Interview with Mark Berry, Chair, New Zealand Commerce Commission

Editor's Note: *In this interview with* The Antitrust Source*, the Chair of the New Zealand Commerce Commission, Mark Berry, discusses New Zealand's new merger guidelines, Trans-Tasman cooperation, the Commission's special role as a sectoral regulator, and how the Commission addressed the domestic consequences of a monopoly established to export New Zealand's milk production.*

Mark Berry was appointed Chair in April 2009, and holds a term that will expire in 2014. Prior to coming to the Commerce Commission, he was a partner in the law firm Bell Gully, a consultant with Chapman Tripp, a barrister sole, and, from 1999 to 2001, Deputy Chair of the Commission. He holds a J.S.D. from Columbia University, New York. He has taught at Otago University Law School. In 2010, he also was appointed for a three-year term as an Associate Member of the Australian Competition and Consumer Commission.

This in-person interview was conducted by Meg Guerin-Calvert for The Antitrust Source *on April 9, 2013.*

ANTITRUST SOURCE: The Commerce Commission seems to have an incredibly broad scope of responsibility, including fair trading, consumer credit, business competition, regulated industries and, within those, a fair number of major industry sectors. Could you give us an overview of the organizational structure of the Commerce Commission and how each of these functional areas are included and prioritized? And then we're very interested in how you have the teams of lawyers and economists organized.

MARK BERRY: Right, well our mandate is indeed very broad. We started out like the FTC, as an antitrust authority. New Zealand came quite late to regulation and so it wasn't until 2001 that regulatory regimes emerged, first telecommunications, then dairy, and more recently electricity lines businesses, gas pipelines, and certain airport services.

There was no particular logic as to why we became the regulator; my expectation is we were simply the body that was in place and so that's how we have grown over the last little while since 2001. In terms of our organization we are an independent agency, with a board comprising, currently, seven members. We also have a commissioner from the ACCC—Jill Walker—on a cross-appointment to our commission and I'm also a cross-appointee to ACCC.

We're not a big organization. We have around 175 staff in total, including all of our operational performance branches. I think of our organization as essentially two pyramids. One is the competition/consumer branch and the other is the regulation branch.

Commissioners are involved in both antitrust and regulatory work. I am involved in all aspects of the Commission's work except for telecommunications.

In terms of the prioritization of work streams, we have both adjudicatory and prosecutorial functions. By virtue of statutory requirements, adjudication naturally takes priority. So when we have a merger clearance or authorization application, or a trade practices authorization application, that is a priority.

We have had in the last three years quite extensive streams of regulatory tasks. We have had to set, for the first time, specific methodologies, which are your basic building blocks of regulation. These have included asset valuation, the cost of capital, and so on. Now all of these regulatory tasks have had quite vigorous legislative timeframes by which they had to be done and so naturally this has also governed prioritization.

Off the back of those tasks, very often we find our decisions are subject to appeals. Also our decisions are open to judicial review, so there is associated litigation, which assumes priority.

For the rest of our work we are the body that investigates and prosecutes matters, particularly under the competition and also consumer laws—but given the limited resources that we have, we have given careful consideration to enforcement criteria to help us prioritize. We have also published enforcement response guidelines and we've had very positive feedback from the marketplace on these guidelines.

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ANTITRUST SOURCE: Before we turn to other topics, you've mentioned a feature that is somewhat different than in many other countries, which is the very, very close relationship with the competition authorities in Australia and having common or cross seats.

Can you elaborate a little bit more on that and maybe also give us a little bit more perspective as to how that cooperation relationship between the two countries has operated?

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BERRY: We have a particular history of economic closeness to Australia, and much of it goes back to government initiatives. That began at the time of our CER, or Common Economic Relations Treaty, which was entered into with Australia back in 1983. As a result of that, there has been, particularly from the New Zealand point of view, an awareness of the benefits to the New Zealand economy through getting closer to Australia and having access to Australian markets.

As part of our harmonization we have very often mirrored Australian commercial legislation, and in fact our Commerce Act directly reflects that, and is largely based on the Australian model, the Trade Practices Act of 1974.

Our courts have very often relied upon Australian case law in interpreting our Commerce Act. In addition there is value for businesses that transact on both sides of the Tasman to be subject to laws that they know and understand on both sides.

In terms of information sharing, last year our Commerce Act was amended to enable us at the NZCC to share compulsorily acquired information with the ACCC and also to provide investigative assistance to the ACCC and other recognized overseas regulators. The amendments reflect similar provisions in Australian legislation. There are certain safeguards, so that won't happen automatically. If there are public interest concerns or if matters are legally privileged, these could be reasons not to share the information, but otherwise, we have a true spirit of cooperation and sharing information with the ACCC.

Another indicator of our close working relationship with Australia is that we have a very close dialogue with the members and staff of the ACCC and other recognized overseas regulators. For example, the investigators have monthly meetings together and there is close communication on matters of common inquiry.

There have been a number of trans-Tasman matters—these are largely mergers with global dimension, and I know that our staffs have worked very closely with the ACCC staff to see how

they're analyzing the markets. The same is true if we have a trade practice investigation. In these cases, we will talk to the ACCC and learn from the wealth of experience they can share with us on that.

ANTITRUST SOURCE: Keeping that in mind, you had mentioned that you do have the new draft merger guidelines. Could you give us an idea of the most important changes or perhaps even clarification of priorities or analytics that might have occurred? I think one area that's of great interest oftentimes is the precise wording of efficiencies analysis and how it's taken into consideration. If you could speak to those that would be of great interest.

BERRY: We have put out new draft merger guidelines. The changes are not radically different but simply reflect updates to account for developments in New Zealand case law and to have regard to developments and international precedents, such as for example the FTC and DOJ guidelines. We haven't revisited our merger guidelines for ten years or so.

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If I could just highlight two matters in relation to these guidelines: First is the cornerstone counterfactual analysis that we do under our merger provision, Section 47. This section prohibits mergers that are likely to result in a substantial lessening of competition. Our case law has developed a very rigorous counterfactual analysis that involves analyzing the situation both with and without merger. The factual, or merger, is always quite straightforward to analyze. But inevitably when we look at what are likely counterfactuals without the merger, we do get into some degree of speculation. We are required to identify whether or not there is a real chance of any given counterfactual happening. This is an area where the courts have had much to say. There needs to be more than the mere possibility of the counterfactual, but it does not need to be more likely than not. And so, for example, a probability of less than 50 percent could be counted as a counterfactual for the purposes of our section 47 analysis.

Another issue which has come out of our case law is that the courts have accepted that we may find multiple counterfactuals. Now this does get to be a little bit messy potentially—we do look at some cases where you arguably could say that there could be more than one counterfactual. And so our task usually is to take the one counterfactual that would have the most competition concerns attaching to it. And if it is found that this counterfactual is likely to involve a substantial lessening of competition, then clearance will not be granted to the proposal.

A problem may be seen to arise where a merger may be turned down on the basis of a counterfactual which is perhaps not the most likely counterfactual. That is a problem of our jurisprudence. Our new draft guidelines simply reflect these principles developed by our courts which we are bound to follow.

The second question, on efficiencies, is another matter where there has been particular color surrounding the legislation. From the outset we have had an authorization process. In a small market economy it is recognized that there could be mergers that could pose a substantial lessening of competition resulting in detriments. We can still authorize that merger if there are countervailing public benefits. Public benefits include efficiencies, and so we look at all three here—productive, dynamic, and allocative. So we have a robust process under which efficiencies can be taken into account. That is the authorization process, and we have separate guidelines on this.

The question of how we think about efficiencies also arises in relation to assessments of whether any merger may substantially lessen competition. According to precedent, it is relevant to have regard to efficiencies in this setting, but there's been no particular elaboration as to how this is to be done.

And so we have looked at efficiencies in this situation and given guidance to the extent we can. We have identified two key factors which we think would need to be established before efficiencies can count in this setting. First, the efficiencies would not be realized without the merger and secondly—and we were largely guided I think by North American guidelines—we say that the efficiency gains are not going to be given much weight, unless we are assured that they would likely be passed on to the consumers in some way.

Efficiencies are not going to be easy for anybody to establish under the substantial lessening of competition test. We have yet to give clearance to a merger on efficiency grounds, but we do recognize the relevance of the consideration under the substantial lessening of competition test. However, we will continue to see authorization cases where the more comprehensive efficiencies defense comes into play. For example last year we had a matter that was a two-to-one merger in the wool scouring industry. In that matter, we found that it would result in a substantial lessening of competition, but we granted authorization based on countervailing public benefits that were established in the case.

ANTITRUST SOURCE: Where is the place for those considering transactions or involved in transactions to see how such public benefits tests have actually been met or implemented?

BERRY: We publish reasons for our decisions. These are available on our website. Also, there are court precedents on the public benefit test. I just mentioned the wool scour case, *Godfrey Hirst*. This was one such case that went to the High Court on appeal. And so we clearly articulate in our decisions how we apply a test for typical productive efficiency gains. These are the efficiency gains that are most clearly articulated. We find it more difficult to attach quantification to dynamic efficiency gains but we normally will do as much as we can in this regard. Based on our case law we are required to the extent possible to quantify benefits and detriments.

And so typically people coming to us with an authorization application will have an economic expert with a brief that would have clearly articulated what they claimed to be the benefits and detriments of the proposal. At the end of the day we undertake both quantitative and qualitative assessment.

ANTITRUST SOURCE: Let's switch for a moment and come back to the responsibilities that the Commission has in quite an array of regulated sectors, including dairy, natural gas, and electricity. And given that scope, could you give us a perspective on what the major developments have been there? One area that I think is going to be a bit less familiar to some of the readers is the concept of a price quality default path. I leave it open to you to talk about what the key developments and areas have been in one or more of those sectors.

BERRY: I'll talk mainly about what is known as Part Four of the Commerce Act which deals with electricity lines services, gas pipelines services, and the airports. This is a new area of our regulatory role. In 2008, our Commerce Act was amended to produce this new important regulatory regime. It involves setting input methodologies and associated default price quality paths and related regulatory instruments.

For the past three years we've being going through consultation processes. We have been endeavoring to bring clarity to what we are doing so that regulated entities and interested persons will understand how this is all unfolding. We have delivered our decisions, and these have been subject to appeal. So we are going through growing pains, and this new regulatory regime is

essentially only just now three years old. There probably needs to be another three to four years before the regime begins to properly settle in. We get criticism about the lack of certainty and how this may impact the dynamics of the market and ability to invest. But I think this is simply a function of developing a new complicated regulatory regime for the first time.

The guiding principle that we have had to follow under Part Four is that we are developing regulation to promote long-term benefits for consumers by promoting outcomes consistent with outcomes in competitive markets. And so that is the kind of basic approach that we have had to try and adopt in fashioning our regulatory rules.

In undertaking this task, we have had to take into account various factors, including the need to provide investment incentives, while at the same time ensuring that excessive profits are not earned. So we sit in the middle of this quite difficult contest between regulated entities and consumers.

There are a number of different settings to which regulatory rules apply. The first is that all of the companies I just mentioned, including the three international airports, electricity transmission and distribution companies, and gas transmission and distribution pipelines, are subject to information disclosure requirements. And we are required annually to monitor and to report on the extent to which this informs interested persons. The test here relates to the impact that Part Four is having. To what extent is information disclosure promoting outcomes that are consistent with competitive markets?

The second part of the regime is the price quality paths. Now this is a low-cost form of regulation which is designed to attach to all of these entities, except for airports and consumer-owned electricity lines businesses. Even though we are a very small country, we have twenty-nine electricity distribution companies and so this was the driving force for design of low-cost default price-quality path, or DPPs as we call them. For anybody who isn't happy with their DPP, they can then seek a customized proposal, known as the customized price-quality path, or CPP, to suit their particular needs.

If I could just touch on what we've done with the DPP regime. This is the first regulatory set of prices for a long time, and we were looking at a lot of companies with different profiles. Some are consumer owned and they have needed to raise prices to consumers to enable them to invest properly in their networks. On the other hand, we have utilities that are listed on the stock exchange. We have found that some have been earning excessive profits. We have set revenue caps or weighted average price caps for all of these entities based on current and projected profitability. This is pursuant to a five-year price path under which these companies are entitled to a CPI minus x adjustment annually.

Under the first set of DPPs for electricity distribution companies, there were thirteen winners which had price increases. Some had very substantial increases of CPI plus 10 percent over the next two years with more increases to follow. They were mostly the consumer-owned bodies. There were some which had approximately 10 percent discounts on their revenue and they were public listed companies.

Similar issues have emerged in relation to the gas pipelines. That gives background to what happened with the initial set of default price quality paths. The other major challenge under Part Four has been to set the so-called input methodologies. These are matters such as asset valuation, cost of capital, allocation of common costs, and taxation. We consulted from 2009 to the end of 2010 on the set of these basic building blocks.

ANTITRUST SOURCE: When you say you consulted on it, can you provide a little bit more back-

ground on what role those parties and/ or their advisors played in the process and what role the Commission staff played in that hearing?

BERRY: When we started the process it was a huge task for us because we had never done this before, so you can imagine the challenge in front of us. We recruited a number of contractors. We had an increase of staff of about twenty-five people from memory. We were also lucky to attract staff with foreign regulatory experience, most notably from the United Kingdom.

We started the process by putting out a discussion paper, in which we gave oxygen to all of our views on how all of these matters were going to be analyzed. And we also engaged an expert panel to assist in this process. This panel was headed by Professor George Yarrow.

We held public hearings at which all of the parties participated at the same time. Day one of our hearing was about the purpose of Part Four: what does this new purpose statement mean? How we should think about developing regulation to mimic competition?

Day two was about asset valuation principles at a high level. Day three was on cost of capital, and so on. So over the course of eighteen months we moved from that initial consultation and we eventually put out a draft decision paper for each of electricity, gas, and airports. From here there was an opportunity for final written submissions and cross-submissions before we issued our final decisions.

I should make special reference to the involvement of Professor Yarrow and the expert panel. The panel wasn't just saying what we wanted them to say. They did provide genuine independent input and all parties had the right to make submissions on their views.

We have had extensive appeals on virtually all of our input methodologies decisions, and this is really not a surprise given that it was the first time we had made these decisions, which are of course critical measures for these companies into the future. We have had a hearing in our High Court, starting in September last year and that finished in February this year. That was heard by a panel comprising a New Zealand High Court judge, assisted by two lay members, both being members of the Australian Competition Tribunal with regulatory experience. So that's been the extent of the process that we have followed on developing these important methodologies.

ANTITRUST SOURCE: Are there any major regulated industry sectors in which the Commerce Commission does not have authority, or shares authority with another regulatory agency?

BERRY: We are fairly much the one-stop shop of regulation as it has been imposed. First, there was the introduction of the telecommunications regulatory regime, which was given to us in 2001. That same year, our major dairy company, Fonterra, was created. This national champion was granted bypass from our merger laws. But in return, a regulatory regime was required to address domestic market power issues which arose from their merger. Then followed regulation of electricity lines, gas pipelines, and the airports under Part Four, as I have just been discussing.

The one area that we currently don't have jurisdiction is more in the trade practice arena. There are exemptions in relation to international shipping and aviation. Both of these are currently governed essentially by the transport administration. However, there has been a recent report produced by our Productivity Commission which recommends that these matters should also fall within our jurisdiction. Following that report, a bill is currently before the New Zealand parliament proposing removal of the exemption for international shipping. The Select Committee report on that bill also recommends that the exemption for international civil aviation be reconsidered as part

of a review of the Civil Aviation Act. It seems likely, therefore, that both shipping and civil aviation will transition to a Commerce Act regime.

For completeness, I should add that various rules relating to electricity lines businesses and gas pipelines are set by other agencies, namely the Electricity Authority and the Gas Industry Company. The Electricity Authority is responsible for the structure of prices charged by electricity distributors. The Gas Industry Company is an industry-owned company which works with the government and industry to develop policy relating to rules in relation to all aspects of the gas markets.

But the bulk of the price quality rulings fall on us, through our powers to impose information disclosure requirements, and to set price quality regulation which determines the total revenue suppliers recover.

ANTITRUST SOURCE: What are the types of concerns in monopolization and cartels, and how do these matters come to you?

BERRY: In terms of cartels, we have had a significant traffic of international cases. These are air cargo and like cases which started out with the leniency applications in the U.S. and in Europe. And so we have worked our way through all of those cases as they have come by.

One thing that has only just happened in the last year has been two domestic cartel applications for leniency. These are the first time in a long time that we have received such applications. I expect that the fewness of such applications is due to the small market economy that is New Zealand. As a whistleblower you may pay a price in terms of your future employability.

In terms of the other trade practice work we do, it often is largely driven by complaints that are presented to us. That would be the main way that we become involved in this. We do have an intelligence-gathering unit that is now two years old, and we are building capability in that area and in the related area of advocacy. Indeed, one of the leniency applications I referred to before—in what is a significant sector—is likely to be a result of our advocacy work.

ANTITRUST SOURCE: Can you give us some background as well about the Commission's fair trading and consumer credit work? There again seems to be a fair amount of activity. How in particular do those issues arise as a priority and where are you taking action?

BERRY: Yes, we have a very active fair trading and credit contract consumer unit. It does a high volume of cases. We also do a lot of interventions through our low level inquiry unit, where we get some great results. The low level inquiry unit is designed to provide a rapid response to matters that appear to be minor breaches of the Fair Trading Act. It operates with a strong focus on educating traders about their obligations and consumers about their rights. At the other end of the scale, the major cases we have done are all based on detriment coupled with the goal of achieving consumer compensation.

To give one very recent example, there was a financial product marketed in New Zealand known as Credit Sails. This was marketed as capital protected and so a lot of people went into this and believed that they would at least get a dollar back for each dollar invested. The product failed and investors stood to recover only 2 percent of their capital. We investigated this and concluded that investors had been misled and we advised that we would prosecute. We ended up in a settlement situation. We have achieved a $60 million settlement which puts right 87 percent of the investment without going to court. This is one of a number of cases which have progressed in this way, with very real results being achieved for consumers.

ANTITRUST SOURCE: How particularly have you worked with other jurisdictions in terms of cartel and merger enforcement? Are there specific jurisdictions in addition to Australia that you have tended to be doing much more collaboration with on those?

BERRY: We have also worked very closely with your Department of Justice and the Canadian and European authorities on all of those cartel cases. In terms of the merger regime, there have been a number of international mergers recently, such as the Penguin and Random House merger and the EMI merger, where we have been in a regular dialogue with the agencies in North America or in Europe particularly.

So we do have good access to sharing our views on how we're analyzing the cases, the timelines for decisions, and so on. The information sharing is always easier in the merger arena given that the parties seem to be quite prepared to give waivers for the exchange of information. That's in their interest, in order to achieve decisions as soon as possible.

In the case of cartel investigations, of course, the sharing of information is very different. That's more complicated, and there are going to be a lot more issues there.

ANTITRUST SOURCE: In terms of regulatory regime, the area we haven't talked about very much is dairy. Is that unique to New Zealand?

BERRY: I think it is unique and there are quite discrete rules built around Fonterra. Fonterra is purchasing virtually all of the raw milk from farmers, and it also has a significant downstream presence in the New Zealand domestic market place.

About 95 percent of our dairy production is exported, so to the extent that there are domestic market concerns, they attach to a very small amount of our domestic raw milk production. The policy design problem was for the government to ensure that raw milk was available to other competitors downstream in the New Zealand domestic market and that's where the tension has risen. There have been a number of new processing plants which manufacture cheese or milk powder, primarily for export.

Complaints have arisen in respect of how Fonterra sets the price it pays for milk. Fonterra sets prices through its milk price manual. It's a very complex set of arrangements when you've got a cooperative company being a monopsony buyer for the milk.

There has been a recent revisit of the dairy industry under the relevant legislation resulting in new regulatory provisions. We have a new ongoing role as an overseer to monitor the milk price manual to see whether or not Fonterra's prices are in accordance with the purpose statement of the legislation. Now this is a very new and untested formulation to date. We did do a dry run review last year, and over the course of this year we are looking more closely at that manual and its implementation, so that is a work in progress.

ANTITRUST SOURCE: What do you see for the next year or two as the major challenges or the major areas you will be focused on?

BERRY: I think it's fair to say that we are beginning to see the light at the end of the tunnel on regulatory matters. Just what will come out of the input methodologies appeals is yet to be seen, and time needs to pass before the new regime beds down. But I think the worst is behind us.

There are challenges for us in the years ahead. First of all, we need to do more with less. There will inevitably be higher expectations of us and most likely decreases in real terms of funding. So

we have to act smarter in the way we use our enforcement tools. This includes prioritization of cases and the like, and we need to constantly enhance our staff capability, achieve efficiencies, and so on. I rate those kinds of challenges very highly.

Two other challenges: We are in the process of moving to the criminalization of cartels. There is a bill before parliament which we expect to be passed by the end of this year, so we are doing much to develop capability to handle criminal investigations. We have worked quite closely with other foreign agencies on this. We have had helpful assistance from the Department of Justice, the Canadian Competition Bureau, and the ACCC.

One particular challenge that will come out of this is the collaborative activities exemption under this new regime. There is a clearance regime, so parties can come to us and seek clearance for their collaborative activity on the basis that they will say that it will not substantially lessen competition. We don't know what kind of workflow is going to come with these clearances. Nobody is talking to us yet, so we wait and see with interest. Meantime, we are working up guidelines to help those proposing to make applications.

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The final challenge I would like to mention is our ongoing problem with our monopolization laws. Our Supreme Court has fashioned a very restrictive narrow rule which we don't think was ever intended. The rule in a nutshell is that there is only a violation of our monopoly law on the following basis: First you have to suppose that the market is hypothetically competitive. So, you strip away all aspects of the market dominance. Then you ask the question would the monopolist have acted the same way in this hypothetically competitive market.

That's the framework that we have sitting on our doorstep now to analyze monopolization. We ordinarily don't enter into the policy debate. There is a separate agency, the Ministry of Innovation, Business, and Employment, that advises the Minister of Commerce. But it's been three years since the Supreme Court decision and we are now working harder to raise the debate on this particular topic with the hope that legislative reform may result in the emergence of a more appropriate monopolization law.

And I should add that we are about to have the benefit of Andy Gavil's contribution to this topic. He has agreed to come down and to be a keynote speaker at our first Commission conference in October this year. I had a very useful meeting this morning with him discussing how he's going to lead the discussion.

ANTITRUST SOURCE: Thank you very much. ●