Submission on the Exposure Draft Commerce (Cartels and Other Matters) Amendment Bill

22 July 2011

Introduction

1 Telecom is grateful for the opportunity to comment on the Exposure Draft Commerce (Cartels and Other Matters) Amendment Bill (**Bill**). We appreciate the effort that MED has undertaken to canvass views from across the business sector before coming to a final decision as to whether to take the Bill forward.

2 Traditionally the price fixing provisions of the Commerce Act 1986 (**the Act**) have been less relevant to Telecom than other parts of the Act. However, for reasons given below, there will likely be a greater need for businesses in our sector, to either collaborate in order to deliver new infrastructure, or to pool the expertise necessary to deliver the converged products that consumers are demanding.

3 Therefore the way that we have approached the Bill is to ask whether the proposed framework for prohibiting cartel activities is workable from the perspective of a business that needs to engage in legitimate collaborative activities from time to time. This effectively means that we are looking to be able to set up a process for assessing compliance that we can place sufficient reliance upon to make a clear decision as to whether we can proceed with a proposed activity or not. (This is what we do to ensure compliance under other sections of the Act.)

4 Unfortunately the proposed framework is not easily workable from a compliance process perspective because neither the prohibition, nor the carve out for collaborative activities has an element that can properly be assessed in an objective way, this means that any decision or assessment will be subject to uncertainty.

5 We think that providing a framework that does not allow a party to assess a collaborative activity in an objective way, coupled with an extreme punitive sanction targeted at individuals for getting a subjective judgment wrong will have a significantly detrimental impact on the willingness of ourselves and businesses generally to engage in legitimate collaboration. The consumer will be the overall loser as a result.

6 In our view consumers receive the greatest benefit over the long term (and we note that the goal of the Act is to promote “the long-term interests of consumers”) through the development of new products and ideas. For example the developments in ICT sector that have occurred over the last 10 years have had a transforming effect on business and society and this level of change simply would not have been possible without service providers and telecommunications businesses being able to exchange ideas and forge alliances. Further, Government is on record as saying that it believes that the result of deploying new converged services on the UFB infrastructure will result in genuine uplift in New Zealand’s productivity growth. In that context, why would Government want to develop a new set of prohibitions that could well have the effect of inhibiting the exchange of ideas between e.g. telcos, ICT

businesses and broadcasters and thus the creation of the very kinds of converged products that Government is talking about promoting?

7 We believe that the facilitation of legitimate collaboration is more important than the value of one more increment of extra deterrence that would be achieved via the policy.

Aspects of the Bill we support

8 There are aspects of the Bill that we support, particularly the concept of an exemption for collaborative activity. However, we suggest the following changes:

- Remove the "reasonably necessary" limb of the exemption;
- Introduce a new provision that deems a party not to have a "*dominant purpose of lessening competition*" if it can be shown that the conduct does not have "*the effect, or likely effect, of substantially lessening competition in a relevant market"*; and
- Allow collaborative activities to be undertaken in parallel with clearance applications.

Aspects of the Bill we oppose

9 We do not consider that the main policy proposal to criminalise cartel conduct would serve the interests of New Zealand economically. This is because there is a particular need in small economies for businesses to be able to engage in legitimate collaborative activities. Also as noted above we believe that the importance of allowing businesses to pool resources and exchange ideas to deliver new products is ultimately far more important to New Zealand than greater deterrence for illegitimate activities.

10 We also think that the way in which the policy has been put forward raises a number of social issues that should be considered carefully by the criminal justice sector. This is because the proposal is not only to criminalise cartels, but to criminalise cartels without applying the usual safeguards and expectations of the criminal justice system. For example the "immunity guidelines" would introduce a form of plea bargain into the New Zealand criminal law, and the collaborative activity exemption places the onus of proof on to the defendant.

11 We are also uneasy with the fact that conduct can fall within the scope of quite a serious offence for purely technical reasons, rather than because of intuitively blameworthy conduct. We think that any serious criminal sanction targeted at

individuals should be limited to situations where there is an act that is intuitively harmful, coupled with a state of mind that is morally blameworthy.

12 However, if the decision is to go forward with the introduction of criminal provisions, we suggest that a process of simply notifying the Commerce Commission (**Commission**) of any collaborative activity, before the collaborative activity is irrevocably entered into, and before any party involved in the collaborative activity is notified or a cartel investigation, should be sufficient to take the activity out of the jurisdiction for criminal scrutiny and into the jurisdiction for civil scrutiny alone. This is because the kind of conduct that should be punished with criminal sanctions is not the kind of conduct that a business would be likely to notify the Commission of.

Policy Comment

<u>The practical need for greater collaboration in markets that we operate in</u>

13 One of the consequences of New Zealand being a much smaller and more remote economy than the jurisdictions that we compare ourselves with is that there will often be a much greater need for parties in smaller economies to collaborate in order to achieve efficient levels of scale, spread risk or take advantage of different kinds of expertise.

14 There have always been some very powerful operational reasons for businesses to collaborate in certain contexts in our sector, without which the sector simply would not be able to operate as efficiently as it does. Examples include common approaches to numbering administration and number portability, cooperation in respect of treatment of 111 emergency calls. In fact in some regulatory processes for example MTAS, the Commerce Commission has even gone so far as to encourage parties to seek to agree a common approach to price and non price terms for certain services so as to limit the number of issues that need to be be dealt with via regulation.

15 Going forward, the need to collaborate is going to become far more important as the old model of having a vertically integrated Telecom at the centre of the sector potentially gives way to, structurally separated Telecom, other infrastructure providers, increasing overlap with other sectors, longer and more complex value chains and greater convergence of technologies.

16 In the context of infrastructure deployment, the arrangement between ourselves and Vodafone to deliver Government's RBI solution is a good public example of Telecom collaborating with a traditional competitor in order to build infrastructure that will deliver a Government policy goal and benefit New Zealand. Equally, the MED will be aware that we are looking to partner with Enable Networks to deliver part of our UFB solution. Also the legislation behind the UFB scheme generally supports

collaboration in some contexts, for example standard form contracts across the industry are promoted.

17 Further, as our sector evolves and begins to overlap with other sectors (e.g. broadcasting and ICT) the need for collaboration also increases because we may need to pool the skills and expertise of different organizations that may or may not be competitors in some markets in order to deliver the new converged and multifunctional products that consumers want.

18 This is true even at a global level. Singapore's "Project NIMS" provides some useful discussion of the kinds of alliance issues that are being raised to provide consumers with the products they need. "Project NIMS" is a joint initiative by IDA and MDA to develop a strategy to build up capabilities, infrastructure and the industry ecosystem in the area of interactive multimedia application and services[1].

19 Unless the Act changes in such a way as to facilitate this legitimate collaboration, we believe that it risks becoming an increasing roadblock to economic growth and innovation in New Zealand for our sector, rather than a tool for serving the interests of end users.

Literature in support of the principle that small economies have a greater need to collaborate

20 As well as seeing the need to collaborate at practical level in our day-to-day work, there is also a relatively well established body of economic literature supporting a view that parties may need to collaborate to a greater extent in small economies. For example, as noted by Lewis Evans and Patrick Hughes:

…For any economy, particularly in the presence of competition, cooperation enhances economic performance. In small economies cooperation can be particularly efficient – for example, in achieving scale and thereby export performance – although it may entail interaction among a large fraction of players in an industry[2]*…*

21 Equally, global academics such as Michal Gal[3] have also commented on the particular factors that come into play with respect to small remote economies, and the need for

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[1] http://www.ida.gov.sg/Infrastructure/20090807131841.aspx (link to "Project NIMS")

[2] Abstract of *Competition Policy in Small Distant Open Economies: Some Lessons From the Economic Literature* (December 2003) Lewis Evans and Patrick Hughes new Zealand Treasury Working Paper 03/31

[3] See for example *The Effects of Smallness and Remoteness on Competition Law – The Case of New Zealand* (New York University Law and Economics Working Papers 2006) **Michal s. Gal** Page 7 "The Basic Dilemma"

players in those economies to collaborate more and structure their competition laws differently to those in larger economies in order to take this difference into account.

Current wording of the Act does not maximise beneficial collaboration

22 The Act in its current form has a bias toward sacrificing beneficial collaboration in order to have a greater deterrent impact on anticompetitive collaboration because it provides for a per se prohibition on any conduct falling within the technical parameters of price fixing, irrespective of the reason or impact on markets[4]. For the reasons given above we think this is the wrong bias for the law to have in a small economy, or potentially for any country at this point in time where the exchange in different forms of expertise is so vital for innovation and development of new products.

23 Therefore we support the introduction of a broad exemption for collaborative activities that focuses on the overall substance of the collaboration rather than on form as a step in the right direction.

24 However, we note that the MED has not directly amended the per se nature of the prohibition in section 30 of the Act. In contrast, other jurisdictions, such as the US, are moving away from taking a per se approach to interpreting their price fixing provisions.

25 Overall, we are of the view that parties should be able to collaborate, so long as their conduct is efficiency enhancing does not have the effect of harming competition (including considerations of efficiency that flow from collaboration). This approach is consistent with a body of law that is intended to "*promote competition in markets for the long-term benefit of consumers*" and appropriate for a small economy.

Exemption for collaborative activity

26 While we are supportive of the concept of the exclusion for procompetitive collaboration, we suggest some changes to its formulation.

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[4] We note that there are some existing carve outs from section 30 e.g. joint venture and joint buying exceptions. However, these carve outs have been drafted with some difficult criteria to fulfill that don't necessarily have any bearing on the competition effect of the activity in question. For example, to take advantage of the joint venture carve out, parties essentially have to set up a new corporate vehicle to carry out the activity. In our view having a separate corporate vehicle does not have any bearing on whether a project is beneficial or harmful to markets.

"Reasonably necessary" limb

27 The key change that we suggest is that the "reasonably necessary" limb of the exclusion should be removed. There are two reasons for this:

- First, if a party can establish that collaboration will not result in any harm to competition, then that in itself should remove the need for any punitive action to be taken. In fact we think it would be undesirable for collaboration that is clearly beneficial to be caught as cartel conduct, simply because it does not meet a "reasonably necessary" standard. Conduct should not be deterred or outlawed on the basis of criteria that are irrelevant to the overall purpose of the Commerce Act i.e. the promotion of competition for the long term benefit of consumers

- Second, although it is possible to set up compliance systems and processes that model the likely **effect** of a collaborative activity on competition in markets, this is not the case for assessing whether an activity is "reasonably necessary". In our view a decision as to whether conduct is "reasonably necessary" is a subjective business judgment call rather than something that can be modeled in a scientific way. The downside of a judgment call is that it is ripe to be second guessed if a transaction is looked at long after the event.

28 Overall if there is a threat that the necessity of your business decision will be second guessed years after the event, if the burden is then on you to prove that it was necessary (which is how the scheme has been designed), and if there is a 7 year prison sentence at stake if you cannot prove your case adequately, and proving the state of mind of your staff can be much more difficult if allegations are being made years after the event, then the carve out becomes subject to far too much uncertainty to place reliance on. If the carve out is too uncertain, then it will not fulfill its proper role of facilitating legitimate business collaboration. If you add to this that the limb causing the uncertainty is in fact irrelevant to the question as to the impact of conduct on competition, then logically the limb should be removed.

"dominant purpose of lessening competition in a relevant market" limb

29 We understand that the MED has formulated the wording of the "dominant purpose" limb of the carve out for collaborative activity in response to industry concerns that they should be judged from the perspective what they were trying to achieve as at the time they engaged in the conduct, rather than on what the ultimate effect of the activity was. We can see why that kind of reasoning makes sense when an individual staff member is being accused of a crime.

30 However, we are of the view that a purpose based formulation is ultimately more problematic than an objective effects based test in the following contexts:

- First, when a business has to make an upfront assessment of whether a proposed activity complies with the Commerce Act, it is far preferable to take an approach that models the likely effects of a collaborative activity on markets and make the decision to proceed or not based on that, than it would be to attempt to distil down into what might be in the minds of individual employees that are involved in the venture and to somehow capture that thinking for the future. That approach is difficult if the carve out is based too heavily on purpose rather than effect. To put it another way the elements of a cartel prohibition should be designed in such a way that a party can build a reliable compliance process around it.

- Second, when considering liability for a business, attributing purpose can be an abstract and complex exercise. For example, if some employees were to have an anticompetitive intent when they first propose that a business take part in a collaborative activity, but then the business only approves the activity after receiving legal sign off, based on a reasonable analysis of the impact of the collaboration on markets, then where does that leave the business in terms of its overall purpose?

31 Therefore, our suggestion is to insert a further "effects based" provision that deems a business not to have a "dominant purpose of lessening competition" if it can be shown that the conduct "*does not or would not likely have the effect of resulting in a substantial lessening of competition in a relevant market"*. This formulation is well known and consistent with other provisions in the Commerce Act and it requires an assessment of what the likely consequence of one's actions are.

32 A further reason for the MED to approve of our proposal to consider the effect on markets is that it goes to the heart of what actually happened, or what is likely to happen as a result of that conduct. In our view an analysis of what the effect of conduct is, or is likely to be would be an issue that parties would almost inevitably have to traverse in any prosecution in any event because:

- The effect of an act, often sheds some light on the credibility of any claims as to purpose; and

- The extent of harm would be relevant to sentence.

Clearances for collaborative activity

33 Businesses will be less inclined to make their own judgment on whether to proceed with any collaborative activity if:

(a) the consequences for falling on the wrong side of the compliance line increases; and

(b) if there is too much uncertainty and subjectivity hard wired into the test for being able to claim the carve out.

34 We believe that the combination of introducing severe criminal penalties on individuals in the event of breach, coupled with the subjectivity as to what "reasonably necessary" and "dominant purpose means", and the fact that there will be no jurisprudence surrounding these provisions for some time means that there will be a strong leaning toward seeking a clearance, rather than being willing to chance their own view. Therefore it is important that clearances are made available.

35 However, we are concerned that if the regime results in slow turn around of clearance decisions, then businesses may simply elect not to proceed with their ventures at all.

36 As an aside we also note that in addition to timeframes often being of the essence in business activities, the clearance process is often not a viable mechanism for businesses to use anyway because it is a public process. Being required to give your rival advance notice of your venture can in itself defeat the value in proceeding.

Proposal 1 – Introduce a simple notification process to remove activity from criminal jurisdiction

37 For the reasons given above we think that the threat of criminal sanctions will be a driver to make businesses disproportionately inclined to not proceed with a collaborative activity or to seek the comfort of clearances, rather than making their own judgments. This is undesirable. Therefore if there were to be a quick, easy and confidential way to remove conduct from the criminal sphere at the least, that could alleviate at least some of the need to make a clearance application (potentially beneficial for both the Commission and the businesses concerned).

38 One way to achieve this outcome is obviously not to criminalise in the first place. A second possibility would be to create a new simple notification process that removes activities from the criminal jurisdiction but not civil jurisdiction.

39 In essence the party or parties would provide the Commission with a fairly basic outline of their project before the collaborative activity is irrevocably entered into, and before any party involved in the collaborative activity is notified or a cartel investigation. Once this is lodged they would have immunity from criminal sanctions. To maintain the immunity the parties must provide any further information the Commission reasonably requests.

40 This thinking behind the proposal is that any conduct that a business would be prepared to notify the Commission of to any extent is probably not the kind of conduct that the policy is aiming to punish. The conduct that should attract criminal

sanctions is probably conduct that a party would attempt to keep secret at all costs, rather than an activity carried on in good faith, which happens to fall on the wrong side of the line.

41 It should be noted that this proposal does not resolve all the problems with the proposed cartel regime. More specifically, the threat of civil sanctions will still be sufficient enough to deter a wide range of desirable collaborative activities.

Proposal 2 - Modify the requirement that clearance applications must be forward looking

42 The clearance process would be more workable, and pressure would be removed from the Commission to process quickly, if there was not a requirement that an activity could not start at all until clearance was granted. Indeed, it seems inefficient not to enable a project to be advanced in parallel with a Commission clearance process.

43 On the other hand we understand that it may be undesirable from a policy perspective to enable parties to obtain for a clearance for any activity that took place in the long distant past.

44 Therefore our proposal is that the Commission should be able to grant clearance for any activity provided that the **application** is made before the collaborative activity is irrevocably entered into. The risk is then with the private sector to determine how far they want to take implementation before the Commission makes its finding on the application.

45 Further, we consider that agreements entered into six months before the proposed Amendment Bill is enacted should have an opportunity to apply for clearance within six months of the Amendment Bill coming into force.

Criminalisation of cartels

46 We have set out our view above to the effect that small economies are different from the countries we tend to benchmark against. New Zealand with its entire population of 4 million people does not have the same ability to resource large scale investment, or highly skilled workers in the same way that:

- The EU can with its population of around 780 million;
- The US can with its population of around 300 million;
- The UK can (which is roughly the same geographic size as New Zealand) but with a population of around 60 million;

- Even Australia has a population of around 4-5 times the size of that of New Zealand.

47 The only way that the investment and talent gap can be bridged is through greater collaboration within New Zealand than is the case in these other jurisdictions. This means that the over riding policy objective here should be to avoid deterring legitimate business collaboration, rather than erring toward over enforcement.

48 Thus New Zealand should not jump toward criminalisation of cartels simply because that is the approach that is taken in other larger jurisdictions. Our view is that because there is a much greater need for collaboration in New Zealand than is the case elsewhere, this pushes the appropriate policy settings on a topic such as the criminalization of cartel activities in a different direction to those other jurisdictions.

Chilling effect on legitimate business activities

49 Overall we believe that the criminalization of cartels will have a chilling effect on legitimate business activity that is disproportionate to any benefits flowing from the criminalisation of illegitimate activities. This is for three fundamental reasons:

(a) The policy places the most severe consequences of getting things wrong on to individuals. If individuals feel more personally in the line of fire, we think that the result will be an overly risk averse attitude toward legitimate collaborative activities;

(b) We do not feel comfortable that only true hard core cartel conduct will come under fire for criminal sanctions if the Bill is implemented. It is difficult for us to ask our employees to make judgment calls in the face of severe penalties for honest mistakes. We note that the explanatory materials do not attempt to draw a line between hard core conduct and other conduct; and

(c) The current sanctions and enforcement framework appear to be successful in terms of bringing cartel conduct to light (hence the reason why the policy attempts to bring so many aspects of the civil regime across into the criminal context).

Social issues

50 We note that if cartel conduct becomes criminalised it will be necessary to introduce a form of plea bargaining into the New Zealand criminal justice system in order to retain the highly successful leniency policy. We think that the introduction of such a policy has far wider ranging implications than for the business community and competition enforcement.

51 We note that the proposal is for the onus of proof to be on the defendant if the collaborative activity carve defense out is claimed. The stated rationale for this is that the defendant has greater knowledge of the details of the transaction, so the obligation should be on him or her. Our view is that that the rationale would not necessarily hold true if the Commission is pursuing an individual, especially one who has left the business that engaged in the conduct.

52 It is possible that the effect of the Bill would be to de facto introduce retrospective criminal sanctions in the event that an activity infringing the price fixing prohibition was entered into before the Act came into force and continues. The scenario is where parties enter into a collaborative arrangement prior to the Bill coming into force and that arrangement becoming caught after the event once section 30 has been amended. It would seem unreasonable to expect a business to pull down a very significant existing collaborative arrangement e.g. some form of infrastructure building partnership or even to turn its mind to the risk.

53 We note that the Commission's powers under section 98 of the Act would enable the Commission to potentially abrogate defendants rights to silence. This is not mentioned in the discussion papers.

54 We feel uncomfortable that the criminal offence is not made up of a clear cut wrong act coupled with a blameworthy state of mind.

55 Intuitively, we would regard a serious cartel offence as requiring the Crown to prove:

(a) Conduct that either harmed competition or was likely to harm competition; and

(b) Some form of blameworthy state of mind e.g. dishonesty (which is the element in the UK) or secrecy.

56 Instead the blameworthy act is any collaboration that falls within the technical parameters of section 30 (even if it is beneficial to markets). The state of mind is then a very technical form of knowledge that does not necessarily have any real culpability to it. This formulation does not seem right for a crime punished by 7 years imprisonment.

57 We believe that these issues have wide ranging implications and that feedback should be sought on this from across the criminal justice community.

Conclusions

58 As a business that would have the compliance burden of any policy that is developed, we believe that any policy should have the following characteristics:

(a) It should be reasonably possible to separate permissive conduct from conduct that falls on the wrong side of the line. - In this case the level of subjectivity hard wired into the collaborative activity exemption is problematic.

(b) Intervention should be targeted at activities that are harmful only. – In this case the per se nature of the offence potentially covers beneficial activities as well as harmful activities and as noted above the carve out we would seek to rely on is problematic in nature.

(c) The scale of penalty for transgression should make sense in light of the general hierarchy of obligations and drivers on businesses, otherwise perverse incentives arise. – In this case the threat of extreme criminal sanctions for falling on the wrong side of the line (and we note that it may only be a technical wrong doing) are more severe than almost any other obligation that would be on the business and on staff working for the business. We do not believe that the level of priority created for complying with the prohibition that is being accorded to it is truly appropriate. For example it does not seem right that it should be more important for our staff to fall on the right side of the line when entering into some sort of new product development venture with another party, than it is for our network to avoid failure.

(d) The regime should be reasonably fair at a human level because ultimately it will be ordinary people that face the consequences of the regime. – In this case it is possible for individuals to be in the line of fire for extremely serious sanctions as a result of merely technical wrong doing and no blameworthy state of mind. Further, the proposal is to enforce the sanctions without conferring the rights and protections that people accused of crimes normally have. For example the obligation is on the defendant to prove their innocence if they are claiming the carve out and rights to silence seem to be abrogated because of the lack of any amendments made to s98. We consider this to be fundamentally unfair.

59 Because the nature of the regime proposed, seems so far from what we would regard as best practice for a compliance regime, we believe it will have a genuinely inhibiting effect on the exchange of ideas between different kinds of business involved in the value chain for delivering ICT products to consumers and the innovation of new products. In our view a chilling effect on developing the kinds of product that will assist New Zealand to overcome its distance and scale disadvantages as against other countries would result in a loss for business, for the consumer and for New Zealand's productivity.