti-competitive conduct is coming under increasing scrutiny in New Zealand. We are not alone in this – all western jurisdictions are facing the same challenge in relation to the equivalent provisions in their legislation. Much of the debate is based around the appropriate level of caution and the need to beware of false positives or false negatives. There is a need to ensure we do not chill pro-competitive behaviour, while at the same time ensuring that competition is not blocked. With the assistance of a panel of experts the Commission is undertaking a review of section 36. This review will assess the purpose of the section, the effectiveness of the current provision, and the effectiveness of the Commission's enforcement actions under the

provision. At the same time we will continue to take enforcement action under section 36. The Commission has two cases before the Court against Telecom. In April this year, the High Court found that Telecom did not use its dominant position in the market for fixed line retail telephone services to residential customers when it introduced the 0867 package, so it did not contravene section 36. Our appeal in this case is scheduled to be heard by the Court of Appeal in April next year. The outcome of this appeal is important as it will give direction to future section 36 cases.

We are currently awaiting judgment in our second case involving access to Telecom's network by its competitors. This case is about the price, and the manner in which Telecom provided access to its high speed data services to competing telecommunications service providers during the period from late 1998 to late 2004.

Clearances

In the area of clearances, last year the Commission determined 26 applications for merger or acquisition, declining two of these. On average we took 47 working days to reach a decision. We continue to find that clearance applications are becoming more complex. Often they involve a reduction in competitors from three to two. Frequently applications involve a large number of markets, and the analysis of these markets can be complex. The assessment of markets and constraints on market power require extensive information and analysis. This is also the experience internationally.

As part of our continuing efforts to improve our processes, we recently reviewed our approach to clearances. As a result of this review the Commission is implementing a number of recommendations and will publish a revised version of the document 'Mergers and Acquisitions Clearance Process Guidelines', before the end of the month.

Fair Trading Act

I'll turn now to the Fair Trading Act, under which we receive the highest volume of complaints from the public, most frequently take businesses to court, and achieve some of the more high profile successes. I need only say the word 'Ribena' and I think most people in this room would know just how important the Fair Trading Act is for the average consumer, and for firms in retail markets.

For markets to work effectively there must be fair and accurate information so that consumers can make properly informed buying decisions. The reason we took the Ribena case so seriously was because consumers were told the product had certain properties it did not possess. It was a model case because it was clear there was consumer detriment – New Zealanders had been misled as the product did not have the level of Vitamin C claimed. But importantly also, there was competitive detriment to other businesses.

Because we receive so many complaints from consumers each year, we are careful to prioritise Fair Trading investigations and litigation to ensure we achieve the most impact. One significant consideration is the scale of the detriment.

A series of cases we have taken against a number of banks and credit card companies is a good example, demonstrating wide detriment. Nine financial institutions have admitted to inadequate disclosure of currency conversion fees. The case saw record penalties and compensation under the Fair Trading Act of more than \$24 million in refunds for affected consumers, as well as \$377 thousand in fines, and \$550 thousand in costs.

Achieving refunds and penalties is only part of the picture though. A key aim of any action taken under the Fair Trading Act is to ensure businesses comply with the law and that there is industry-wide behaviour change. I think with these cases we have sent a very strong message to the banking industry that there must be adequate disclosure of all fees so that consumers are fully informed and can shop around for the best deals.

Similarly, the Commission has achieved a change in the behaviour of sun screen and tobacco companies for the way their products are marketed, without having to go to Court, enabling a speedy resolution to significant consumer health matters.

Increasingly, the Commission finds itself confronting the global market. This is no exception in Fair Trading. The proliferation of deceptive offers over the internet, and difficulties in identifying and taking action against those responsible, has increased the need for strong relationships with other enforcement agencies internationally. Scams and deceptions take many different forms, and the internet has allowed a new avenue for these rip-offs. But it is not just the internet. Consider for a moment how often your dinner is interrupted by a telephone sales pitch. What you may not realise is that increasingly the cold-caller is based in another country.

So what happens if that telephone sales pitch parted you with some of your hard earned money – but the product never arrived, and you belatedly discover the business you dealt with is based off-shore, where the Fair Trading Act does not apply.

Significantly, the Commission achieved an important precedent setting court ruling late last year in relation to these sorts of activities. We wanted to stop an Australian-based telemarketing company, and its affiliated companies, from selling memberships in New Zealand to an accommodation discount scheme that were effectively worthless. We were successful in gaining an injunction against Discount Premium Holidays preventing the company from continuing to offer the memberships. The Court's ruling that telephone calls into New Zealand constituted conduct in New Zealand means the Commission can take action against overseas conduct affecting New Zealand consumers.

New focus areas

One of the Commission's roles, and strengths I believe, is to scan the market and be aware of developing problem areas, under which enforcement action will be increasingly needed,

in order to keep markets dynamic and responsive to consumers' needs.

We continually reassess our priority areas. Last year we added telecommunications, particularly broadband offerings, as this was an area of emerging competition. This year we brought in two new areas of focus under the Fair Trading Act – environmental sustainability claims and retirement savings claims.

Environmental sustainability has become the catch-cry of business everywhere and has the potential to exert significant influence over a consumer audience that is increasingly aware of global warming and other environmental issues. Our Fair Trading team will shortly publish guidelines for businesses on making “green” claims.

The second new focus area is retirement savings claims. With the roll out of KiwiSaver, New Zealanders are increasingly turning their minds to retirement savings. There is now a proliferation of retirement savings products in the market.

The Commerce Commission will be taking a close look at the fees and returns being offered by retirement savings products, to ensure they do not mislead consumers, so that they can make informed choices about which provider and product to invest their money with. Hidden fees and even small discrepancies in interest rate offers can lead to substantial financial detriment to consumers.

Increased activity under the CCCF Act

I want to turn now to the Commission's work with the Credit Contracts and Consumer Finance Act (CCCF Act). The Act came into force from October 2003 in relation to buy back transactions of land, and fully into force in relation to consumer credit contracts, consumer leases and non-consumer credit contracts, from April 2005.

The Commission's enforcement actions under the Act have resulted in court ordered fines of close to \$200,000 being awarded against non compliant credit providers and also voluntary

and court ordered refunds in excess of \$3 million being returned to over 24,000 debtors. In addition, as the result of a CCCF Act investigation just last week, a settlement was reached under the Fair Trading Act with GE Money. 3610 affected customers will receive a total of about \$3.1 million in refunds after they bought items on ‘interest free’ terms but were incorrectly charged interest.

The Commission currently has 35 active consumer credit investigations underway, of which many relate to allegations of unreasonable fees. We have witnessed a marked increase in the number of complaints from consumers about credit contract matters, which demonstrates that consumers have become more aware of their rights under the Act.

During the early stages of its enforcement of the Act, the Commission took an educative approach to its compliance activities. Since the advent of the Commission’s first prosecution under the Act, the Commission has signalled quite clearly that it now expects compliance to be “the norm” and will, when appropriate, take higher level enforcement action. In short, litigation is now a priority for the Commission.

With some of the Credit Contracts and Consumer Finance Act remaining untested, the Commission intends to use civil and criminal proceedings to give creditors greater certainty about the obligations imposed under the Act, and an indication of how various provisions will be interpreted by the Courts.

Reasonableness of fees is a current area of focus. Anecdotally, the Commission is aware that many creditors have increased the fees they charge, some have matched their competitors, and some appear to have just selected a dollar value for their fees, without reference to their cost structures, even though credit fees must be based on cost. While the Commission recognises that justifying fees under the Act can be a complex process, involving consideration of accounting, economic and commercial issues, it still expects this process to be undertaken adequately if creditors elect to charge fees, rather than recovering their costs through interest rates. The consumer detriment in unreasonable fees cases can be considerable, impacting adversely on the debtor’s ability to repay the loan and their

subsequent credit opportunities.

The Commission will be issuing draft credit fee guidelines for public consultation early in the New Year. This will enable the credit industry to have greater clarity around how the Commission will interpret and enforce the credit fees provisions.

Given the ability of the Court to order refunds or reductions of unreasonable fees, the potential impacts of breaching the Act in this area can be significant.

Regulation

In some markets, for example, where natural monopolies exist, it is not possible to rely on competition, or the threat of competition, to ensure that resources are allocated and utilised efficiently in the economy.

The Commission currently has regulatory responsibilities in telecommunications, dairy, electricity, gas, and most recently the three major international airports.

Because competition is such an effective process for delivering low prices and high quality, in markets where competition is not possible, we try to mimic competitive outcomes through regulation.

In particular, this can occur when an industry has the characteristics of a ‘natural monopoly’, which is often the case for network and utility companies in the electricity, gas, telecommunications, water, rail and airport sectors. A natural monopoly exists when a particular set of goods and services can be supplied over time, by a single firm, at a lower cost than two or more firms.

Telecommunications markets are often characterised by the presence of large firms with substantial market power. However, unlike many utility markets, effective competition in telecommunications can be promoted through regulation. Once effective competition has developed, it may be possible for regulation to be reduced or removed.

Left unchecked, monopolies can exercise market power in a number of ways. They may: raise prices to earn persistent monopoly profits; not engage in efficient cost-cutting; under-supply their services; under-invest; and/or reduce service quality. The flip side of a monopoly is a ‘monopsony’, where the market has a single or dominant buyer—for instance, Fonterra in the dairy industry.

The Commerce Commission regulates a number of markets with monopoly or monopsony characteristics.

Telecommunications Regulation

Telecommunications is a market where there is still scope for the further development of competition, particularly in broadband and mobile services markets.

In the broadband market, the Commission has focused on setting terms and conditions, including price, for key wholesale inputs such as unbundled local loops. This work is almost complete. Industry has responded strongly to the availability of these services, and innovative offers to consumers have proliferated. The price of residential broadband services in New Zealand compares favourably to that in other similarly developed countries, and broadband growth has been strong.

In the longer term, network operators may be changing the way services are supplied to customers in quite fundamental ways, through the development of next generation networks, including fibre deployment. The Commission is undertaking a major project scoping the impact of next generation networks, and will hold a public conference early in the New Year to explore the opportunities and challenges associated with such networks.

Mobile services markets continue to present challenges as, by international standards, average mobile calling per user remains low, and prices remain high.

The Commission has continued its strategy of seeking to lower barriers to efficient entry for new entrants to the mobile service market. In this regard New Zealand Communications is expected to launch services in 2009. The Commission is also investigating whether extending the scope of regulation to mobile termination charges would promote competition.

The three-way operational separation of Telecom New Zealand – into fixed network, wholesale, and retail services - was required by the Telecommunications Act 2001. This is a significant development, along with measures to provide more transparency. Successful implementation of operational separation, particularly against a backdrop of rapid technological change, may provide scope for lessening legacy regulation.

Key features of the Commerce Amendment Act

You will be aware that Parliament recently passed the Commerce Amendment Act. The amendment is a significant change which is designed to create greater certainty and provide a broader range of “fit for purpose” regulatory instruments.

The Commerce Amendment Act amends the regulatory provisions in Parts 4, 5 and 6 of the Commerce Act. Also, Part 4A—which is specific to the regulation of electricity lines services—will be repealed on 1 April 2009. The amended provisions directly affect the scope and approach of the Commission’s role in regulating electricity and gas distribution/transmission services, and extend the Commission’s responsibilities to include the regulation of specified airport services. Most of the provisions in the Amendment Act came into force from 14 October this year, although the majority of provisions relating to electricity lines services will not come into force until April next year.

A key feature of the new regulatory framework is an overall purpose statement common to all the regulatory provisions under the Act. The prior lack of a purpose statement in Part 4

of the Act had led to litigation.

Although the Commission had its interpretation of the previous Part 4 provisions upheld by the Court of Appeal earlier this year, the inclusion of the new purpose statement is an important step toward improving clarity.

The new Part 4 regulatory regime provides for the Commission to undertake an inquiry at the request of the Minister of Commerce, or on its own initiative, into whether, and how, to regulate particular goods or services.

The types of regulation provided for in the Act now include: information disclosure regulation; negotiate/arbitrate regulation; default/customised price-quality regulation; and also individual price-quality regulation. Part 4 also directly imposes regulation on certain electricity, gas and airport services.

Another key feature of the new regime is the introduction of “input methodologies”. These are the rules, processes and methods to be set upfront and applied by the Commission when implementing various regulatory instruments. Input methodologies are intended to promote certainty for suppliers and consumers. The Commission needs to set input methodologies applying to the regulation of electricity, gas and airports by June 2010.

We intend consulting on a discussion paper next month, which looks at proposed regulatory principles and our preliminary interpretation of the amending legislation.

There are also new appeal provisions relating to Commission decisions on input methodologies, as well as to Commission determinations on customised and individual price-quality regulation.

Current economic environment

Due to substantial increases in prices and a slowdown in the economy the Commission was called upon to conduct market studies into supermarkets, dairy pricing, petrol pricing and

most recently electricity markets.

Although we do not have the authority to conduct this type of market study without reference to a merger application or other investigation, some countries' agencies can conduct market studies (eg ACCC and EC).

We are also aware that the crisis engulfing the global economy has implications for the level of cartel activity. In times of economic distress, the temptation for corporate executives to turn to price-fixing and market allocation for short-term relief is often irresistible.¹

According to a recent paper by an American anti-trust specialist, Don Klawiter, an historical review of economic downturns shows major global cartels over the years have had their origins at moments of economic stress. At these times, he says, executives believe their competitors will support them and not 'turn in' the cartel, as it is saving jobs and keeping the industry viable.

Finally, the Final Authorisations on the control of the gas distribution services of Powerco and Vector (Auckland) were announced by the Commission on 31 October 2008, following extensive public consultation on a wide range of relevant issues. A key aspect is the provision of commercially realistic rates of return on capital. The Commission considered the provision of such returns across a number of regulatory jurisdictions and took account of current economic conditions and the impact on the cost of raising and servicing debt. The Commission decided to allow a post-tax weighted average Cost of Capital of 9.59 percent per annum which is higher than all comparable allowances currently proposed by regulators in Australia and the United Kingdom.

Conclusion

I have talked this evening about the benefits of competition, and what actions the Commission is taking, and intends taking in the future, to promote competition. And in

¹ Klawiter, September 2008 Release Two, "Cartel Enforcement Today: The Perils of the Economic Downturn" available online at <https://www.globalcompetitionpolicy.org>

those markets where competition does not naturally exist, the actions we take to mimic the benefits of competition through regulation.

As you have heard, the Commission must continually adapt to changing markets, though our core business remains the same. Our aim is to promote dynamic and responsive markets so that all New Zealanders benefit from competitive prices, better quality and greater choice.

We believe that competition is the best way to allocate our scarce resources. It empowers consumers and, perhaps most important of all, competition provides the right incentives for firms to strive for excellence.

Consumers and businesses do need protection, but they should be protected *through* market forces, not protected *from* them.

I'd like to end with a quote from Herbert Hoover, the 31st President of the United States, because it so succinctly sums up the benefits of competition. He said, "Competition is not only the basis of protection to the consumer, but is the incentive to progress."i[ii]

Thank you.
