

Paula Rebstock's Keynote Address
“Enforcing Competition Law During an Economic Crisis”
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Thank you for inviting me to be part of this conference which will spend the next two days considering the current state of competition law and regulation. I would also like to acknowledge the Minister of Commerce.

I will talk, today, about the benefits that competition offers, what the Commerce Commission is doing, and what we intend doing under the legislation we enforce.

I will also speak on our economic regulatory responsibilities and how, where there is little or no competition, the Commission aims to foster over time, the outcomes that could be expected from competitive markets.

However, I would like to start by looking at the implications for competition from the global economic downturn and the financial crisis.

Competition and the economic downturn

The global economy is probably experiencing its deepest crisis since the Great Depression of the 1930s. Many governments are under pressure to protect, or even to bail out, particular firms and industries. There have been calls to pull back on the enforcement of competition and regulation policies. In times like this, understanding how markets work, and the place of regulation in markets, is fundamentally important.

When financial markets seize up, the impact is felt throughout the economy. The financial crisis is giving way to a real economy slowdown. Economic growth is slowing, or even going into reverse in some countries; unemployment is rising; and firms are experiencing falling profits and are planning to reduce investment. Falling demand in one country will lead to falling export demand in others, and so the economic slowdown will be transmitted around the world.

The Secretary-General of the OECD, Angel Gurría, explained the cause of the financial crisis as *a systemic failure*. He said, “*The failure was created by the system itself; by the system which we created; and by a toxic combination of unethical behavior by companies and a faulty regulation and supervision of their activities.*”¹

¹ Angel Gurría: The challenge of the financial crisis and faith in multilateralism. Helsinki, Finland, 19 January 2009

Mr. Gurría went on to say that 2008 was a reminder of how damaging badly regulated markets can be for the economy. He highlighted the importance of the market economy, and the role of competition authorities in guaranteeing it. The market economy functions through a framework of rules, and a part of the OECD's response to the crisis is to focus on reviewing and strengthening the financial, competition and governance framework.

The Commission believes that competition has a critical role to play in ensuring a sustainable recovery takes place. Neelie Kroes, the EC Commissioner for Competition, has pointed out that competition law is not the problem, but rather should be part of the long-term solution.²

Likewise, John Fingleton, the Chief Executive of the UK Office of Fair Trading, argues that some reactions to the current economic situation create the risk that the emphasis on open, competitive markets, and the benefits that they deliver, could be reduced, or even lost, as part of an over-regulatory response. He points out that the suspension of competition rules in the United States in 1933 is considered to have lengthened the Great Depression, and that the Japanese government's intervention to restrict competition in "structurally depressed industries" prolonged the recession in that country in the 1990s.³

The effect of the economic downturn on competition in New Zealand

The impact of the global financial crisis on the New Zealand economy has, so far, been relatively limited by international standards, although the worst could be yet to come.

In normal economic conditions, a central role of competition policy is to provide a level competition playing field, so that businesses may compete without artificial advantages, on their merits, and consumers benefit from being able to choose between a range of reasonably priced goods and services. This way, resources are allocated to where they are most valued, and are used efficiently. Wherever possible, competition law seeks to uphold competition standards for these benefits to be gained.

In normal economic cycles to relax such standards would be dangerous; it would risk favouring the inefficient and poorly managed business, against another, more efficient competitor; it would risk allowing anti-competitive mergers to proceed; it might even lead to anticompetitive arrangements between competing businesses to be overlooked. The issue for the Commission is that competition may be distorted if some competitors are given advantages, to the detriment of the effective working of the economy as a whole.

It has to be remembered that a recession, as part of the normal business cycle, although painful at the time, can facilitate strong improvements in long-term productivity. Unlike a

² Neelie Kroes: In defence of competition policy. Opening remarks at conference "Competition policy, growth and consumer purchasing power" in Brussels, 13 October 2008

³ John Fingleton's paper of 20 January 2009 is based on a speech he gave on 3 December 2008 at the Annual Charles River Associates Conference in Brussels.

boom, when inefficient players may survive and even grow, an economic downturn will tend to drive out less efficient firms. Harsh as it may sound, this could contribute to a stronger and more efficient supply base, by reallocating resources to where they can be more effectively used, and by driving innovation and productivity growth in the next period of expansion.

What about periods of economic crisis?

The Commission acknowledges that extraordinary times may require Governments to intervene in markets in the public interest. Sometimes Government will feel it necessary to act in ways that appear to diverge from the principles of sound competition.

Last week the Secretary General of the OECD and the head of the IMF stressed that while this may be necessary, countries should ensure that any support for individual companies and national champions should be transparent and temporary. Furthermore, they drew attention to the risks of escalating global protectionist measures and beggar-thy-neighbour responses. As a small trading nation the New Zealand Government has already signaled its concerns about this very risk.

Also, we are aware that in times of economic distress the temptation for corporate executives to turn to price-fixing and market allocation arrangements for short-term relief can be irresistible. According to a recent paper by an American anti-trust specialist, Don Klawiter, an historical review shows that major global cartels frequently have their origins in times of economic stress.⁴ It is possible that the economic slowdown may also result in the Commission seeing more applications for the authorisation of anti-competitive arrangements between businesses, and ultimately to have to deal with more such arrangements that have not been authorised.

Another effect we are seeing is a decline in merger clearance applications. Reduced merger activity has been observed internationally. The decline is presumably partly because of a tightening of credit available from the financial sector, and partly because of a “wait-and-see” attitude amongst potential acquirers. However, it is possible that clearance applications might increase in the future, if the recession bites more deeply, from proposals to acquire potentially ‘failing firms’.

So in this climate, how does the Commission proceed?

Cartels: Enforcement action taken

Anti-cartel enforcement activity has, for the past four years, been a priority area for the Commission, and in light of the issues I have already discussed, it is appropriate that this remains the case. Cartels have grown worldwide. In addition to consumers having to pay

⁴ Don Klawiter: Cartel Enforcement Today: The Perils of the Economic Downturn. www.globalcompetitionpolicy.org

more for their goods, and businesses having to pay more for input products and services, cartels undermine New Zealand's international competitiveness.

Cartels are difficult to detect and extremely difficult to investigate because of their secretive and international nature. Our leniency policy, where the first member of a cartel to blow the whistle is given immunity from prosecution in return for providing evidence, has been successful in detecting both international and domestic cartel activity. We will continue to strongly pursue cartels and take enforcement action to deter cartels from using New Zealand as their base.

Last year, the Commission closed or completed five cartel investigations and opened five new investigations. Last month another cartel investigation was opened, and there are now 14 active investigations. They cover a range of industries, affecting businesses and consumers across the community. Of those current cartel investigations, six are purely domestic cartels.

The six cartel cases currently in litigation involve credit card Interchange fees, Wood Chemicals, Air Cargo, Visy cardboard, Waikato Pathology and Gas Insulated Switchgear. To give you some insight into the diversity of the market situations in which cartels can develop, let me tell you a little more about two of those cases.

Air cargo cartel

In December the Commission initiated proceedings against 13 airlines and seven airline staff, including senior executives, for extensive cartel activity in the air cargo market. The allegation is that airlines throughout the world colluded to raise the price of freighting cargo by imposing fuel surcharges. This affected the price of cargo both into and out of New Zealand. Some airlines are cooperating with the Commission and an early resolution may be possible in these cases.

Over the more than seven years this agreement was allegedly in place, airlines obtained total revenue of about \$2.9 billion from transporting air cargo to and from New Zealand. The alleged collusion is likely to have caused extensive harm to the New Zealand economy. New Zealand is a long way from its overseas markets, and the impact on our ability to compete internationally will have been disproportionately greater than in other jurisdictions.

Credit Card Interchange Fees

The Commission is taking proceedings against 11 defendants, including Visa and Mastercard over the fees the banks agree between themselves for dealing with credit card transactions. This is a substantial case, as transactions on New Zealand Visa and MasterCard cards totalled \$28.2 billion in 2007.

This figure covers transactions made anywhere in the world, while the Commission's action concerns only payments made in New Zealand. These interchange fees are subject to close scrutiny by agencies around the world. We have alleged that fixing the interchange fees is anti-competitive and increases the cost of credit card services. The case will be heard in the second half of this year.

Review of the leniency and cooperation policy

Can we be more effective in breaking up cartels? The answer is that we can, with the right tools and resources.

We are reviewing our Leniency and Co-operation policies, which can be highly effective in identifying the existence of cartels and in assisting the Commission's investigations.

In this review we are taking account of our major trading partners' equivalent programmes and the good practice recommendations of the International Competition Network.

The Commission is also aware of the limitations of a financial penalty regime such as New Zealand's 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. As part of this review we are also developing guidelines on penalties for cartel offences.

The draft of the new policy will be circulated for public comment later in the year.

Section 36: Investigations and Review

Section 36 of the Commerce Act deals with unilateral conduct or 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 dominant business, is crucial to competitive markets.

The effectiveness of section 36 as a tool for preventing unilateral anti-competitive conduct is coming under increasing scrutiny here and overseas. The correct analysis of market power presents a fundamental problem that has been widely recognised, and presents a key challenge for competition authorities.

With the assistance of a panel of experts, the Commission is undertaking a review of section 36 to assess its purpose and effectiveness and will consider these issues in a New Zealand context.

The panel of experts includes Justice Gault, James Farmer QC, Peter Hinton, a partner at Simpson Grierson, Sir John Vickers of Oxford University and Stephen Calkins of Wayne State University Law School.

At the same time, we will continue to take enforcement action under section 36. One such case we continue to pursue through the courts is against Telecom. In April last 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 internet access package, and so did not contravene section 36.

The Commission lodged an appeal and the case is due to be heard next month. We consider this an important appeal. The Commission believes the competition issues had the potential to impact significantly on the telecommunications market. The case also deals with crucial legal issues that are not only relevant to this case, but also for future section 36 cases.

Another section 36 case we have recently investigated, and closed, involved a complaint against Fonterra for its introduction of a tactical pricing regime. Fonterra offered suppliers that had switched or were at risk of switching to a rival dairy processor, higher raw milk prices. Fonterra argued that the higher payments were offered in order to match those being offered by its competitors.

The Commission concluded Fonterra did not breach section 36 of the Commerce Act. While it is acknowledged that Fonterra is likely to have a substantial degree of market power in the raw milk market, the prices they offered to the targeted suppliers were no higher than those of their competitors and were, in some cases, lower.

In this instance, the Commission considers that Fonterra's behaviour is consistent with what can be expected in competitive markets.

Mergers in a time of economic downturn

As I noted earlier, we have seen a decline recently in the number of applications for clearance. Given the economic climate, we expect that of those we do receive, a few will base their applications for clearance on a "failing firm" argument.

We would expect that in using this argument to justify selling to a competitor with substantial market power the 'failing company' must be able to demonstrate that they have taken strong steps to either save the business or seek an alternative buyer which does not raise competition concerns.

The Commission fully understands that businesses in these circumstances will seek quick decisions. When a company is at risk of failing the Commission will make every effort to give these applications priority. For their part businesses can assist the Commission by providing quality, comprehensive information in support of their applications.

Earlier this month the Commission granted clearance on an application by Fletcher Building Ltd to acquire 100 % of the shares and assets of Stevenson Group Limited's masonry businesses in Auckland and Whangarei. There was time pressure on this

application, because Stevenson had already set a date on which it would close the doors. Jobs hung in the balance. And yet it was important the Commission vigorously apply the requirements of the Commerce Act, and make the right decision for the markets affected, in the wider public interest.

In this case the Commission considered that there would not be a substantial lessening of competition in the relevant market, because there was no realistic prospect of another competitor purchasing the plant and keeping it operating in the masonry business.

Given the current environment it is important that companies and their legal and economic advisers understand the Commission's approach. For this reason, the Commission will shortly produce guidelines on the issue of "failing firm" arguments in clearance applications.

More guidelines developed - Commerce Act

Developing guidelines is an area of focus for the Commission. The Commission is increasingly looking for new ways to influence industry behaviour to enhance competitive markets, without resorting to costly and time consuming litigation. Guidelines are one way the Commission helps businesses to understand their responsibilities under the Acts which we enforce.

For example, at the end of last year the Commission released guidelines on the supply of school uniforms to inform schools on the possible Commerce Act implications of exclusive supply arrangements. We also published guidelines on the Process for Merger and Acquisition Clearance applications to assist businesses and their advisers when applying to the Commission for a clearance. And, during 2009, we intend to complete the development of a streamlined process for applicants seeking authorisation of straightforward mergers. The aim is to provide a fast track alternative for such applications.

We have also been adding to a suite of guidelines under the Fair Trading Act, so let me now turn to our activities in Fair Trading and the Credit Contracts and Consumer Finance Act.

Keeping consumers informed

Dynamic responsive markets benefit consumers and businesses. Under the Fair Trading Act we encourage traders to give consumers accurate information and consumers to take responsibility for making informed decisions, and when necessary we take litigation.

Our Fair Trading work ties very closely to our enforcement of the Credit Contracts and Consumer Finance Act 2003. This Act protects the interests of consumers in connection

with credit contracts, consumer leases, and buy-back transactions of land. I will come back to this shortly.

Firstly, let us come back briefly to the current economic environment. Businesses thrive in an environment where consumers are confident. The latest OECD data on consumer confidence, however, shows it has experienced an unprecedented collapse.⁵ Consumers, with less money in their pockets, will be more discerning than ever before. In order to make good choices they need accurate information from traders, but they also need to be given the opportunity to make a choice in the first place. In a recent editorial for the OECD, Angel Gurría said “One sure protection for consumers is choice, and governments must uphold competition standards for this to happen.”

In times of economic crisis we can expect to see more traders using misleading information to try to gain a competitive advantage. Consumers need to be alert to this, and increasingly they are. The Commission receives more than 15,000 complaints each year via our Contact Centre. Obviously we can not investigate every complaint, which means we need to look at making the most of every intervention.

In practice this means firstly, prioritising major cases of egregious industry practice and consumer detriment. Secondly we focus on key target areas – these are currently sustainability, retail telecommunications products and financial products. And thirdly, we will do more to educate businesses and consumers about how not to breach, or fall victim to a breach of the Fair Trading Act or Credit Contracts and Consumer Finance Act.

Let me start with the last of those points. The Commission has been working on producing guidelines on several topics which help traders to understand their obligations under the Fair Trading Act. Last year our guidelines on green-washing were very well received by industry, and soon we will be releasing guidelines on carbon neutral marketing claims. Guidelines will also be produced on “Made in New Zealand” labelling. We are also finalising guidelines that will address how the Commission applies its enforcement criteria with regard to the reasonableness of credit fees. We will be consulting on these shortly.

I mentioned our focus areas of sustainability, telecommunications products and financial products. It is an important job of any competition agency to scan the markets and keep abreast of new technologies, consumer trends and business developments. In any emerging area of competition it is common for some business to try to gain competitive advantages, sometimes illegally. The area of sustainability claims is a very good example. Significant competitive leverage may be gained by claiming to be carbon neutral, but proving the claim is true may be difficult. You can expect to see more activity by the Commission under this banner this year.

The importance of financial products to the economy and the long-term well-being of New Zealanders has been brought home over the past year as we have seen many people

⁵ Financial crisis sees collapse in OECD consumer confidence:
http://www.oecd.org/document/4/0,3343,en_2649_33715_42061060_1_1_1_1,00.html

lose their retirement savings. We will focus on ensuring that claims about financial returns are not misleading. When we are talking about tens and hundreds of thousands of dollars saved over a lifetime the devil is in the detail –consumers need good quality information that they can understand, and it is very important that potential gains are not over-stated.

Other topics of interest to the Commission in the finance area at present include the reasonableness of credit card overseas transaction fees and late payment fees. You will be aware that we are also investigating the reasonableness of bank mortgage ‘break fees’.

I mentioned earlier the cross-over in our work investigating the Fair Trading Act and Credit Contracts and Consumer Finance Act. An example is the settlement the Commission recently entered into with GE Money.

GE Money admitted breaching the Fair Trading Act by making misleading representations to some customers that it was entitled to charge interest during an interest free period specified on their hire purchase contracts. The investigation had been undertaken by our CCCF investigators but in the end the breach was a Fair Trading matter.

As a result of this settlement about 3,600 affected customers will receive a total of approximately \$3.1 million in refunds. Working with GE Money, court action was avoided and consumers were reimbursed quickly.

Compliance with the Credit Contracts and Consumer Finance Act is a priority area for the Commission, given the deterioration in consumer confidence in the financial sector and the important role that a competitive lending market can play in strengthening the New Zealand economy.

Economic Regulatory Framework

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

In some markets it is not possible to rely on competition or the threat of competition to ensure that resources are allocated and utilised efficiently. 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, airport, water and rail sectors, among others.

The Commerce Commission regulates a number of markets with monopoly or monopsony characteristics. Let me start with telecommunications.

Telecommunications

The Commission's focus is to increase competition in telecommunications markets with targeted intervention, and to ensure that competition is sustainable in the longer term. A competitive telecommunications sector underpins economic growth and productivity. The government recognises this, and has stated that one of its top priorities is the roll-out of an ultra-fast national broadband network.

The Commission's main priorities in telecommunications are in the mobile and broadband sectors.

Our strategy in the mobile sector has been to lower barriers to entry to encourage efficient entry of a third network operator. The sector is on the brink of major, and promising, changes. Telecom is, in effect, re-entering this market with a new technology platform, which should make it easier for consumers to switch between operators. New Zealand Communications has also been building out its mobile network, and has announced that it will begin to offer services this year. International experience suggests that new entry into a market with only two players can deliver real benefits to consumers.

The Commission's work on national roaming and co-location on mobile towers has played a significant part in providing an environment in which investors feel confident in funding new entry, as well as investing in the existing players. The Commission is now reviewing mobile termination charges, to ensure effective competition in this sector. We expect to issue a draft recommendation to the Minister in June.

In the broadband sector, the Commission's work in setting terms and conditions for new regulated access services such as bitstream and unbundled loops is beginning to deliver results. 25,000 lines were unbundled by the end of December last year. While this number is not large, the rate of growth is promising. The rapid transition to VDSL technology in New Zealand is a good example of responsiveness to competitive pressure.

The Commission will finalise its initial set of decisions on regulated broadband services when we complete our Standard Terms Determinations on sub-loop services in May this year.

These cover the new infrastructure that Telecom is deploying in its cabinetisation process – the fibre to the cabinet, the cabinet itself, and the copper network between the cabinet and the home. As cabinetisation becomes more prevalent, there will be greater certainty regarding access arrangements for the new infrastructure.

The scope for creating innovative services in telecommunications which lower costs for businesses and increase value for consumers may provide the industry with some resilience in the face of the current downturn. The Commission is undertaking a study of the next wave of innovative technology in the industry – so-called Next Generation Networks – to gauge its impact on market structure and competition. This week we are hosting a Conference which will draw together international and local experience of the

challenges and opportunities arising from next generation technologies. This will feed into the draft report of the NGN Study.

Let me move now to the changes in our other regulatory responsibilities.

New and Extended Responsibilities

Late last year the economic regulatory provisions of the Commerce Act 1986 were amended via the Commerce Amendment Act 2008. These amendments provide a greater emphasis on improving certainty for regulated entities and providing incentives for investment. These are important objectives in the current economic climate.

The amendments to the Act affect the Commission's role and the scope of services that are regulated. Electricity lines businesses continue to be subject to specific regulatory arrangements, however, the Act now also sets out separate provisions for gas pipeline businesses and airports.

These sectors have a considerable impact on New Zealand's economy. The pricing of electricity, gas and aviation services provide important inputs into the productive enterprises of businesses across numerous sectors. As such they have a direct impact on businesses' ability to compete effectively in national and global markets.

New Objectives

A key feature of the new Part 4 of the Commerce Act is a new purpose statement that applies to all goods and services regulated under that Act. The statement has a number of elements in common with the Part 4A purpose statement for the targeted control of electricity lines businesses. The Commission welcomes the explicit emphasis in the new purpose statement on incentives for innovation and investment.

Two other features of the new regime are firstly that it provides for the Commission to undertake an inquiry at the request of the Minister of Commerce, or on its own initiative, into whether, and if so how, to regulate particular goods or services. And secondly, 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. Their purpose is to give greater certainty, and transparency which is expected to help improve the climate for investment in infrastructure.

New Mechanisms

The types of regulation under the new Part 4 differ from those under the previous regime. Previous options included control of prices, revenues and quality following a breach of thresholds, and an information disclosure regime for electricity lines services. On a number of occasions, the Commission also entered into administrative settlements with electricity lines businesses instead of declaring control.

The types of regulation that are now provided for comprise information disclosure regulation; negotiate/arbitrate regulation; and price-quality regulation.

All suppliers of electricity lines services (including transmission and distribution services), suppliers of certain gas pipeline services, and suppliers of specified airport services (at Auckland, Wellington and Christchurch international airports) are subject to information disclosure regulation going forward.

Most suppliers of electricity lines services (except those that are consumer-owned) and suppliers of certain gas pipeline services are also subject to price-quality regulation.

Transpower is subject to price-quality regulation following the expiry of its administrative settlement made under Part 4A in 2011.

New Challenges

The Commission is now faced with implementing the new regulatory regime within tight statutory timeframes. We have prioritised our workstreams and issued a discussion paper on the new regulatory provisions in December last year. We are currently reviewing submissions.

Our biggest priority is to determine the input methodologies for the specified regulated sectors by 30 June 2010. Another priority is to set the new default price-quality paths that will apply to suppliers of electricity lines services from 1 April 2010 and to gas pipeline businesses from 1 July 2010. Determinations on the default paths for suppliers of electricity lines services will be made by this December.

As I have said, Transpower continues to be subject to its administrative settlement. However, before the settlement expires in 2011, the Commission must make a recommendation to the Minister of Commerce on which type of price-quality regulation should apply to Transpower. We aim to make that recommendation by July next year.

The Commission is confident it can implement the new regulatory regime in a timely manner, but it will involve a series of tight consultation processes over the next 12 to 18 months.

Conclusion

I have talked, today, about the Commission's work programme across its portfolios of responsibility. And I have, I trust, demonstrated how this work benefits business and consumers.

As we enter a deep economic crisis, the preservation of competitive forces is more important than ever. Competition is vital to sustainable economic recovery and growth.

It would be unacceptable for the tough economic times to be used as a convenient excuse for collusive, anti-competitive conduct such as price fixing, market sharing and bid-rigging. Nevertheless, the Commission acknowledges that in times of crisis, governments will intervene in markets in the public interest. In so doing, creating permanent or long term distortion to competition should be avoided.

Last week the OECD and IMF recommended to 80 competition authorities and their governments that relief measures, if they have the result of restricting competition, must be temporary and monitored, and plans made to return markets to effective competitiveness in the longer term.

In our work, the Commission will be ever more vigilant to the potential for stressed corporate executives to turn to price-fixing as a means of short-term relief. On the more positive side, we will be mindful of time pressures associated with clearance applications involving a business at risk of failing. And we will be making it easier and less costly for businesses to gain clearance for straightforward mergers or acquisitions by streamlining the process.

We will be monitoring emerging consumer trends, and ensuring the basic principles of traders providing accurate information to consumers are not forgotten in a desperate bid to stay afloat. We will help reassure consumers that markets are still the best way to allocate a country's scarce resources and that they can have confidence in the rules governing New Zealand's market economy. And in the regulated industries, we will be working very hard to deliver on tight statutory timeframes as a result of the Commerce Act amendment, as we recognise the importance to these businesses of regulatory clarity, certainty and incentives to invest as they go forward.

Sound competition principles and a focus on the benefits that come from dynamic, competitive markets provide a sustainable path to economic recovery.

Thank you