



**Welcome to Bell Gully's Competition Update, a review of current legal issues in the New Zealand competition sector.**

In this July 2006 issue, we summarise recent developments in the competition and regulatory world likely to impact your business, including:

**Vendor alert - High Court finds a vendor liable as a party to a breach of the Commerce Act**

The High Court (*Commerce Commission v New Zealand Bus Limited & Others*) has found a vendor liable as a party to a breach of the Commerce Act. This judgment has materially increased the risks for a vendor in adopting an "it's the buyer's problem, not mine" approach to the competition law aspects of merger and acquisitions. Vendors (and their legal advisors) now need to think carefully about their level of involvement in any competition issues the buyer may have.

**Are the High Court and the Commerce Commission in the business of picking winners?**

The High Court's decision in *NZ Bus* also highlights an apparent and growing trend in merger and acquisitions analysis, which was first adopted by the Commission in its 2005 *Fletcher Building/Stevensons* decision. The High Court found that if the target company or asset would be otherwise sold to a new entrant who would use that acquisition as a springboard to increase competitive intensity in the market (or even a related market), then a sale to an existing competitor might well be found to substantially lessen competition.

**Judicial comment on the "association" test**

The High Court has also provided guidance on the impact of cross shareholdings in merger analysis. The result of the court's analysis is that an acquirer cannot simply rely on a finding that it is associated with the target prior to an acquisition to avoid analysis under section 47. An increase in the degree of association can still result in a substantial lessening of competition.

**"Take advantage of" does mean "use" - but still very difficult for the Commerce Commission to prove a misuse of market power**

In May, the Commission issued a warning to Baycorp that its behaviour in imposing a \$5 default loading fee on independent debt collectors (but not its own) risked breaching section 36 of the Commerce Act, which prohibits a person from taking advantage of market power. Amendments to section 36 in 2001 lowered the threshold for the application of section 36 from firms with dominance to firms with substantial market power and changed the causal requirement from *use* to *taking advantage*. The Commission's approach in the Baycorp case treating *use* as synonymous with *taking advantage* means that it will remain difficult to establish that a firm is actually in breach of section 36.

**Government's decision to unbundle the local loop now before Parliament**

The Government has introduced the Telecommunications Amendment Bill to Parliament, which implements its decision to unbundle Telecom's local loop. The Bill also amends the Telecommunications Act in other important ways consequent on the Ministry of Economic Development's implementation review of the Telecommunications Act. We outline some of the key changes.

**Ministry of Economic Development to review Parts IV and V of the Commerce Act**

In May this year the Minister of Commerce announced a review of certain parts of the Commerce Act including the provisions dealing with clearances and authorisations. The Minister posed the question: do New Zealand companies have the scale and scope to compete globally? In this article we outline options for amending the clearance and authorisation provisions of the Commerce Act that might be considered as part of the review.

### **Other developments**

- Australian Competition and Consumer Commission and the Commerce Commission reach in principle agreement on a trans-Tasman mergers protocol
- Telecommunications Commissioner not seeking reappointment
- Commission will examine reasons for the lack of new entry into the mobile telephone market
- Commission discussion paper on the form of gas control
- Commission revokes Pohokura joint selling authorisation given a change in circumstances
- Authorisation for NZRU's players' salary cap.



### **Need more information?**

For more information on any of the cases, articles and features in *Competition Update*, please contact one of our team:

**Phil Taylor** phil.taylor@bellgully.com

**Jenny Stevens** jenny.stevens@bellgully.com

**Torrin Crowther** torrin.crowther@bellgully.com

**David Blacktop** david.blacktop@bellgully.com

*Disclaimer: this publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication.*

## **Vendor alert - High Court finds a *vendor* liable as a party to a breach of the Commerce Act**

*When advising on the sale and purchase of a business the past rule of thumb, from a vendor's perspective, has been that any competition law issues arising from the sale are primarily the purchaser's problem.*

The reason for this is that if the acquisition infringes section 47 of the Commerce Act – which prohibits acquisitions that substantially lessen competition in a market – it is generally the purchaser who will have to deal with the consequences. Consequences can include the imposition of a substantial financial penalty and/or a requirement that certain assets be divested.

However, the High Court<sup>1</sup> has now increased the risks for vendors of adopting an “it's not my problem approach” by imposing liability on the vendors of a business for being a party to a breach of the Act.

In *NZ Bus*, Justice Miller found that the acquisition of Mana Coach Services Ltd (Mana) by NZ Bus would infringe section 47 of the Commerce Act. Further, in a first in competition law in New Zealand, the court also found that the vendors were a party to that breach by aiding and abetting and being knowingly concerned with the contravention of the Act by NZ Bus.

In future, vendors (and their legal advisers) will need to consider much more carefully what the vendor's level of involvement will be in any competition issues the purchaser may have. Traditionally, a willing vendor would have supported a purchaser in obtaining a clearance from the Commerce Commission (and in many cases, the vendor would have taken an active role in the Commission's investigation). In this case, NZ Bus agreed to keep Mana's owners informed of the progress, status and details of the clearance application. But it was the vendor's existing knowledge of the market, its involvement in the clearance process and the information the vendor, therefore, had about the likely competition issues that led the court to conclude that by agreeing to waive the clearance condition Mana had assisted NZ Bus to infringe the Act.

The court did not determine questions of relief and penalty in this decision, that having been left to a future hearing should it be required.

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<sup>1</sup> *Commerce Commission v New Zealand Bus Limited & Others* (Unreported, High Court, Wellington, 29 June 2006).

## Are the High Court and the Commerce Commission in the business of picking winners?

*The High Court's judgment in NZ Bus is also important for the evolution of substantive merger analysis in New Zealand. The court's decision:*

- *highlights how critical it is to define the correct alternative to the deal in question (the so-called "counterfactual"); and*
- *marks a further departure from a strict "barriers to entry" analysis in assessing the level of constraint imposed by potential competition by reinforcing that the LET test is the appropriate test for assessing the constraint from potential competitors.*

### Background

The case centred on the provision of subsidised bus services in the Wellington region. The Greater Wellington Regional Council operates a tender for the operation of subsidised bus services, with those tenders subject to strict rules.<sup>2</sup> NZ Bus and Mana were the only major operators of subsidised bus services in the Wellington region but with each operating in distinct geographic parts of it.

### The counterfactual

In bringing proceedings to stop the acquisition, the Commission argued that competition was only likely to emerge in the geographic parts of the region that NZ Bus operated in if a major overseas or other New Zealand bus company acquired Mana and then used it as a springboard to compete with NZ Bus. In contrast, NZ Bus claimed that competition from Mana would be unlikely to emerge in its part of the region whether the acquisition proceeded or not.

After hearing evidence from industry players, including those identified as potential entrants into the market, Justice Miller accepted the Commission's characterisation of the counterfactual:

"I prefer the view that the counterfactual involves acquisition of the 74% [of Mana] by a substantial entrant that would use it as a springboard to compete in the Wellington regional market, notwithstanding that such a strategy would result in NZ Bus retaliating".<sup>3</sup>

### Barriers to entry and the LET test

It was not enough for the court to simply conclude that a new entrant would acquire Mana in the counterfactual. It was also necessary to conclude that the new entrant would be unlikely to enter in a constraining fashion by an alternative method.

In assessing whether a new entrant could enter *de novo*, Justice Miller downplayed the importance of defining barriers to entry and establishing that those defined barriers to entry were low. The court preferred to focus on *conditions of entry* through the lens of the "LET" test.

The LET test asks whether entry:

- is *likely*;
- will be of sufficient *extent* to constrain the merged firm; and
- will be *timely*.

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<sup>2</sup> For example, the maximum size of any one tender is limited to 22 buses and the maximum time allowed between the tender and the commencement of service is limited to eight months.

<sup>3</sup> Paragraph 190.

The court's judgment reinforces the approach taken by the High Court in *Air New Zealand v Commerce Commission*<sup>4</sup> and suggests that purchasers cannot simply rely on a dogma of low barriers to entry as an answer to any competition problem. While a lack of barriers to entry is a necessary condition for a finding that the LET test is satisfied, it is not sufficient. All factors that would prevent entry in the next three years must be examined, and a purchaser will need to demonstrate either a history of entry into the market or provide a compelling explanation why entry has not previously occurred but would be likely to occur in the future (i.e. incumbents have been achieving normal returns or conditions of entry that formerly existed have been removed).

### **When must entry be likely?**

The judge rejected NZ Bus's argument the court need not be satisfied that entry was presently likely but only that entry would be likely in response to a price increase or other future change in NZ Bus's behaviour. However, that begs the question: a price increase or change in behaviour relative to what price and what behaviour? Justice Miller held that the starting price and behaviour for that comparison was not today's market price and behaviour. Rather, it will be the price and behaviour that would have occurred in the market if the acquisition did not proceed because:

- he was not satisfied that the *current* market price was the competitive price – there was evidence that Mana and NZ Bus typically did not tender against each other and that there was a correlation between the number of tenders submitted and the winning subsidy price; and
- in the counterfactual new entry would be likely and that would reduce prices compared to current market levels.

Accordingly, Justice Miller stated:

"In this case, in which there is evidence that NZ Bus and Mana already possess market power and the counterfactual involves acquisition by another competitor, **the question posed by the LET test is whether and how far prices will fall in the counterfactual relative to the factual.**" (emphasis added)<sup>5</sup>

### **Are the court and the Commission in the business of picking winners?**

The court's decision reiterates the approach previously taken by the Commission in Decision 558: Fletcher Concrete and Infrastructure Limited/W Stevenson and Sons Limited, where the Commission has declined clearance on the basis that an asset for sale will be used as a staging post to enter an adjacent market.<sup>6</sup>

While neither the Commission nor the court should be in the job of "picking winners" where an asset is up for sale, the approach taken by the court and the Commission does place a great deal of emphasis on defining the correct counterfactual in a situation where an asset is up for sale and potential purchasers include an existing player and a new entrant. In this case, the court's conclusion was based on evidence received under oath and tested under cross-examination. We would be concerned if this recent predilection towards "picking winners" was to pervade merger analysis in situations where there was not very clear and corroborated evidentiary support for that approach.

Having said that, neither the court nor the Commission have abandoned an analysis of constraints on market players. It is highly unlikely that the Commission would simply decline to grant clearance on the

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<sup>4</sup> (2004) 11 TCLR 347.

<sup>5</sup> This approach accords with that suggested by Professor Steven C Salop who has commented that where the alleged anti-competitive effects include the deterrence of a new efficient competitor: "the proper competitive benchmark should be the price that would prevail after the price reduction caused by the entry...If instead the current price is used as the competitive benchmark, the result might be an erroneous finding of no market power". Salop S "The First Principles Approach to Antitrust, Kodak, and Antitrust at the Millennium" *Antitrust Law Journal* (2000) Vol 68, pg 187 at 197.

<sup>6</sup> In Decision 558 (Fletcher Concrete and Infrastructure Limited/W Stevenson and Sons Limited) the Commission declined clearance for Fletcher Concrete to acquire Stevensons' masonry, precast and readymix concrete businesses. The Commission was concerned with the effect of the acquisition on competition in the upstream duopoly cement market in which Stevensons did not compete and in which Fletcher's was not acquiring any assets. The Commission defined the counterfactual in that case as being a third party acquiring Stevensons and using that downstream business as a method for entering the cement market.

basis that there is an alternative purchaser not currently present in the market. Nor would we expect the Commission to decline clearance on the basis of a bid by a new entrant where a competitive market already exists and will continue to exist following an acquisition involving incumbents. The additional finding that the alternative purchaser would be unlikely to enter the market absent acquiring the asset for sale would be needed. Of course, following this judgment, an alternative and competing purchaser would be likely to tell the Commission that it required the asset in question to enter the market (or an adjacent market) in which competition was limited.

## Judicial comment on the “association” test

*Another interesting feature of the NZ Bus case was the court’s comments on the implications of two persons being associated for merger analysis.*

NZ Bus argued that NZ Bus and Mana were “associated” prior to the acquisition by reason of NZ Bus’s existing 26% shareholding in Mana. Hence, NZ Bus argued that the acquisition of the remaining 74% should “be treated as an internal transfer that does not substantially lessen competition”.

The court found NZ Bus and Mana were not associated by reason of NZ Bus’s existing 26% shareholding in Mana, but also noted in *dicta* that even if they were associated:

“It would turn the section on its head to presume that it creates an exception where acquirer and target are already associated, whether or not the acquisition substantially lessens competition on the facts.”

That is, the court still had to consider whether an increased (and in this case a 100%) shareholding would change the competitive dynamics of any market.

## **“Take advantage of” does mean “use” - but still very difficult for the Commission to prove a misuse of market power**

*On 19 May 2006 the Commerce Commission formally warned Baycorp that its practice of charging independent debt collectors \$5 to load credit default information on Baycorp's consumer credit database was a “potential breach” of section 36 of the Commerce Act. This is the first public warning on section 36 that the Commission has given under the amended section 36 (amended in 2001) and since the Privy Council's decision in Carter Holt Harvey v Commerce Commission.<sup>7</sup>*

### **Counterfactual analysis remains in place**

Section 36 of the Act prohibits a person that has a substantial degree of power in a market from taking advantage of that power for one of three, proscribed, anti-competitive purposes.

The 2001 amendments to section 36 reduced the threshold at which section 36 applies from firms with dominance to firms with substantial market power. This change increased the number of firms to which the section applies. However, until the Commission published its investigation report into the *Baycorp* case there had been little discussion from the Commission or New Zealand courts on what would be required to establish that a firm with market power had *taken advantage* of that power. The Commission's approach in the *Baycorp* case (and previously in its investigation into an alleged breach of section 36 by Air New Zealand) confirms that *use* and *taking advantage* are synonymous and, therefore, that the counterfactual analysis established prior to the 2001 amendments in *Telecom v Clear* (and used by the Australian courts in a number of cases) remains appropriate.

Accordingly, while section 36 might apply to more firms now, it appears no easier for the Commission to establish the necessary link between the market power and the conduct at issue (the *Baycorp* case notwithstanding).

### **Background to the report**

Baycorp operates both a debt collection business and a credit reporting database in which negative information on consumers' and businesses' credit history is recorded. When debt collectors are engaged to collect a debt they load default information on the database. Because retailers and financiers use this database to conduct credit checks, the loading of default information has two effects:

- it increases the accuracy of the database and, hence, the value of the database to retailers and financiers; and
- it greatly increases the debt collector's chance of returning the debt to his or her financier or retailer client because another retailer is unlikely to advance further credit.

The investigation arose from Baycorp's move in 2001 to charge independent (i.e. non Baycorp) debt collectors \$5 to load default information on its database.

### **Substantial degree of market power**

At the relevant time (2001) Baycorp did not face any competition from other consumer credit database suppliers. Accordingly, the key issue was whether Baycorp was constrained by the potential for new entry, which the Commission assessed by applying the same LET test that it applies in its merger clearance analysis. The Commission concluded that entry did not satisfy the LET test because a new entrant would need a comparable consumer credit database in order to be able to effectively compete with Baycorp.

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<sup>7</sup> The Commission terminated another investigation into an alleged breach of section 36 by Air New Zealand following its entry onto certain provincial New Zealand air routes in competition with Origin Pacific Airways with a finding that Air New Zealand was at all times acting competitively and lawfully.

### Taking advantage of market power

The Commission stated that Baycorp would be said to have “taken advantage of” its market power if it would not have imposed the \$5 fee in the manner it did if it had faced competition from another comparable database provider. This is the counterfactual test reaffirmed by the Privy Council in *Carter Holt* under the old “use” of a dominant position test.<sup>8</sup>

The Commission’s analysis proceeded in two stages.

- The Commission concluded that Baycorp would want independent debt collectors to use its system in a competitive market because the most complete and accurate database would have a competitive advantage.
- Given that, would Baycorp charge independent debt collectors \$5 if there was another comparable database available? The Commission concluded that in a competitive market the \$5 fee would not be sustainable and in fact no fee would be charged.

The basis for the Commission’s conclusion that in a competitive market the \$5 would not be charged was that some debt collectors had been deterred from loading default information and that the \$5 fee was far in excess of the marginal cost of loading default information.

We are not convinced by this logic: the fact that *some* debt collectors were deterred from loading default information by the \$5 fee does not mean that in a competitive market a \$5 fee is not justified.<sup>9</sup>

Furthermore, as recognised by the Commission itself, consumer credit databases have many characteristics of a two-sided market. In that situation it is not self evident that Baycorp would not charge a loading fee greater than the marginal cost of loading default information in a competitive market.

Unfortunately, this decision creates considerable uncertainties for vertically integrated firms who supply products to their downstream competitors, given the Commission’s focus on the *level* of charge imposed and the comparison of that charge to, seemingly, a perfectly competitive benchmark (i.e. price equal to marginal cost). Our view is that the correct comparator is what might be described as a workably competitive market (i.e. where a firm has slightly less than a substantial degree of market power) and what price could be sustained in that market.

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<sup>8</sup> And cited by Australian courts as relevant to determining a taking advantage under section 46 of the Trade Practices Act.

<sup>9</sup> Such a conclusion appears to implicitly assume that the loading of each individual default information is of equal value (i.e. there are constant returns to loading default information). If there were diminishing returns, then the \$5 might be justified if only an immaterial number of debt collectors were deterred from loading default information, so long as that immaterial number did not undermine the integrity of the database.

## **Government's decision to unbundle the local loop now before Parliament**

*The Government has introduced the Telecommunications Amendment Bill, which implements its decision to unbundle Telecom's local loop. However, the Bill will also amend the Telecommunications Act in other important ways consequent on the Ministry of Economic Development's implementation review of the Telecommunications Act.*

### **Unbundling the local loop**

Local loop unbundling is the most publicised amendment proposed in the new Bill. From a legislative perspective, unbundling the local loop is a very simple process of amending Schedule 1 of the Telecommunications Act by adding local loop unbundling (and ancillary services) to the list of designated services. The effect of this amendment would be that Telecom would be obliged to provide an access seeker with access to its local loop in accordance with specified standard access principles and at an initial price calculated by benchmarking the price paid for access in other countries, and, in the long run, a price based on total system long run incremental cost (TSLRIC) – essentially a cost-based pricing formula.

### **Greater incentive to reach commercial agreement in a timely fashion**

Currently, an access seeker can only apply to the Commerce Commission for a determination of a dispute if it can satisfy the Commission that:

- it does not have an agreement for supply in place; and
- it has made reasonable attempts to negotiate a commercial agreement for supply of the service.

Many access seekers complained that this requirement had two effects:

- It left the access seeker to choose between the lesser of two evils: accept an early commercial offer on inferior terms to a Commission determination; or seek to negotiate a better agreement or seek a determination, thereby delaying entry.
- Because the process was only bilateral, smaller access seekers complained that they could not rely on a Commission determination to enter the market quickly.

The Bill proposes the removal of the requirement of no existing supply agreement. This amendment is designed to provide an access provider with greater incentives to agree a commercial solution that reflects Commission determinations.

### **Standard access determinations**

However, more importantly – especially in relation to the quick diffusion of the benefits of local loop unbundling – the Bill proposes the introduction of standard access determinations. This process will allow the Commission to unilaterally commence a process to set the standard terms and conditions for a regulated service. This is an alternative to resolving numerous bilateral disputes. In practice, with respect to the local loop, the process (if initiated by the Commission) will require the Commission to request Telecom to submit a standard terms proposal and then consult with interested parties on that proposal and issue a determination.

Once a determination is issued, access seekers will be able to require Telecom to provide access to its local loop on the basis set out in the determination or, alternatively, seek to negotiate an alternative arrangement.

Such standard term determinations or reference offer arrangements are used in a number of other countries, notably, the United Kingdom, Singapore and Switzerland. The ACCC also has a similar power in Australia.

### **Commission and Government to take a more hands-on role**

The Bill proposes that the Commission would be empowered to continually monitor the performance and development of the telecommunications sector and requires the Commission to have regard to statements of Government policy.

Given the Commission's already onerous tasks under the Bill and its current ability under the Act to institute a Schedule 3 investigation into whether or not any telecommunications service should be subject to the provisions of the Act (e.g., the Commission's Mobile Termination Rate Investigation was a Schedule 3 investigation), it is not clear what impact its new monitoring role will have in practice. Likewise, the requirement to "have regard to" statements of Government policy is likely to have little practical impact. This has certainly been the experience with the similar requirement in section 26 of the Commerce Act following the decision of Justice Wylie in the High Court that the Commission must have regard to, but is not bound by, such policy statements.

### **Formal undertakings process**

During the Mobile Termination Rate inquiry both Telecom and Vodafone submitted undertakings to the Commission stating that they would voluntarily lower their mobile termination rates as an alternative to regulation. The fact that the Act provides no formal process for the Commission to consider and accept undertakings has been criticised.

The Bill sets out in a new Schedule 3A a formal process for the Commission to follow if it is to accept undertakings. Under the proposed process, an access seeker can submit an undertaking within 40 working days of the Commission giving notice that it is conducting an investigation into whether or not to recommend a service be regulated. If accepted, undertakings would be registered and the Commission or a third party would be able to enforce that undertaking in the High Court.

### **Enforcement**

The Bill also seeks to enhance incentives for participants to comply with the Act by allowing the Commission to apply to the High Court for pecuniary penalties if a participant has breached certain provisions of the Act.

Specifically, Telecom will be required under the Bill to separate its accounts for wholesale and retail arms so as to promote transparency and assist the Commission and other parties in assessing whether it is complying with its non-discrimination obligations. Indeed, Telecom has moved one step further setting up separate wholesale and retail divisions within its business (although this would not preclude the Government from legislating for business separation at a later date).

# Ministry of Economic Development to review Parts IV and V of the Commerce Act

*The Minister of Commerce has announced the MED will undertake a review of Part IV (which deals with the imposition of price control) and Part V (which deals with clearances and authorisations) of the Commerce Act.*

*The terms of reference for that review have not yet been released. However, the Minister has stated that a key focus of the review is answering the question: do New Zealand companies have the scale and scope to compete globally?*

*In this article we outline some options for amending the clearance and authorisation provisions of the Commerce Act that might be considered as part of the review.*

## Possible options for reform

There are a number of ways in which the clearance and authorisation regime could be amended which might provide as much competition as possible, while recognising the unique characteristics of New Zealand's economy and geographic position. Bell Gully has no view on the appropriateness or otherwise of these options and any policy option would be the subject to detailed policy analysis. Nevertheless they are options that might well be canvassed in the MED's review. These options are not mutually exclusive.

- Clearances for restrictive trade practices.

Currently, clearances are available for business acquisitions, but not for market arrangements between competitors. Because of the cost of seeking authorisation, and the penalties associated with a breach of the Commerce Act, the authorisation process might deter some businesses from implementing business arrangements that have an uncertain effect on competition.

Allowing businesses to apply for faster and less costly clearances might create more certainty for businesses seeking to pursue these types of business arrangements.

- Remove the need for quantification of benefits and detriments

Currently the Commission is bound by the statement of Richardson J (as he then was) in *Telecom Corp of NZ Ltd v Commerce Commission* ([1992] 3 NZLR 429) that it has a responsibility to attempt, so far as possible, to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.

There are few cases (either authorisation cases or regulatory intervention cases) where the Commission has been able to accurately calculate the relevant benefits and detriments. The exercise depends critically on the data and assumptions used. In our experience, this means that quantification often results in esoteric arguments between parties' external economic experts and the Commission's economists (both internal and external) with each advocating his or her own approach. The outcomes from this process are often widely varying estimates depending on the assumptions and data sources used, and an increased cost for the Commission and all parties involved. Furthermore, clients often complain that the economic models do not resemble or mimic commercial reality.

In Australia, the Trade Practices Act does not require an applicant for authorisation to quantify, in precise terms, the benefits claimed to arise if authorisation is granted. Nevertheless, there must be a factual basis for concluding that the public benefits are likely to result. We agree with the statements of the Australian Competition Tribunal in *Qantas Airways Limited* ([2004] ACompT 9) which stated:

"We consider that the nature of public benefits needs to be defined with some precision, a degree of precision which lies somewhere between quantification in numerical terms at one end of the spectrum and general statements about possible or likely benefits at the other end of the spectrum",

and:

"All other things being equal, detailed quantification is the best option. However, quantification at all costs is not required by the Act, and has never been sought by the Tribunal. There are diminishing returns to the quantification exercise. Benefits should be quantified only to the extent that the exercise enlightens the Tribunal more than the alternative of qualitative explanation."

The authorisation process could be made simpler, and substantially faster and cheaper if the requirement to quantify net benefits were removed. Some might argue that this would mean that the Commission would have to rely on "intuitive" judgments. However, the Commission already does this in respect of clearances and we see no reason in principle why the approach should be different for authorisations.

- Inclusion of mandatory consideration of increased export receipts for Authorisations.

The test for an authorisation is general and broad (i.e. a benefit to the public of New Zealand). Given the Minister's apparent concern with New Zealand's ability to compete on the world stage, there might be merit in considering enacting a provision similar to Australia's section 90(9A) of the Trade Practices Act which requires the ACCC when granting an authorisation:

- to regard a significant increase in the real value of exports or a significant substitution of domestic products for imported goods as public benefits; and
- to take into account all relevant matters that relate to the international competitiveness of any Australian industry.

The Commission already utilises a total surplus standard in assessing authorisations and, therefore, these matters are considered as part of any authorisation decision. However, such an amendment might bring into sharper focus matters that directly affect New Zealand's international competitiveness.

- Broader ability for Commission to accept and enforce undertakings.

A business can offer two types of undertakings to ameliorate any competition concerns or concerns that claimed public benefits will not accrue:

- Structural undertakings, which are where a business undertakes to divest itself of a set of assets in order to allow another business to compete; and
- Behavioural undertakings, which are where a business undertakes to do, or not to do, certain things to either promote competition or ensure public benefits accrue.

The Commission cannot accept behavioural undertakings in respect of an application for clearance of a business acquisition and has, historically, been generally reluctant to accept behavioural undertakings in respect of business arrangements. Structural undertakings are easy to monitor and enforce because they are one-offs. In contrast, behavioural undertakings require ongoing monitoring and enforcement.

Nevertheless, the Government's legislative intervention in the Fonterra case provides an example of the use of both structural and behavioural undertakings to provide a solution. In that case, the Government required Fonterra to divest New Zealand Dairy Foods to an un-associated party (a structural undertaking) and enacted the Dairy Industry Restructuring (Raw Milk Regulations) 2001 (a form of behavioural undertaking).<sup>10</sup>

A possible option would be to provide a mechanism to encourage the Commission to play a more active role in designing, accepting and enforcing behavioural undertakings. While such an approach would require the Commission to have some form of ongoing monitoring role, given the number of authorisations applied for, it might not create a significant resource cost – especially if those behavioural undertakings were given the force of regulations and could also be enforced by third parties.

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<sup>10</sup> The Raw Milk Regulations required Fonterra to make raw milk available to competitors in certain quantities and on the same terms as it supplied milk to itself. These regulations were designed to lower barriers to entry in the market and ensure that New Zealand Dairy Foods would continue to act as a strong competitive threat in the domestic dairy market.

**Next steps**

There are options available that could reduce the hurdles facing beneficial business arrangements from occurring, however, some of those options might impose equally significant detriments on the business community. We will continue to keep a watching brief on proposals for reform in this area.

## Other developments

### **Australian Competition and Consumer Commission and the Commerce Commission reach in principle agreement on trans-Tasman mergers protocol**

The ACCC and the Commerce Commission have agreed in principle to a trans-Tasman mergers protocol. This protocol does not affect the law that will be applied in either country nor the analysis or determination by each Commission. Rather, it is designed to generate a more efficient process where an acquisition has impacts in both New Zealand and Australia. The proposed mergers protocol covers:

- cooperation on specific transactions being considered by both agencies;
- merger reviews being considered by one agency, but where the other may be in a position to assist with that review; and
- general cooperation and information exchange to assist the agencies to carry out their general merger review responsibilities.

The protocol follows recommendations from the Trans-Tasman Harmonisation Committee, of which Bell Gully partner Phil Taylor is a member.

### **Telecommunications Commissioner not seeking reappointment**

Telecommunications Commissioner Douglas Webb has decided not to seek reappointment when his term expires in March 2007. Mr Webb is New Zealand's first and only Telecommunications Commissioner and his departure has led to disquiet in some quarters given the changing regulatory framework that will emerge in New Zealand over the next 18 months. His departure has been described by one industry participant as "a bit like the All Blacks changing their first five a month before the World Cup begins". However, Mr Webb was publicly criticised by the Prime Minister for his decision to recommend against local loop unbundling in 2004.

### **Commission will examine reasons for the lack of new entry into the mobile services market**

The Commerce Commission has announced that it will examine the reasons for the lack of new entry into the mobile services market as a prelude to deciding whether or not to commence an investigation into possible changes to the regulatory framework. New Zealand has two incumbent cellular networks (Telecom and Vodafone) roughly sharing the market 50/50.

### **Commission discussion paper on the gas form of control**

The Commerce Commission has released a discussion paper on the form of control it should adopt in regulating the gas pipelines businesses of Powerco and Vector. This discussion paper forms part of the Commission's determination of a final pricing authorisation under the Commerce Act. Unlike many other jurisdictions the Commerce Act splits price control inquiries into two parts: first, the question is should control be imposed and second, the question is what form should that control take. The Commission is careful not to predetermine the form of control when asking the "should" question. The Commission's preliminary view is that a weighted average price cap is the preferred form of control for standard consumers and a total revenue cap is the preferred form of control for non-standard customers and metering services.

The full discussion paper is available at the Commission's website: [www.comcom.govt.nz](http://www.comcom.govt.nz)

Meanwhile the action continues on Powerco and Vector's judicial review proceedings in relation to the Commission's decision to place them under control (i.e. the antecedent decision to the form of control). In an interlocutory judgment issued on 9 June 2006, the High Court (Justice Wild) granted leave to Powerco and Vector to cross-examine, Paula Rebstock, the Chair of the Commerce Commission.

### **Commission revokes Pohokura joint selling authorisation given a change in circumstances**

The Commerce Commission has determined to revoke an authorisation given in 2003 to Shell, Todd and OMV to jointly sell gas derived from the Pohokura gas field, which lies off the coast of Taranaki in New Zealand's North Island. The original authorisation was given on the basis that it would speed up the commencement of sales from the field as the participants could negotiate single contracts as opposed to separate contracts. Subsequently the parties could not agree on terms and so sold their shares separately

with no delay in production. The Commission determined this was a material change in circumstances for the purposes of section 65 of the Commerce Act and hence revoked its authorisation.

The Commission's full decision is available at its website: [www.comcom.govt.nz](http://www.comcom.govt.nz)

### **Investigation into wholesale and retail electricity markets continues**

The Commission's investigation into the performance of New Zealand's wholesale and retail electricity markets is continuing. The focus of the investigation is on whether there have been breaches of the Commerce Act: it is not a wide ranging policy review. The Commission has appointed Professor Frank A. Wolak of Stanford University to empirically measure the ability of participants in both the retail and wholesale markets to raise prices above competitive levels.

### **Authorisation for NZRU's players' salary cap**

The Commerce Commission has authorised the New Zealand Rugby Union's salary cap for its Air New Zealand Cup Competition. The Commission concluded that the net benefits flowing from a more even distribution of players through teams were "modest". The NZRU had initially also applied for authorisation of rules for its Division 1 competition which included a ban on paying players or loaning players between unions. The NZRU withdrew this aspect of the application after the Commission indicated in its draft determination that it would not authorise those rules.