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**ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN NEW ZEALAND**

-- 2011 --

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## ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN NEW ZEALAND

1 July 2011 – 30 June 2012

### Executive Summary

1. This report presents the significant competition law and policy developments in New Zealand for the year ended 30 June 2012.
2. The report's primary focus is in two areas: restrictive trade practices (that is, coordinated behaviour involving anticompetitive agreements and conduct involving the unilateral misuse of market power); and business acquisitions and mergers that raise competition concerns under the Commerce Act 1986 (New Zealand's key competition legislation). This includes a discussion of the related activities and organisational structure and resourcing of the New Zealand Commerce Commission (NZCC), New Zealand's principal competition and regulatory authority, during the relevant period.
3. Accordingly, the report does not focus on developments in consumer laws and legislation related to the economic regulation of natural monopoly businesses and other markets where competition either is not possible or is limited, and for which the NZCC is the enforcement or regulatory agency. The report does, however, briefly touch upon the economic regulation of the dairy and telecommunications sectors, for which the NZCC is responsible. This is covered in section 2 of the report.
4. Section 2 also discusses two pieces of legislation pertinent to New Zealand's competition law – the Search and Surveillance Act 2012 and the Canterbury Earthquake Recovery Act 2011 – before looking at recent regulatory developments in the dairy and telecommunications sectors. It then identifies new publications by the NZCC during the relevant period aimed at making information available about its work and educating the public about the provisions of the Commerce Act. The section ends by discussing two major legislative proposals to amend the Commerce Act: the Commerce Act: the Commerce (Cartels and Other Matters) Amendment Bill, and the Commerce Commission (International Co-operation, and Fees) Bill.
5. The next three sections report on the NZCC's main activities and resourcing with respect to its competition enforcement and adjudication functions and policy advisory work in the 12-month period to 30 June 2012. Section 3 summarises the activities related to competition enforcement and adjudication. The role of the NZCC in the formulation of competition-related policies is discussed in section 4. Details of the resourcing of the NZCC are provided in section 5.
6. To assess its effectiveness and ensure it is delivering value-for-money results, the NZCC has during the relevant period undertaken various stakeholder surveys and attempted to measure the impact of its targeted advocacy work. In addition, it has carried out an *ex post* review of a determination it made to give a clearance to a certain business merger, in order to gauge the impact of the merger on the relevant market. Details of these are provided in the first part of section 6.
7. Finally, in the second part of section 6, the report discusses *Competition in New Zealand*, a major multi-year cross-departmental research project undertaken to look at competition across the New Zealand economy and determine the nature and extent of competition in New Zealand industries.

## **1. Introduction**

### ***1.1 Background***

8. This report describes key competition law and policy developments in New Zealand during the 12-month period of 1 July 2011 to 30 June 2012. This period corresponds with the New Zealand government's fiscal year and the New Zealand Commerce Commission's financial year.

9. The New Zealand Commerce Commission (NZCC) is New Zealand's primary competition enforcement and regulatory authority. Its purpose is to achieve the best possible outcomes in competitive and regulated markets for the long-term benefit of New Zealanders.<sup>1</sup>

10. The NZCC is responsible for enforcing laws relating to competition, and economic regulation in markets where there is little or no competition and little or no likelihood of a substantial increase in competition (the Commerce Act 1986), fair trading (the Fair Trading Act 1986), and consumer credit (the Credit Contracts and Consumer Finance (CCCF) Act 2003).

11. With respect to competition law, the purpose of the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand. The Act prohibits conduct that restricts competition (restrictive trade practices). It also prohibits the acquisition of assets of a business or shares if the acquisition leads to a substantial lessening of competition in a market.

12. Restrictive trade practices include anticompetitive coordinated behaviour and unilateral conduct. Coordinated behaviour refers to agreements between competitors, including cartels, not to compete with each other. Such agreements may relate to price fixing, restricting outputs, allocating customers, suppliers or territories, and bid rigging. Unilateral conduct includes a person or business taking advantage of their substantial degree of power in a market (a dominant position) for an anticompetitive purpose, or specifying a minimum price at which their goods or services can be sold by another.

13. In addition to its enforcement functions, the NZCC has some quasi-judicial functions under the Commerce Act. It can approve a business acquisition or merger that does not substantially lessen competition (known as a clearance). It can also approve a business acquisition that is anticompetitive or a restrictive trade practice that involves an agreement (except one relating to price fixing) but which would ultimately benefit New Zealand consumers (known as an authorisation). The effect of clearance and authorisation determinations by the NZCC is to offer businesses protection from legal action under the Commerce Act.

14. The aim of the two pieces of consumer legislation – the Fair Trading and CCCF Acts – is to promote fair competition and help ensure consumers can be confident of the accuracy of the information they receive when making purchase choices. The Fair Trading Act prohibits false and misleading behaviour by businesses. It also specifies when consumers must be given information about certain products and promotes product safety. The CCCF Act covers consumer lending, consumer leases and buy-back transactions. It requires lenders to disclose certain information to consumers when they enter into a credit contract and sets out rules about interest, payments and credit fees.

15. With respect to its economic regulation functions, the NZCC is responsible for implementing several pieces of legislation aimed at regulating natural monopoly businesses and other markets where competition either is not possible or is limited. Under Part 4 of the Commerce Act, the NZCC currently regulates electricity lines and gas pipeline services supplied by electricity and gas distribution and

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<sup>1</sup> The NZCC's website address is: <http://www.comcom.govt.nz>.

transmission businesses and specified airport services at three international airports located in the cities of Auckland, Wellington and Christchurch. The Telecommunications Act 2001 regulates the supply of telecommunications services in New Zealand. The Act is administered by the NZCC under the stewardship of a Telecommunications Commissioner, a statutory position under the Act. Finally, the Dairy Industry Restructuring Act 2001 provides for the regulation of certain aspects of the dairy sector in New Zealand.

16. The NZCC is an independent government entity. Whilst it is primarily accountable to the Minister of Commerce for its performance, it is not subject to direction from the government in carrying out its enforcement, adjudication and regulatory control activities. The NZCC is, however, required to have regard to statements of government economic policy communicated by Ministers under the Commerce Act or the Telecommunications Act.

17. In general, the role of providing government with policy advice on competition matters belongs to the Ministry of Business, Innovation and Employment. The demarcation of roles between the NZCC and the Ministry ensures a clear separation and independence between the operational and policy functions within New Zealand's competition regime. That being said, whilst the primary role of the NZCC is an operational one, where relevant, the NZCC uses its experience to provide advice on policy developments and sectoral and legislative reviews, with particular focus on the operational aspects of a regime.

## **1.2 *Scope of this report***

18. With that background in mind, this report concentrates on describing developments in competition law and policy for the relevant period. Hence, the report focuses on key competition developments concerning restrictive trade practices and business acquisitions and mergers, including the related activities and organisational structure and resourcing of the NZCC. The report excludes coverage of any developments related to the consumer laws which the NZCC enforces. Likewise, it ignores developments in the economic regulation of goods and services under Part 4 of the Commerce Act.

19. The report does, however, briefly comment, in section 2.1, on changes in the regulation of the telecommunications and dairy sectors. The reason for so doing is that the regulatory regimes for these two sectors are more in the nature of regulating access to vertically-integrated business to promote competition in downstream markets. These access regimes are also transitory in response to how the relevant markets evolve due to, for example, technological or market structure developments. The Competition Committee may be interested to learn how, for instance, structural changes in the telecommunications and dairy sectors affect competition in the relevant markets and the implications of this for economic regulation versus the application of general competition laws.

## **2. *Changes to competition laws and policies, proposed or adopted***

### **2.1 *Summary of new legal provisions of competition law and related legislation***

20. Section 2.1 begins by discussing two enactments that amend the Commerce Act, and that affect (or may affect) the application of the Commerce Act or the powers of the NZCC: the Search and Surveillance Act 2012; and the Canterbury Earthquake Recovery Act 2011. It then considers recent competition-related developments in the dairy and telecommunications sectors.

### 2.1.1 *Search and Surveillance Act 2012*

21. The Search and Surveillance Act 2012 is a major overhaul and reform of the legislation surrounding search, surveillance and inspection powers. It impacts on a wide number of legal, government and regulatory agencies, including the NZCC<sup>2</sup>.

22. This new Act aims to bring increased clarity and certainty for judicial officers, enforcement agencies and those subject to searches. In particular, it repeals the search warrant powers that were previously spread over 69 different enactments (including the Commerce Act) and replaces these with standardised provisions. These provisions seek to balance human rights interests and the requirements of law enforcement. They also provide for new technologies, such as computer searches. Section 313 of the Search and Surveillance Act inserts a new search, surveillance and inspections regime into the Commerce Act, which comes into force from 1 October 2012.

### 2.1.2 *Canterbury Earthquake Recovery Act 2011*

23. In response to the impacts of the major earthquakes that struck the city of Christchurch in 2010 and 2011, the New Zealand Parliament passed the Canterbury Earthquake Recovery Act 2011. The Act states a number of purposes. In broad terms, these can be categorised as the provision of appropriate measures to ensure the expeditious and focused recovery of greater Christchurch from the impacts of the earthquakes, enabling the participation of affected communities in the decision making relating to the recovery, and restoring the social, economic, cultural and environmental well-being of greater Christchurch communities.

24. Section 71 of the Canterbury Earthquake Recovery Act enables any provisions of a large number of enactments (including the Commerce Act) to be modified or extended, or for an exemption to be granted from them, in order to promote the purposes of the Canterbury Earthquake Recovery Act. Section 71 has to date not been used with respect to the Commerce Act. Where necessary, the NZCC's enforcement and adjudication work under the Commerce Act has taken into account factors arising from the Christchurch earthquakes.

### 2.1.3 *Dairy sector*

25. The Dairy Industry Restructuring Act 2001 (DIRA) provided for an authorisation under the Commerce Act to allow for the formation of the dairy co-operative Fonterra. Upon its creation, Fonterra collected 96 per cent of New Zealand's milk production. In recognition of Fonterra's dominant market position, the DIRA set up a unique regulatory regime with the purpose of promoting the efficient operation of New Zealand dairy markets.

26. Fonterra was still subject to the provisions of the Commerce Act prohibiting restrictive trade practices. However, whereas the Commerce Act provides for *ex post* examination of whether or not a company has taken advantage of market power, the DIRA is designed to act as an *ex ante* incentive regime such that Fonterra does not have the incentive to act in an anticompetitive manner.

27. In particular, the DIRA promotes contestability in the market for farmers' milk through a requirement that Fonterra operate an "open entry and exit regime". This means that Fonterra must accept all milk supply offers from dairy farmers in New Zealand and allow relatively costless exit from the co-operative. These requirements ensure that Fonterra cannot "lock in" its farmer-suppliers and, as a

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<sup>2</sup> Under section 98A(2) of the Commerce Act, an authorised employee of the NZCC may obtain and execute warrant to search for evidence of offence against most provisions of the Commerce Act.

consequence, Fonterra faces commercial incentives to pay efficient prices for farmers' milk and capital invested in Fonterra.

28. Amendments were made to the DIRA in July 2012 to further bolster the contestability of the market for farmers' milk. The amendments require greater transparency of how Fonterra sets the price it pays farmers for milk and introduce a new farm gate milk price monitoring regime to be undertaken by the NZCC.

29. The DIRA regime is transitional in nature. It is designed to expire at the point where dairy markets have become workably competitive, that is, at the point where Fonterra is no longer considered to be dominant. If and when this point is reached, the Commerce Act would be relied upon in relation to restrictive trade practices.

#### *2.1.4 Telecommunications sector*

30. The Telecommunications Act 2001 created an industry-specific regulatory regime for telecommunications, overseen by the Telecommunications Commissioner within the NZCC.

31. The NZCC can set comprehensive terms and conditions for regulated wholesale telecommunications services, such as interconnection, unbundled local loop services and mobile termination. The NZCC can also recommend that new wholesale telecommunications services be regulated, and if the recommendation is accepted by the Minister for Communications, then the service can be added to the schedule of regulated services under the Telecommunications Act. The NZCC produces regular reports on developments in competition in telecommunications markets under its general monitoring powers.

32. The New Zealand Government in 2011 selected four partners to participate in the roll-out of a fibre-to-the-home network that will be available to 75 per cent of New Zealanders by 2020. The government is contributing \$1.35 billion to this Ultra-fast Broadband (UFB) initiative with significant amounts of private co-investment also being contributed by the government's UFB partners. The UFB network will be an open-access network. The NZCC will enforce the open-access obligations. The NZCC will also administer an information disclosure regime for UFB networks.

33. Telecom New Zealand, the incumbent telecommunications provider, structurally separated into two companies (Telecom New Zealand Limited and Chorus Limited) in November 2011. Chorus owns the copper access network, and is building the fibre access network in many parts of New Zealand. Telecom owns the retail business, the mobile network and the international cable network. Universal service obligations are shared between these two firms.

34. There are no company-specific restrictions on investment in Telecom New Zealand. It is subject to generic regulation of overseas investment. There are company-specific foreign ownership restrictions on investment in Chorus, the structurally-separated fixed-access network arm that was formerly part of the incumbent.

## **2.2 Other relevant measures, including new guidelines**

35. The NZCC has a statutory role in making available information about its work and educating the public about the provisions of the Commerce Act. As part of this role, the NZCC publishes various written material to inform its stakeholders, including: guidelines on NZCC process; anticompetitive practices

guidelines; anticompetitive practices fact sheets; mergers and acquisitions guidelines; and mergers and acquisitions fact sheets.<sup>3</sup>

### 2.2.1 Guidelines

36. NZCC guidelines set out how the NZCC will approach scenarios that arise in its enforcement and regulatory work and/or provide in-depth information about rules and practices for avoiding anticompetitive behaviour and mergers and acquisitions.

37. In March 2012 the NZCC published *Guidelines for Quantitative Analysis*. These guidelines outline the principles the NZCC follows for undertaking quantitative analysis as part of its decision making. They are intended to help ensure that any quantitative analysis produced by the NZCC is robust and defensible and achieves its desired objective efficiently.

38. The five key principles identified are:

- The analysis has a clear objective.
- The analysis uses appropriate approaches and techniques.
- The analysis is repeatable and replicable.
- The results of the analysis are robust and explainable.

39. There were no guidelines on mergers and acquisitions or avoiding anticompetitive practices published in the year ended 30 June 2012.

40. The NZCC is currently working on new authorisation guidelines. These guidelines will explain how the NZCC assesses public benefits and detriments. The NZCC intends to publish these guidelines in the next financial year.

41. The NZCC is also currently drafting new merger clearance guidelines. These guidelines will explain how the NZCC assesses whether a merger substantially lessens competition. The NZCC intends to publish these guidelines in the next financial year.

### 2.2.2 Fact sheets

42. Fact sheets published by the NZCC provide quick and easy to follow information about anticompetitive behaviour and/or NZCC policies or processes. They are designed to assist the general public, media, and small businesses that perhaps do not have legal advisors. Relevant fact sheets are provided by the NZCC to people who make enquiries of the NZCC, and to anyone who receives a compliance advice or warning letter. All fact sheets are available on the NZCC's website.

43. The new fact sheets published are:

- *Price Fixing and Cartels* (July 2011);
- *Mergers and Acquisitions: Applying for a Clearance* (September 2011);

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<sup>3</sup> The NZCC's guidelines and fact sheets are available at <http://www.comcom.govt.nz/commission-policies/> and <http://www.comcom.govt.nz/competition-downloads/>.

- *Mergers and Acquisitions: Merger Assessment* (September 2011);
- *Leniency Policy for Cartels* (October 2011);
- *Exemptions under the Commerce Act* (February 2012);
- *Taking Advantage of Market Power* (June 2012); and
- *Agreements that Substantially Lessen Competition* (July 2012).

### **2.3 Government proposals for new legislation**

44. The Government is currently working on two significant amendments to the Commerce Act: the Commerce (Cartels and Other Matters) Amendment Bill and the Commerce Commission (International Co-operation, and Fees) Bill. Both Bills are part of New Zealand's commitment to achieving the outcomes identified in the *Single Economic Market Outcomes Framework* endorsed by the Prime Ministers of Australia and New Zealand on 20 August 2009.

#### **2.3.1 Commerce Act: Commerce (Cartels and Other Matters) Amendment Bill**

45. The Commerce Act: Commerce (Cartels and Other Matters) Amendment Bill proposes a new exemption regime for collaborative activities, an associated clearance regime, and the criminalisation of hard-core cartel activities.

46. A key feature of the Bill is that it clarifies the definition of cartel conduct to include the various forms of cartel behaviour as defined by the OECD: price fixing, bid rigging, output restriction, and market allocation. Cartel conduct is currently prohibited under section 30 of the Commerce Act only to the extent that there is an effect on the price for goods or services. The definition of cartel conduct in the Bill makes it clear that contracts, arrangements and understandings that contain, or give effect to, any of the four specific forms of cartel conduct are prohibited.

47. As a counterbalance to this more inclusive definition of cartel conduct, the Bill focuses on the substance of collaborative conduct (rather than on the form) by introducing a collaborative activity exemption. The purpose of the exemption is to ensure that legitimate pro-competitive arrangements are not prohibited. The exemption applies to all pro-competitive, efficiency-enhancing collaborations and not only to structural joint ventures, as currently provided under the Commerce Act.

48. The Bill also introduces a clearance regime to enable firms to approach the NZCC for a ruling on whether a proposed collaborative activity would raise competition concerns. In order to grant a clearance, the NZCC would need to be satisfied that the collaborative activity would not have, or would not be likely to have, the effect of substantially lessening competition in a market, and that if the relevant activity contains a cartel provision, that the provision is reasonably necessary for the purpose of the collaborative activity.

49. The part of the Bill that has attracted the most attention is the proposed imposition of criminal sanctions for hard-core cartel offences. The Bill, however, sets high thresholds for "intent" and "beyond reasonable doubt" criteria which must be satisfied in order for criminal behaviour to be proven.

50. The Commerce Select Committee is expected to report back to the New Zealand Parliament on its consideration of the Bill in the first quarter of 2013.

### 2.3.2 Commerce Commission (*International Co-operation, and Fees*) Bill

51. The Commerce Commission (International Co-operation, and Fees) Bill was introduced into the New Zealand Parliament on 9 September 2008 and is currently awaiting passage of its final parliamentary stage.

52. The main aim of this Bill is to enable greater co-operation between the NZCC and overseas competition and consumer regulators (particularly the Australian Competition and Consumer Commission). To achieve this, the Bill amends the Commerce Act, the Fair Trading Act, and the Credit Contracts and Consumer Finance Act to allow the NZCC to use its statutory powers to provide investigative assistance to overseas regulators and to provide, subject to conditions, compulsorily acquired information to them.

## 3. Enforcement of competition laws and policies

### 3.1 *Anticompetitive practices*

#### 3.1.1 Summary of activities

53. In the year ended 30 June 2012, the NZCC has been busy with a number of investigations, and has seen the progression of some important litigation. This litigation has related to international cartels and in one case to section 36 of the Commerce Act, which deals with a person or business acting unilaterally to take advantage of a substantial degree of market power. Further details of these are set out below.

54. In these restrained economic times the NZCC has continued to find the most effective ways to help business comply with competition laws. Choosing the right tools and enforcement approach is critical, and advocacy is a vital part of this.

55. Throughout the year the NZCC has undertaken both targeted and *ad hoc* education and advocacy work. Through this work, combined with publication of enforcement action taken, the NZCC hopes to see a lift in business and consumer awareness of competition law, particularly in the sectors targeted by the NZCC.

56. In the year ended 30 June 2012 the NZCC continued its targeted advocacy campaign in the non-residential construction sector, and commenced a campaign in the health sector. These advocacy campaigns continue. The NZCC's impact measurement work in respect of the construction industry advocacy has shown a lift in awareness of competition law. This is detailed below in section 6.1.2.

57. Table 3.1 shows the number of restrictive trade practices enforcement cases investigated by the NZCC and determinations made in the two years ended 30 June 2011 and 2102.

**Table 3.1: Restrictive Trade Practices Enforcement and Authorisation  
Activity for the Years Ended 30 June 2011 and 2012**

	2011/12	2010/11
Number of coordinated behaviour cases	9	22
Number of unilateral conduct cases	2	11
Number of authorisation applications processed	2	0

### 3.1.2 Significant investigation cases

58. The NZCC made one investigation report public in the year ended 30 June 2012 (details below). Other significant investigations are ongoing.<sup>4</sup>

59. The NZCC decided to take no action against Television New Zealand Limited (TVNZ) or Sky Network Television Limited (Sky) after concluding an investigation into allegations of a breach of section 27 of the Commerce Act (agreements that substantially lessen competition) or section 47 of the Commerce Act (prohibited business acquisitions).

60. TVNZ, New Zealand's national broadcaster, entered into a joint venture agreement with Sky to launch a new low-cost subscription TV service, known as Igloo.

61. The NZCC received a number of complaints that the joint venture had the potential to substantially lessen competition in the pay TV market.

62. However, the NZCC concluded that the joint venture would make little difference to the level of competition in the pay TV market so there was unlikely to be a breach of the Commerce Act.

### 3.1.3 Authorisations

63. The two applications the NZCC received for restrictive trade practices authorisations were the first received in many years.

64. In one, the NZCC declined the application to authorise the proposed Kotahi joint venture between Fonterra (a major dairy co-operative) and Silver Fern Farms (a meat processing business), as the proposal did not require authorisation. Under the proposal Kotahi would coordinate domestic and international freight services. The freight services would initially be for Fonterra and Silver Fern Farms, with other importers and exporters being invited to become partners and customers in the future. The application was declined as the NZCC found that the joint venture would be unlikely to harm competition, and therefore it did not require authorisation.

65. In the other, the NZCC authorised a proposal from the Refrigerant Licence Trust Board. That proposal would see wholesalers of refrigerants entering into an agreement that would result in the wholesalers selling refrigerants to only those customers trained to safely handle them. The NZCC found that the public benefits of the proposal outweighed the small competitive detriment that would occur.

### 3.1.4 Significant court cases

66. The period since 1 July 2011 has seen some significant judgments regarding:

- When New Zealand courts will have jurisdiction to consider international cartels (Visy, Kuehne+Nagel, Air Cargo).
- The application of New Zealand's monopolisation provision (*Data tails*).
- Penalties for defendants who have admitted entering into various cartels against which the NZCC has commenced proceedings.

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<sup>4</sup> The NZCC does not ordinarily comment publicly on on-going investigations so as not to prejudice the investigation.

67. Each of these judgments and their significance is discussed in turn below.

3.1.4.1 *Judgments concerning jurisdiction / the extraterritorial application of the Commerce Act*

68. The Commerce Act applies to a person if:

- They engage in conduct in New Zealand (either themselves, or where the conduct of another is attributed to that party<sup>5</sup>); or
- They are resident or carrying on business in New Zealand and engage in conduct outside New Zealand that affects a market in New Zealand.<sup>6</sup>

69. While the NZCC may serve proceedings on a person outside New Zealand, the overseas defendant can protest the jurisdiction of the New Zealand courts to hear the proceeding. Whether the New Zealand courts will assume jurisdiction will depend (among other things) on whether there is a good arguable case that the defendant engaged in conduct in New Zealand<sup>7</sup> or that the terms of section 4(1) (see paragraph 68 b above) apply.

70. Since 1 July 2011 three cases have considered whether New Zealand courts have jurisdiction to hear cases under these rules.

- Visy: conduct in New Zealand, “carrying on business in New Zealand”, “affect on a market in New Zealand”

The *Visy*<sup>8</sup> case relates to an alleged trans-Tasman cardboard packaging price-fixing cartel between Visy Board Pty Limited and its competitor Amcor. Visy admitted its part in the cartel in Australia, but denies the cartel extended to New Zealand.

In these proceedings, Visy challenged on appeal the New Zealand High Court’s jurisdiction to hear the case on the basis that:

- It had not undertaken conduct in New Zealand;
- It was neither resident nor carrying on business in New Zealand and so its overseas conduct was not caught by the Commerce Act; and
- Even if was carrying on business in New Zealand, its conduct had not affected a market in New Zealand and so fell outside the scope of the Commerce Act.

The Court of Appeal unanimously dismissed Visy’s protest. In doing so, the Court found on the facts that Visy had engaged in conduct both in and outside New Zealand. In relation to the conduct outside New Zealand the Court explained that:

- Whether or not a person is “carrying on business in New Zealand” is a question of fact in each case. A number of factors are relevant and the test must recognise the modern ways in which business is transacted, such as the internet. On the facts, Visy did carry on business in New Zealand.

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<sup>5</sup> This occurs via section 90 of the Commerce Act.

<sup>6</sup> Commerce Act, section 4(1).

<sup>7</sup> High Court Rules, rule 6.27(2)(j)(i).

<sup>8</sup> *Commerce Commission v Visy Board Pty Limited* [2012] NZCA 383.

- Conduct will affect a market in New Zealand where it “relates to” a market in New Zealand. Price-fixing conduct directed towards New Zealand consumers will inevitably affect a New Zealand market.

While the Court of Appeal’s judgment may be appealed to the Supreme Court, the judgment is significant because it establishes a set of factors relevant to when a person will be carrying on business in New Zealand. The judgment also clarifies that offshore conduct directed towards New Zealand markets will “affect” a New Zealand market for the purposes of jurisdiction.

- Kuehne+Nagel freight forwarding cartel proceedings – attributing conduct of a New Zealand subsidiary

The Court of Appeal’s judgment in *Kuehne+Nagel*<sup>9</sup> provides guidance on the circumstances when a New Zealand subsidiary’s conduct in giving effect to a cartel entered into offshore can be attributed to the offshore parent of the New Zealand subsidiary.

The case arose from the NZCC’s proceedings against six freight forwarders. The NZCC alleges that the defendants entered into and gave effect to price-fixing agreements.

While five of the defendant freight forwarders settled with the NZCC and paid fines totalling NZ\$8.5 million, Kuehne+Nagel International AG protested against the jurisdiction of the New Zealand High Court to hear the proceedings.

Kuehne+Nagel is the ultimate holding company, but it is based in Switzerland and does not conduct business on its own behalf in New Zealand. It does, however, have a New Zealand subsidiary.

It was not disputed that Kuehne+Nagel was not resident or carrying on business in New Zealand and so section 4(1) of the Commerce Act did not apply.

The question was whether Kuehne+Nagel could be said to have engaged in conduct in New Zealand because the conduct of its New Zealand subsidiary – Kuehne+Nagel NZ – could be attributed to it via section 90 of the Commerce Act. Kuehne+Nagel said the conduct could not be attributed and therefore protested jurisdiction.

In October 2011, the High Court dismissed the protest in relation to the NZCC’s allegations that Kuehne+Nagel had “given effect to” the alleged cartel in New Zealand. The High Court found that there was a good arguable case that the acts of the New Zealand subsidiary Kuehne+Nagel NZ could be attributed to Kuehne+Nagel.<sup>10</sup>

In May 2012, the Court of Appeal upheld the High Court’s judgment and its approach to section 90 of the Commerce Act. While the Court of Appeal unanimously endorsed the principle that a subsidiary does not carry on business as an agent for its parent merely as a result of the legal and commercial capacity of the parent to control the subsidiary, the Court found on the facts that there was a good arguable case that the New Zealand subsidiary:

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<sup>9</sup> *Kuehne+Nagel International AG v Commerce Commission* [2012] NZCA 221.

<sup>10</sup> The Court found “... to come within the wording of s 90(2) Kuehne + Nagel does not itself need to actively conduct a freight forwarding business (in New Zealand or elsewhere). What is required is Kuehne + Nagel NZ giving effect to the proscribed agreements on behalf of Kuehne + Nagel at the direction or with the consent or agreement of an agent of Kuehne + Nagel, for example Kuehne + Nagel Management AG or Kuehne + Nagel (Asia Pacific) Management Ltd, given within the scope of the actual or apparent authority of the agent”. *Commerce Commission v Deutsche Bahn AG* HC Auckland CIV-2010-404-5479, 12 October 2011 at [56].

*... engaged in conduct in New Zealand on behalf of [Kuehne+Nagel] in the sense that it was the representative of [Kuehne+Nagel] (that is the means by which the appellant secured representation in the relevant freight forwarding market in New Zealand and elsewhere) and conducted [Kuehne+Nagel's] business, affairs and activities in this country at the direction of the appellant and for its benefit.*

Kuehne+Nagel are not appealing the Court of Appeal's judgment to the Supreme Court. The proceeding will now proceed to trial, most likely later in 2013.

- Air Cargo cartel price-fixing proceedings – a market in New Zealand?

The Air Cargo case<sup>11</sup> arises from the NZCC proceedings against various international airlines in which the NZCC alleges the airlines colluded to raise the price of freighting cargo by imposing fuel surcharges on cargo shipments into and out of New Zealand. The conduct is alleged to have occurred over a period of more than seven years.

The proceedings have been split into two stages. The first stage involved a preliminary jurisdictional question which included requiring the High Court to decide whether there was a "market in New Zealand" for the inbound air cargo services (jurisdiction over outbound cargo was not disputed). The defending airlines said there was no such market.<sup>12</sup>

The High Court found that in order for the Commerce Act to apply to a price-fixing agreement, it was necessary for there to be a market in New Zealand for the relevant goods or services. On the facts the Court held that there was a market in New Zealand for inbound cargo services. The High Court said it was sufficient that part of the market is situated in New Zealand, noting that it saw:

*... the fact that part of the service takes place in New Zealand as an important facet of the reality that part of the market is in New Zealand.*

The arrival and handling of cargo in New Zealand, and the demand for cargo shipments from New Zealand importers, were key factors in the Court's finding that a market exists here for inbound cargo services.

The judgment is significant given the magnitude of the proceedings, and the findings that while there must be a market in New Zealand, it may be sufficient that part of a service takes place in New Zealand for there to be a market in New Zealand.

The defendants have appealed the decision to the Court of Appeal, although this appeal has been stayed pending the substantive liability hearing. That hearing is scheduled to commence in March 2013.

### 3.1.4.2 Monopolisation – Telecom 'Data tails' case

71. In July and August 2012, the Court of Appeal released two judgments in the NZCC's long-running 'data tails' litigation against Telecom Corporation of New Zealand Limited.<sup>13</sup> The case concerned the alleged unilateral misuse of market power, which is prohibited under section 36 of the Commerce Act.

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<sup>11</sup> *Commerce Commission v Air New Zealand Ltd* (2011) 9 NZBLC 103,318 (HC).

<sup>12</sup> The defending airlines said that competition for inbound cargo to New Zealand occurred only at overseas ports of origin and not in New Zealand, and that for these reasons the NZCC's inbound price-fixing claims were outside the reach of the Commerce Act.

<sup>13</sup> *Telecom Corporation of New Zealand v Commerce Commission* [2012] NZCA 278, and *Telecom Corporation of New Zealand v Commerce Commission* [2012] NZCA 344.

72. During the relevant period covered by the proceedings Telecom was the owner of New Zealand's telecommunications network. The Court of Appeal explained:

*Rival telecommunications service providers had sought access to Telecom's network in order to provide their own data transmission services. This access was achieved by TSPs utilising data tails, which are the connection between an end customer's premises and the point where a rival TSP can take delivery of data signals from Telecom.*

73. The proceedings concerned Telecom's pricing of these data tails. The NZCC alleged that Telecom had taken advantage of its substantial market power by charging a price for wholesale access that was above the 'efficient component pricing rule' (ECPR) implied price. The NZCC argued that ECPR had been endorsed by the Privy Council in an earlier case<sup>14</sup> as the appropriate pricing model where there is a dominant vertically-integrated provider of network infrastructure and services.

74. In order to succeed under section 36 of the Commerce Act, a plaintiff must prove (amongst other things) that the defendant with substantial market power took advantage of its substantial market power. This requires a plaintiff to show that the defendant would not have acted as it did if it did not have substantial market power but was otherwise in the same circumstances.<sup>15</sup> This is known as the 'counterfactual test'. The Court of Appeal adopted this counterfactual test.

75. In applying the counterfactual test in its earlier case, the Privy Council had held that prices set in reliance on ECPR would not breach the counterfactual test. Since this decision it has generally been accepted that pricing which is at or below ECPR pricing would not amount to a taking advantage of substantial market power; likewise, pricing above ECPR will be indicative of a taking advantage of substantial market power.

76. In these proceedings, the High Court had found that Telecom had:

- Breached ECPR and therefore breached section 36 where Telecom provided all data tails used by the competitor to supply services access – the 'two tail scenario'; but
- Not breached ECPR and therefore not breached section 36 where a competitor acquired access only at one end – the 'one tail scenario'.

77. The High Court fined Telecom NZ\$12 million and Telecom appealed the two tail finding, and the NZCC cross-appealed the one tail finding.

78. In its two judgments, the Court of Appeal endorsed the High Court's two tail finding, and overturned the High Court's one tail finding holding that Telecom's one tail pricing amounted to a breach of section 36. The Court also endorsed the NZ\$12 million penalty.

79. While there were a number of issues canvassed, the key feature of the decision is the way in which the Court dealt with ECPR pricing.

80. In its judgment, the Court of Appeal confirmed that prices above ECPR would amount to a taking advantage of substantial market power.

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<sup>14</sup> *Telecom Corporation of New Zealand Ltd v Clear Communication Ltd* [1995] 1 NZLR 385 (PC).

<sup>15</sup> *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111.

81. However, the Court also suggests that where a firm's prices are consistent with ECPR, those prices may nonetheless amount to a taking advantage of substantial market power in breach of the Commerce Act if those prices are at a level at which a rival is unable to compete.

82. The Court of Appeal judgment has not been appealed.

### 3.1.4.3 Penalties

83. There have been a number of penalty hearings in the relevant period. These have resulted from settlements entered into by the NZCC and defendants in which an agreed penalty has been put to the Court. In such circumstances, the Court's role is limited to assessing whether the penalty falls within an appropriate range, and therefore there is little in-principle discussion.

84. However, for the record, the major cases have been:

- In the Air Cargo proceedings (paragraphs 84–89 above), Korean Air Lines Co. Limited, Emirates, and Japan Airlines Co. Limited settled with the NZCC following the stage one judgment, each admitting liability and being fined NZ\$3.5 million, NZ\$1.5 million, and NZ\$2.275 million respectively.
- In December 2011, the High Court imposed a penalty of NZ\$3 million against refrigerator compressor manufacturer Empresa Brasileira de Compressores S.A (Embraco) following it admitting its involvement in an understanding with another competitor to increase prices for some compressor units supplied into New Zealand.

## 3.2 Mergers and acquisitions

### 3.2.1 Summary of activities

85. The number of business acquisition and merger clearance applications continues to be lower than in previous years, which the NZCC believes is a result of the global financial crisis. However, the NZCC has noticed a small increase in the number of clearance applications received regarding global mergers.

86. Table 3.2 on the next page shows the number of merger clearance and authorisation applications received by the NZCC in the two years ended 30 June 2011 and 2012 and any proposed or actual acquisitions or mergers for which clearances or authorisations were not sought but which were investigated by the NZCC to ascertain their effects on market structure and competition (market structure cases).

**Table 3.2: Mergers and Acquisitions Activity for the Years Ended 30 June 2011 and 2012**

	2011/12	2010/11
Number of clearance applications processed	9	10
Number of authorisation applications processed	1	1
Number of market structure cases investigated	1	1

87. Table 3.3 sets out details of clearances, authorisations and investigations related to merger and acquisitions activity in the 2011/12 year.

**Table 3.3: Merger and Acquisition Clearances, Authorisations and Investigations for the Year Ended 30 June 2012**

<b>Case</b>	<b>Description</b>	<b>Resolution</b>
Universal Music Holdings Limited and EMI Group Global Limited	Application seeking clearance	Cleared
Canterbury SCL Limited and Medlab South Limited	Application seeking clearance	Cleared
Visy Industries Pty Limited and VPRS Limited and HP Industries Holding Limited and HP Industries (New Zealand) Limited	Application seeking clearance	Cleared
Epay New Zealand Limited and Ezi-Pay Limited, EFTDATA Holdings Limited and Compass Communications Limited	Application seeking clearance	Declined
IAG New Zealand Holdings Limited and AMI Insurance (Operations) Limited	Application seeking clearance	Cleared
Pact Group Pty Limited and Pacific BBA Plastics (NZ) limited and Viscount Plastics (NZ)	Application seeking clearance	Cleared subject to a divestment undertaking
iSite Limited and O.T.W. Advertising Limited	Application seeking clearance	Cleared
GEA Process Engineering A/S and Nu-Con Limited	Application seeking clearance	Cleared
Seagate Technology PLC and Samsung Electronics Co Limited	Application seeking clearance	Cleared
Southern Cross Hospitals Limited and Aorangi Hospital	Application seeking authorisation	Authorisation granted
Television New Zealand and Sky Network Television Limited	Investigation	No further action

### 3.2.2 *Significant cases*

88. It is rare for NZCC clearance or authorisation cases to be appealed to the High Court. One such appeal was heard in the relevant period. This was an appeal by a third party against the NZCC's decision to authorise a merger of New Zealand's only two wool scouring companies.<sup>16</sup>

89. The NZCC can grant an authorisation where it is satisfied that the acquisition is likely to substantially lessen competition, but where it identifies that the acquisition is likely to result in such benefits to the public that it should be permitted. This requires the NZCC (and the appeal court) to balance detriments from the lessening of competition and the public benefits arising from the acquisition.

90. The High Court in *Godfrey Hirst* confirmed the correct approach to be taken in an authorisation case, is for the NZCC to attempt, so far as it is possible, to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments exceed quantified benefits.

91. The appellants' real challenge on appeal was that the NZCC was wrong to authorise a "merger to monopoly". They argued this both as a matter of principle, and on the facts of the case. The Court rejected the argument that a special test applied in a merger to monopoly case.

<sup>16</sup> *Godfrey Hirst NZ Ltd v Commerce Commission* (2011) 9 NZBLC 103,396.

#### **4. The role of competition authorities in formulating and implementing other policies**

92. As discussed in section 1.1, the NZCC is an independent government entity responsible for enforcing various pieces of legislation. Although it may provide views on competition-related policy developments, this is usually restricted to commenting on operational matters. Fundamentally, to ensure an appropriate separation of policy and operational functions, the competition regime in New Zealand operates on the basis that advising government on policy development issues falls upon the Ministry of Business, Innovation and Employment. However, the NZCC may provide advice on or information relevant to policy developments or legislative change when it has relevant expertise.

93. In the relevant period the NZCC made a short submission to the New Zealand Productivity Commission (NZPC) on the NZPC's inquiry into international freight transport services. The NZPC published a report making findings and recommendations to improve the performance of international freight transport services to and from New Zealand. These included recommendations in relation to the current exemptions from the application of the Commerce Act provided to international shipping and civil aviation. The exemptions, which relate to co-operative agreements between competitors to fix prices or set capacity, are granted under the Shipping Act 1987 and the Civil Aviation Act 1990. The NZPC recommended that the exemptions could be narrowed.

94. The NZCC's submission provided information to the NZPC on two NZCC activities that had relevance to the NZPC's considerations: the streamlined authorisations process for merger and restrictive trade practices applications, and airport regulation under Part 4 of the Commerce Act.

95. In August 2011 the NZCC reported its decision not to initiate an inquiry into milk markets under Part 4 of the Commerce Act. The purpose of a Part 4 inquiry is to determine whether to recommend to the Minister that markets with little or no competition be regulated to mimic outcomes in competitive markets. The inquiry was called for after public concern at the high retail price of milk.

96. The NZCC concluded that a full pricing inquiry was not warranted. This conclusion was based on an analysis of the state of competition in the relevant markets, and whether Part 4 could effectively solve any potential problems identified.<sup>17</sup>

#### **5. Resources of the NZCC**

##### **5.1 Human resources**

97. The NZCC recognises that one of its most important resources is its people. For this reason, in the year ended 30 June 2011 the NZCC established *Better investment in people* as one of its five on-going strategic programmes aimed at business improvement.

98. The NZCC is led by a Board made up of NZCC Members who are appointed by the Governor-General on the recommendation of the Minister of Commerce (in the case of the Telecommunications Commissioner, on the recommendation of the Minister for Communications and Information Technology) and Associate Commissioners who are appointed by the Minister of Commerce. In addition, under the Commerce Act the Governor-General on the recommendation of the Minister of Commerce must appoint two Cease and Desist Commissioners for the sole purpose of hearing "cease and desist" applications.<sup>18</sup>

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<sup>17</sup> The NZCC's full report is available at [www.comcom.govt.nz/reports-and-judgements/](http://www.comcom.govt.nz/reports-and-judgements/).

<sup>18</sup> Under the Commerce Act, the NZCC has powers to obtain orders against anticompetitive behaviour. Cease and Desist Commissioners are able to make orders to restrain anticompetitive conduct or require a person to do something to restore competition or the potential for competition in a market.

NZCC Members have both governance and decision-making roles in exercising the NZCC's powers and functions. At least one NZCC Member must be a barrister or solicitor. The NZCC Board is headed by the Chair and Deputy Chair, who are both NZCC Members. As at 30 June 2012, the Board comprised six Members (including the Telecommunications Commissioner) and two Associate Commissioners.

99. The Chief Executive is responsible for managing the NZCC's operations and is accountable to the NZCC Board. The Chief Executive is supported by a senior leadership team consisting of three General Managers responsible for the branches of the NZCC: Competition; Regulation; and Organisation Performance.

100. The NZCC's staff have a wide range of skills and experience to ensure the organisation's effective functioning. This includes people with backgrounds in economics, finance, engineering, business and law, and with a mix of both private and public sector experience. As at 30 June 2012, the NZCC employed 77.25 full-time equivalent (FTE)<sup>19</sup> staff in the Competition Branch.

101. The Competition Branch deals with both competition and consumer law issues. All staff employed in the Competition Branch can potentially work on either competition or consumer issues. However, staff are separated into teams according to areas of specialisation. Table 5.1 shows numbers of FTE staff in the relevant teams.<sup>20</sup>

**Table 5.1: Restrictive Trade Practices and Business Acquisitions and Mergers – Numbers of FTE Employees as at 30 June 2012**

	<b>Restrictive Trade Practices</b>	<b>Business Acquisitions &amp; Mergers</b>	<b>Advocacy &amp; Development</b>	<b>Lawyers</b>	<b>Economists</b>	<b>Total</b>
Technical Staff	11.66	6.6	6.4	12.4	4	41.06
Support Staff		1		5.8		6.8
<b>Total</b>	<b>11.66</b>	<b>7.6</b>	<b>6.4</b>	<b>18.2</b>	<b>4</b>	<b>47.86</b>

## 5.2 Annual budget

102. The NZCC's budgeted operating expenditure<sup>21</sup> for its competitive markets function (restrictive trade practices and business acquisitions and mergers activity) for the year ended 30 June 2012 was NZ\$13.670 million (US\$10.753 million)<sup>22</sup>. This compares with actual operating expenditure for the year ended 30 June 2011 of NZ\$12.754 million (US\$10.032 million).<sup>23</sup> Table 5.2 on the next page provides a breakdown of this operating expenditure.

<sup>19</sup> An FTE employee is equivalent to one employee working full time for a full year. There is likely to be less FTEs than actual people employed since some employees are hired on a part-time basis.

<sup>20</sup> The table shows the number of staff in the Competition Branch employed primarily on competition issues (that is, on restrictive trade practices and business acquisitions and mergers work under the Commerce Act), with the exception of numbers of staff in the advocacy and development team, lawyers and economists, whose expertise is utilised across both competition and consumer law issues.

<sup>21</sup> At the time of writing, the NZCC's audited actual operating expenditure for the year ended 30 June 2012 was not available.

<sup>22</sup> All conversions in this report from New Zealand dollars to United States dollars are based on an exchange rate as at 30 June 2012 of NZ\$1 = US\$0.7866. This exchange rate was sourced from the Reserve Bank of New Zealand (available at <http://www.rbnz.govt.nz/>).

<sup>23</sup> To put this expenditure in context, the NZCC's total budgeted operating expenditure across all its functions (as discussed in section 1 of this paper) for the year ended 30 June 2012 was NZ\$41.996 million (US\$33.034 million). This compares with total actual operating expenditure for the year ended 30 June 2011 of NZ\$35.525 million (US\$27.944 million).

**Table 5.2: Annual Operating Expenditure for Competitive Markets  
(Restrictive Trade Practices and Business Acquisitions and Mergers)  
for the Years Ended 30 June 2012 (Budgeted) and 30 June 2011 (Actual)<sup>24</sup>**

	<b>Budget 2011/12 NZ\$000</b>	<b>Budget 2011/12 US\$000</b>	<b>Actual 2010/11 NZ\$000</b>	<b>Actual 2010/11 US\$000</b>
Market structure cases	139	109	41	32
Coordinated behaviour cases	2,190	1,723	1,759	1,384
Unilateral conduct cases	697	548	328	258
Determinations	3,387	2,664	2,726	2,144
Framework development	943	742	790	621
Public information/education	417	328	317	249
Reports to Ministers	0	0	122	96
Litigation	5,897	4,639	6,671	5,248
<b>Total</b>	<b>13,670</b>	<b>10,753</b>	<b>12,754</b>	<b>10,032</b>

## 6. New reports and studies on competition policy issues

### 6.1 NZCC reports and studies

103. In the year to 30 June 2012 the NZCC carried out a number of stakeholder surveys, measured the impact of targeted advocacy work and carried out one *ex post* evaluation of its work. The NZCC is placing increased importance on impact measurement. Evaluating the impact and quality of its decisions enables the NZCC to achieve the best possible outcomes in competitive markets and ensures it is providing the best value for money.

#### 6.1.1 Stakeholder surveys

104. In October 2011 Research New Zealand, an independent research company, carried out a survey of around 350 businesses employing 100 people or less. The purpose of the survey was to gauge awareness and perception of the NZCC and the legislation it enforces. This was a repeat of a survey that had been carried out in 2010. The 2010 survey revealed low levels of awareness by businesses that the Commerce Act applied to their business, and a correspondingly low level of compliance programmes in place.

105. The 2011 survey revealed that the percentage of small- to medium-sized businesses with compliance programmes remained effectively unchanged. The NZCC has not yet decided whether to repeat this survey. Given the size of the businesses involved and the corresponding low levels of potential detriment from any offending, it is not clear that this is where the NZCC should focus its resources.

106. In May 2012 the NZCC surveyed approximately 150 businesses with more than 100 employees to determine how many have an active compliance programme regarding the Commerce Act. This survey showed that significantly more (38 per cent) had a Commerce Act compliance programme than small- to medium-sized businesses. This survey will be repeated in the next year.

<sup>24</sup>

In Table 5.2, references to “cases” means to investigations undertaken by the NZCC in relation to business acquisitions and mergers for which prior clearances or authorisations were not sought from the NZCC but which the NZCC assesses may raise concerns about competition in the relevant markets, and to potentially anticompetitive coordinated and unilateral conduct. “Determinations” refers to clearances and authorisations considered by the NZCC in relation to notified business acquisitions and mergers, and to authorisations in relation to anticompetitive coordinated conduct.

107. In the year ended 30 June 2012 the NZCC also carried out online surveys with businesses that had received a compliance advice or warning letter from the NZCC. The survey asked whether the printed resources that had been provided together with the letter, for example, fact sheets, were helpful. The response was overwhelmingly that the resources were both user-friendly and useful.

#### 6.1.2 *Measuring the impact of targeted advocacy work*

108. Because a significant portion of the NZCC's education and advocacy work is targeted, it has allowed the NZCC to measure the impact it has had on the specific sectors it has focused on.

109. The non-residential construction sector (firms with a turnover of NZ\$5 million to NZ\$50 million per year) is one such sector.

110. Independent research commissioned by the NZCC in early 2010 showed this sector had very little awareness or understanding of the Commerce Act. The NZCC then commenced an advocacy campaign, including presentations to construction firms, supplying information packs, and placing articles about competition issues in industry publications.

111. After twelve months, in June 2011, the NZCC conducted a survey to measure the impact of its advocacy work. The NZCC found that 30 per cent of the 30 firms surveyed (out of a possible pool of 93 firms) were aware of the education campaign and had an understanding of the key messages.

112. The survey was repeated after another twelve months of continued education. This time 47 per cent of the 30 firms surveyed reported an awareness and understanding of the NZCC's key messages.

#### 6.1.3 *Ex post review of merger clearance decision*

113. In June 2012 the NZCC completed an *ex post* review of the Northland sand market which was affected by a merger between Tomarata Sands Limited and Coastal Resources Limited in 2012. Both of these companies sold sand to customers in Northland, New Zealand. The most important customers in this area were nationwide concrete manufacturers.

114. The NZCC cleared the merger on the basis that suppliers based on the outskirts of the geographic market would supply the Northland sand market and concrete manufacturers would have a degree of countervailing power which would constrain the combined entity.

115. The review consisted of interviewing market participants and sending out questionnaires on pricing to customers.

116. The review found that the relevant market had been correctly identified, as customers had threatened to switch to suppliers on the geographic boundary, and had in fact switched on one occasion. It was found that this appeared to have had a price-constraining effect on the merged entity. The review also found that prices in the market had remained stable since the merger.

## 6.2 *New Zealand study on competition*

117. This section discusses *Competition in New Zealand*, a multi-year research project involving the Ministry of Business, Innovation and Employment, the NZCC, the Ministry of Foreign Affairs and Trade, and the New Zealand Treasury.

118. *Competition in New Zealand* was undertaken to look at competition across the New Zealand economy and determine the nature and extent of competition in New Zealand industries. There is currently

little or no information of the degree of competition in the majority of industries in the New Zealand economy and how they compare with other economies. The project seeks to answer the following questions:

- How competitive are sectors in New Zealand?
- What is the link between the degree of competition and firm outcomes, such as innovation, productivity and management practices?
- How do these compare with other countries?
- What are the implications for competition policy and economic policy more generally?

119. The project uses firm level data from the prototype Longitudinal Business Database (LBD) held by Statistics New Zealand. The research team has drawn on international literature and engaged external experts to help develop frameworks and methodologies.

120. The project has considered competition *in* the market (the traditional view), as well as competition *for* the market. Consequently the analysis has looked at the dynamics of markets and the actions and performance of firms to understand competition in New Zealand.

121. The different areas of work in the project are currently being drawn together into a final report. However, the following are key findings from the project so far:

- **Firm performance is very dispersed within New Zealand industries.** The significant heterogeneity observed in firm productivity, even within narrowly defined industries, appears to be larger in New Zealand. Within markets the researchers expect firms to use the same or similar inputs therefore the differences in performance are stark. In New Zealand the researchers observe persistence in the distribution and firms tend to remain a top or bottom performer in the industry. This is interesting because in a competitive market poor performing firms would be expected to be weeded out of a market, allowing resource to be reallocated to a more productive use.
- **Heterogeneity in the market influences the effect of competition on both the firm and the market.** More efficient firms can gain greater market share, at the expense of less efficient firms who may be forced to shrink or leave the market. This must be taken into account when competition within markets is measured. Traditional measures of competition can incorrectly reflect changes in competition when profits are reallocated towards the more efficient firms and the least efficient firms become unviable and fail. The project uses a new measure of competition, the Profit Elasticity (PE) measure<sup>25</sup>, that is robust to the reallocation of market share.
- **Levels of competition appear to be low in New Zealand.** Despite being close to best practice in terms of competition policy settings, the level of competition in New Zealand industries is lower than the Netherlands and the United Kingdom (for which the researchers have a comparison across measures of PE). This may be a function of the size and distance of the New Zealand economy.
- **High rates of firm entry and exit in New Zealand industries.** Firm entry, exit and competition are interrelated. Entering firms create greater competition and competition in the market influences whether new firms enter. The ease with which a business can be started in New Zealand reflects the high rate of entry. However, while the performance of new firms increases

<sup>25</sup>

Griffith, R., Boone, J. and Harrison, D. (2005) 'Measuring Competition', AIM Research Working Paper Series, No. 22. Advanced Institute of Management Research.

quickly in the first few years of operation, in relation to that of incumbents, their performance does not appear to catch up to the level of incumbents. This raises the question of how low performing entrants can compete with higher performing incumbent firms and remain in the market.

- **How much do new firms contribute to improvements in performance and how much is it due to incumbents?** Competition is a mechanism that drives firms to become more productive by becoming more efficient at what they do or being more creative to escape competition (for example, developing a new product). Productivity growth within an industry is caused by existing firms becoming more productive, more productive firms getting bigger and firms entering and exiting the industry. From decomposing productivity growth<sup>26</sup> the researchers were able to show that the majority of contribution to productivity growth in New Zealand is from incumbents. There is a smaller positive net effect from more entering firms being more productive than the exiting firms they replace.

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<sup>26</sup> Melitz, M.J. and Polanec, S. (2009) 'Dynamic Olley-Pakes Decomposition with Entry and Exit', University of Ljubljana, Working Paper No. 03/09.