

**Competition Update**

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## **Introduction**

Good morning and thank you Andrew for your warm introduction. I am delighted to be here today as part of the Auckland District Law Society “President’s Breakfast” 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.

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 dishwasher, 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.

## **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.”<sup>1</sup>

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. Companies bring out the “number eight wire” and get innovative as they try to out-think each other and be first to take up new technologies.

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, a fast buck, a leg up. Those businesses come to our attention for collusion, abuse of market power or misleading customers.

As New Zealand’s economy grows, so too does the sophistication of the activities of businesses that choose to operate outside of the law. The Commerce Commission makes

no bones about the fact it will go all the way through the courts in pursuit of deterrent financial penalties and criminal convictions for those companies.

### **What the Commission is doing to encourage competition**

Over the past year we have been working at completing investigations and litigation more quickly to ensure that competitive outcomes are delivered as soon as possible.

The Commission has also been selecting strategically important issues to receive a higher level of resources. The area we have signalled as a top priority for us is breaking up cartels.

Cartels have wide-ranging implications in their removal or reduction of competition between market participants. It is worth remembering that the victims of cartels are nearly always, in the first instance, other businesses. While end consumers will eventually suffer, the immediate impact is on downstream businesses, which rely on the cartel for vital inputs.

So, how are we doing? The Commission has a significant anti-cartel workload at present, including a new leniency application alleging price fixing in the European freight forwarding industry which is likely to have had an impact on the New Zealand market.

The Commission is investigating and prosecuting some 13 cartel cases with five cases now before the Court. Five of the 13 cases involve arrangements just within New Zealand, three involve Australasian businesses and five are international cartels. It is important that the Commission prosecute such activity where it is established that it had an impact on New Zealand's markets in order to deter future cartels, punish the participants and to get back some of the illegal gains.

The areas of commerce these cases involve cover a wide range of industry sectors. Cartels are happening in big markets and small. Cases being investigated or prosecuted involve health services, cardboard boxes, paper, the transportation sector (including air cargo and freight forwarding), the energy sector, the building sector as well as a number of inputs to basic industrial processes.

We recently received the judgment against Nufarm, in the timber preservatives cartel case in which the Commission has obtained the largest anti-cartel penalties to date. Three Nufarm companies, which operated the Fernz Timber protection brand, were fined \$1.9 million for price-fixing and market sharing with their competitor Koppers Arch.

The fines bring the total penalties handed down so far in both civil and criminal actions in the case to more than \$7.5 million. There are still proceedings to be dealt with against three individuals living overseas who are fighting the High Court decision on jurisdiction that allows the Commission to pursue them.

The size and complexity of the Commission's cases is well illustrated by the Commission's action against the New Zealand credit card industry over the interchange fees. This case now involves some 14 defendants including Visa and MasterCard. The arrangements as to interchange fees are subject to close scrutiny by agencies around the world. We have alleged that fixing the interchange fees is anticompetitive and increases the cost of credit card services. Credit card rules agreed to between the card operators and issuing banks prevent retailers from negotiating the merchant service fees, or charging credit card users extra to cover them. A court date has yet to be set for the proceedings, but it is likely to be heard in the second half of 2009.

The scale of the Commission's case is considerable. Transactions on New Zealand Visa and MasterCard cards totaled \$19 billion in 2004. In terms of volume of commerce affected alone, this case is the largest the Commission has initiated.

Can we be more effective? The answer is, yes we can, with the right tools. We have a leniency programme in place that enables the Commission to provide immunity from Commission prosecution, which gives a real incentive for those involved in cartels to step forward.

Leniency is awarded on the basis that the applicant will fully co-operate with the Commission. We currently have seven leniency cases in our anti-cartel programme.

While we do have one leniency application that relates to a purely domestic cartel, we are not yet seeing New Zealand firms using leniency to the extent that overseas businesses are. In part this might be due to the nature and level of penalties available. International firms have to face the prospect of severe sanctions in the EU and the US. Many Commonwealth jurisdictions have adopted criminal sanctions for cartel conduct. The EU has adopted significant financial penalties with recent cases resulting in fines in excess of €1 billion. (Microsoft)

Cartels are lucrative and secretive in most cases. The statutory penalties for cartel conduct in New Zealand are the higher of \$10m or three times the illegal gain, or if the illegal gain is unknown 10% of turnover. This is similar to the Australian penalties and represents a reasonable starting position for the imposition of significant financial penalties.

But we must acknowledge that one of the significant challenges for a financial penalty regime is that at the scale many cartels are operating, fines of this magnitude risk being seen as a cost of business. Internationally there appear to be two different approaches used to raise the stakes. Some have very significantly increased financial penalties as in the EU, while others have brought-in criminalisation as in the United States.

Criminalisation of cartel behaviour has happened in many overseas jurisdictions and is promoted by agencies such as the OECD and the US Department of Justice as the way to address the significant economic harm caused. Criminalisation is being pushed for in Australia at the highest level with a maximum prison term of five years proposed.

Amongst OECD countries the highest prison penalty for cartel behaviour is 10 years - in the United States- although the average among OECD countries that have criminalised cartels is three to five years.

The fact that financial penalties are not enough was demonstrated clearly in Australia when, having been fined for its role in the air cargo cartel, Qantas Chief Executive Geoff Dixon was quoted as saying “ we do not believe this or any further financial penalties will materially affect future operating results”.

When you consider the \$ US 68 million fine Qantas has to pay against the more than \$ US 600 million the airline earned from cargo alone in the six years it is alleged the cartel operated – it is easy to understand why a fine alone is not seen as a sufficient deterrent.

With a number of large cartel investigations on our books at present involving alleged cartel conduct by Australian companies, we have a great deal of interest in seeing moves on the other side of the Tasman to provide significant sanctions for cartel conduct. Four of our cases involve Australasian operations and the five international cartels we are investigating affect both New Zealand and Australia.

A further issue we are confronting is the lack of sophistication in the current sentencing approach. With cartel enforcement there are often a large number of parties involved. In the Wood Chemicals case the cooperating parties received an approximate penalty discount of 50%, even though the Commission had gone a long way down its investigation before parties started to come forward.

The issue for the Commission going forward is how to provide reasonable incentives for parties, other than the leniency applicant, to cooperate.

In many jurisdictions there are sentencing guidelines which provide certain and significant benefits to parties that cooperate at an early stage. Obviously it is much easier to set sentencing guidelines if you are the body that sets fines. For New Zealand the Courts will need to give sentencing guidance. One way this may be facilitated is for the Commission to set out its approach and rationale for sentencing submissions, recognising that the ultimate determination of penalty is for the courts.

A further area that does need some attention is the penalties for obstructing a Commission investigation. In the Wood Chemicals case the parties went to some lengths to conceal information. The Commission prosecuted the parties and achieved criminal convictions for the offences, but the penalties available under the Commerce Act are low. In the case of an individual the maximum penalty is \$10,000 and for a corporate it is \$30,000. These penalty levels can be contrasted with a recent case in the EU. The EU imposed a fine of €8 million for tampering with a seal put on a room containing documents obtained during a dawn raid. Excuses/explanations offered included: nearby vibrations, an aggressive cleaning product or a high level of humidity around the sealed room being searched.

Other areas of significance in the competition area include abuse of market power cases and I'd like to briefly update you on some running cases. We are awaiting the judgment in the 0867 case, where it is alleged Telecom breached the Commerce Act with its 0867 dial-up internet access service. The Commission issued proceedings shortly after Telecom introduced the 0867 service in 1999 and the case illustrates the time that such cases can take getting to trial.

We have also recently received a decision in the Bay of Plenty Electricity case. In this case we alleged that Bay of Plenty Electricity had used its dominant position for anti-competitive purposes. Disappointingly, the High Court found that the Commission had not established a breach of either section 36 or section 27 of the Commerce Act. We have now lodged an appeal to this decision.

We are shortly to have a further case against Telecom come to trial. In this case the Commission alleges that Telecom has priced access to its data tail services for high speed data transmission, for the purposes of deterring potential and existing competitors from engaging in competitive conduct.

Next let me turn to what has been happening in the area of mergers and acquisitions.

Under the Commerce Act, the Commerce Commission considers applications for the clearance of proposed mergers or acquisitions that might substantially lessen competition in a market. Last year (2006/2007) the Commission determined 18 clearance applications. Of these 3 were declined. On average we took 45 working days to reach a decision. This year, to date, we have determined 19 applications and the average time taken has reduced to 40 days on average. There has also been a corresponding reduction in the Commission costs as well as the time taken to release written reasons.

The Commission continues to find that clearance applications are generally becoming more complex, often because they involve a reduction in competitors from three to two, the number of different markets involved in any one application and the complexity of the nature of the markets. This is also the experience internationally.

As part of our efforts to continually improve our processes and procedures, we have recently reviewed our approach to clearances. As a result of this review there are a number of recommendations, which the Commission intends to implement in order to improve the clearance process.

Firstly, we will be recommending a change to the Commerce Act to increase the statutory timeframe for clearances from 10 working days to 40 working days.

Secondly, we will be producing process guidelines for clearances to provide applicants and practitioners with a better understanding of the Commission's processes, particularly key milestones. We will consult with interested parties once a draft of these guidelines is complete.

Thirdly, we are reducing the length of our written reasons for ‘straight forward’ clearances. From the start of this year, the length of written reasons for straight forward clearances has been significantly reduced. Straight forward clearances are those that can be cleared on the basis of existing competition and that do not raise novel issues. Full written reasons will still be prepared in those cases where the Commission declines a clearance or the merger results in a change to a previous approach to say, market definition, or where novel issues are raised.

There are a number of other issues and recommendations the report raised, which the Commission is currently considering. If you are interested you can find the full report on our website [www.comcom.govt.nz](http://www.comcom.govt.nz). You will find it under Publications in our Business Competition section.

Finally, you will be aware that later next month we have a date set in the Court of Appeal for the appeal of the High Court decision on the Warehouse matter.

It is not appropriate to go into any great detail here about the case, but I would note that there has been some commentary suggesting that what is being argued here is simply a matter of fact.

This is simply wrong. There are very important issues that go to the heart of the methodology to be used by the Commission to determine whether a substantial lessening of competition will occur if a proposed merger or acquisition is allowed.

The Warehouse case is important not only because it has an impact on all consumers. It also has the potential to redefine the term “substantial lessening of competition” and as such it is important to take the case a further stage.

## **Fair Trading Act**

I’m going to talk now about 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 only need to 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.

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.

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

A series of cases that the Commission has 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. As a result of this action the Commission has achieved a return of more than \$24m in refunds for affected consumers, as well as substantial penalties and cost awards.

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.

Another example of a case in which we hope to observe industry-wide behaviour change involves the real estate industry's use of "buyer enquiry over" approaches as a price guide in marketing properties.

The case against agent Tim Whitehead and Celestine Realty had initially been rejected by the District Court, but the High Court overturned the decision following an appeal brought by the Commission. The judgment makes it clear that an advertised real estate price will breach the Fair Trading Act when the vendor has no intention of selling at that price at the time of the advertising.

To maximise the impact of the proceedings, the Commission has been liaising with the Real Estate Institute to ensure agents are fully aware of the effect of the judgment, and the Institute has recently published guidelines to its members on price guide advertising.

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.

The Commerce Commission is a member of the International Consumer Protection and Consumer Network (ICPEN) and in this capacity we have this week been a lead agency in Fraud Awareness Week. You may have seen some of the media activity this week carrying the message "Fight the scammers – don't respond".

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. Discount Premium Holidays sold more than 2,800 memberships to New Zealand consumers, before they came to our attention.

We were successful in gaining an injunction 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.

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.

As part of our strategic planning process for the coming three years, we have been reassessing our priority areas. Last year we added telecommunications, particularly broadband offerings, as this was an area of emerging competition. This year we will bring 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.

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**

Finally, I want to turn to the Commission's work with the Credit Contracts and Consumer Finance 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 Act repealed the Credit Contracts Act and Hire Purchase Act.

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 \$1.5 million being returned to over 5,300 debtors.

The Commission currently has 46 active consumer credit investigations underway, over half of which relate to allegations of unreasonable fees. In any six month period we are receiving up to 250 complaints from consumers. The number of consumers reporting alleged breaches of the Act has increased steadily as 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. With the advent of the Commission's first prosecution under the Act, the Commission has signaled quite clearly that it now expects compliance with the Act to be "the norm" and will, when appropriate, take higher level enforcement action against non compliant credit providers. 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 of the Act will be interpreted by the Courts.

We recognise that we need to take litigation to clarify the law, especially around reasonableness of fees and this is one of the Commission's current strategic priorities.

The Commission has already taken a number of lower level enforcement actions, such as issuing compliance advice and warnings to creditors and entering into settlements in relation to fees but now intends establishing those precedents through taking litigation.

Anecdotally the Commission is aware that under the Act many creditors have increased fees charged, some have matched their competitors, and some appear to have just have selected a dollar value for their fees, without reference to their cost structures.

Credit fees must be based on cost. Creditors should consider the relevant provisions under the Act when setting or reviewing fees and assess whether the fees are likely to be allowable in light of the provisions of the Act, and the specific rules set for different types of fees.

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.

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. While the competitive process presumes that those businesses responding to market signals will thrive and others will fail, the reality is failure can have significant personal impacts on debtors, and investors alike. The Commission is strongly encouraging creditors to carefully consider how they would justify their fees before they are required to do so and to establish effective compliance systems for reviewing fees, in order to decrease their likelihood of breaching these provisions.

## **Conclusion**

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

As you have heard, the Commission is continually adapting to the 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 stops companies from profiting from underhand behaviour. 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 31<sup>st</sup> 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."<sup>2</sup>

Thank you.

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<sup>1</sup> Angel Gurria, OECD Secretary-General – Presentation of the Competition Assessment Toolkit, June 14 2007 Mexico City.

<sup>2</sup> Herbert Hoover, State of the Nation address, December 2 1930.