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Inquiry into the Services Sector
New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143

Email to: info@productivity.govt.nz

Dear Sir/Madam

Re: Boosting Productivity in the Services Sector – 2nd Interim Report

1. Background

I am writing to you regarding the New Zealand Productivity Commission's (NZPC) 2nd interim report entitled *Boosting Productivity in the Services Sector* (referred to as 'the Report').

BusinessNZ took the opportunity to submit on the 1st Interim Report, outlining our preference for the three options as part of an in-depth examination aimed at generating specific policy recommendations. In our submission, the order of preference was:

1. Improving occupational licensing in the services sector
2. Addressing barriers to the successful application of ICTs
3. Stimulating services competition

As page 14 of the Report points out, the NZPC decided not to proceed with the topic of improving occupational licensing, given the size and complexity of the topic would make it better suited to a dedicated inquiry. BusinessNZ agrees. We believe the scope of this issue warrants a separate inquiry so that the matter is properly examined.

Recommendation: That the Productivity Commission investigates occupational licensing as one of their next inquiries.

Services competition topic by default?

In our submission, we made the following statement on the topic of stimulating services competition:

With respect to competition law, we note that the Report points out that no inquiry participants raised this as a particular barrier to productivity in the services sector. BusinessNZ agrees. While we cannot of course rule out that there may be isolated incidents of competition law leading to barriers for some specific areas of the market, our general impression – much like that of increasing transparency - is that it would be better for NZPC's resources to be spent elsewhere on issues that have broader application across the services sector.

Given the topic of improving occupational licensing has been earmarked for a separate review, by default the two other topics of barriers to successful application of ICT and stimulating services competition have been examined in the 2nd interim report.

2. General View of the Report

Overall, we believe the NZPC has done a good job of addressing the issues that may affect productivity in the services sector, particularly in relation to ICT. Therefore, we support the majority of findings and recommendations that are outlined in the Report.

However, a few NZPC recommendations in the area of lifting competition in the services sector need to be addressed.

3. Comments on Options to Lift Competition in the Services Sector

As stated above, stimulating competition in the services sector was our least supported option for further investigation, as there was no broad business community consensus on the existence of a widespread problem. Therefore, we consider that NZPC recommendations in this area should be thoroughly examined because of the possibility that alarm signals might be sent and/or that there might be unintended consequences.

Rolling an unintended ball?

Overall, we are mindful of the fact that if an NZPC review includes a number of recommendations, this can often lead to a more formal review by some other Government department. The department responsible for the relevant legislation may see the review as an opportunity to fill in its work programme, or may believe having the NZPC mention the issue means some form of action is necessary.

Whether a more formal review is actually warranted is often questionable, but if a review takes place, some sort of change will be likely given a general reluctance to hold a review if no significant change is required. Unfortunately, in many cases, once

a review is undertaken, the expenditure involved leads to the conclusion that some change is necessary to justify use of taxpayers money.

Taking into account our overall concern, the following discussion outlines our unease in three particular areas:

3a. The Commerce (Cartels and Other Matters) Amendment Bill

A dog by any other name

BusinessNZ was pleased to see that the Report included a section on the Commerce Amendment Bill, given previous concerns raised with the NZPC by ourselves and others regarding the criminalisation of cartel conduct.

The Bill has yet to be passed into legislation, with further consultation taking place due to the controversial nature of some clauses, particularly the criminalisation features. At the time of the report back by the Commerce Committee, we congratulated the Committee on its decision to consult further on this aspect of the Bill. The report back stated that *"we are aware that the Bill could be perceived by directors and their advisors to criminalise legitimate business risk-taking behaviour*". Therefore, the committee sought to *"support further consideration of the drafting of these new offences to ensure that the provisions are expressed in a way that provides clear guidance to directors and does not have a chilling effect on legitimate business risk-taking".*

Despite the Commerce Committee and officials best intentions of remedying the situation, we still believe there is no formulation that improves the existing law in this area. The various wording changes made are still most likely to have a chilling effect on legitimate business risk-taking. The directors' duties and offences part of the Act has been drafted in such a way that criminalising directors' duties will harm the scheme and objectives of the Act. Any further attempts to improve the proposed wording will still likely produce the same adverse outcome.

Improved knowledge of bad law does not make it good law

The NZPC notes that the amendment Bill is currently progressing through Parliament, and is expected to be enacted in early 2014. Given the current order of legislation in Parliament we are not sure this will be the case. Nonetheless, the NZPC has made two recommendations with respect to criminalisation of hard-core cartel behaviour:

R4.4 The Commerce Commission should include smaller and younger businesses in its education campaign on pro-competitive collaboration.

R4.5 Industry peak bodies, in consultation with the Commerce Commission, should seek to ensure that businesses are aware of the benefits of pro-competitive collaboration, and guide businesses on what steps they can take to clarify the legality of collaborative arrangements.

Overall, we agree that pre-clearance discussions with the Commerce Commission to increase certainty for businesses will be useful. Also, as is often the case with various Government initiatives, we expect industry peak bodies will be heavily involved in guiding businesses in the steps they must take to clarify the legality of collaborative arrangements.

However, BusinessNZ is disappointed that the NZPC has chosen to concentrate only on the information distribution aspect. Improved knowledge of bad law does not make it good law. We believe the NZPC has missed the fundamental point - namely were criminal sanctions required in the first place? Given the introduction of such measures should be based on substantive proof that the measures are needed, BusinessNZ is perplexed that the NZPC's recommendations centre on the dispersion of knowledge, ignoring any option to review the amendments in the near future to establish whether they have been successful.

Recommendation: That the Productivity Commission includes a recommendation to review the amendments regarding criminalisation of hard-core cartel behaviour.

3b. Unfair Contracts Terms Provisions

As the Report outlines, the Fair Trading Amendment Act passed into law in late 2013, introduced similar unfair contract term provisions to those contained in the Australian Competition and Consumer Law 2010. Therefore, the NZPC makes two recommendations:

R3.5: The Commerce Commission should monitor and compile data on standard form contracts with terms that unfairly restrict a business's right to end a contract (and so present a barrier to switching).

Unfair contract terms provisions introduced in the Fair Trading Act should be reviewed within two years of coming into effect, with a particular focus on whether there is a case for these provisions to be extended to apply to business-to-business contracts.

In some respects, our difficulty with the NZPC's recommendations is similar to our difficulty with the Commerce (Cartels & Other Matters) Amendment Bill. BusinessNZ strongly opposed the introduction of unfair contract terms into consumer legislation, primarily because there was little to no evidence that a problem existed, despite many less than satisfactory attempts by officials over a number of years to prove otherwise.

BusinessNZ agrees with the Commerce Commission's monitoring and compiling of data on standard form contracts, primarily because unfair contract terms legislation is already in place. However, we seriously question the justification for expanding unfair contract terms to business-to-business contracts.

Do as I say, not as I do?

We wish to point out that our submission to the NZPC on the *Regulatory Institution & Practices Issues Paper* included a section on proper review processes, given one of the questions raised asked what type of regulatory processes and practices guidelines would be helpful to assist the NZPC in designing of regulatory regimes. BusinessNZ took the opportunity to outline what we think are some fundamentals for government departments to follow.

However, we are concerned that in relation to the possible expansion of unfair contract terms to business-to-business contracts, the NZPC is not applying a similar amount of rigour to its own recommendations. While we have no concern with reviewing the amendments within two years to ascertain whether they are useful changes, we are concerned the two year review will focus on the extension of the provisions to business-to-business contracts. This is not conducive to proper policy processes.

Also, we believe the NZPC need to be mindful not to fall into the common trap (as have other Government departments) of wanting to simply align ourselves with Australian legislation, yet not seeing what is best for New Zealand's growth. Therefore, the statement that *"this is in line with the Australian Competition and Consumer Act"* does not provide us with strong reason why it should proceed.

As time and recent experience have clearly indicated, reviews of this sort tend to justify change for change sake, rather than weigh the evidence to ascertain whether any provisions should be expanded.

Recommendation: That the second recommendation/paragraph in R3.5 is withdrawn.

3c. Section 36 of the Commerce Act

Section 4.2 of the Report outlines three recommendations concerning section 36 (s36) of the Commerce Act, namely:

R4.1 The Government should review section 36 of the Commerce Act 1986 to assess how best to improve its accuracy in identifying situations where firms take advantage of market power for anti-competitive purposes.

R4.2 Any review of competition law on the misuse of market power should note the future review of competition policy in Australia to achieve a consistent approach that mirrors best practice and furthers the goal of a single trans-Tasman economic market.

R4.3 The Government should consider a reform of section 36 to achieve either:

- *a more flexible approach where courts do not rely on a single counterfactual test for an abuse of monopoly power, regardless of the case; or*

- *more of an "effects" approach that aims to minimise the economic costs of decision errors, and in simpler cases uses appropriate guidance material and mechanisms for quick decisions to mitigate uncertainty.*

While we believe the Commission has done a good job in outlining potential issues associated with s36, we have concerns as to the pre-emptive recommendations for the section's reform.

Obviously, a review of s36 should be as wide as possible. In no particular order, it should include:

- Taking into account the historical context why s36 is in its current form, as well as the fundamental issue of scale and approach when examining New Zealand's competition legislation against other countries.

- Ensuring that potential amendments do not have a chilling effect on the legitimate commercial activities of large New Zealand companies, or will prop up inefficient new entrants into a market.

- Analysing the cost and commercial uncertainty resulting from Commission investigations (which often take a number of years to reach a conclusion).

In addition, as mentioned above, we believe recommendation 4.2 of the paper has the potential to fall into the trap of simply replicating Australian laws without examining both the problem and the solution from a New Zealand perspective. As the Report points out, *"the Australian federal Government is planning a 'root and branch' review of its competition law"*. Therefore, one could argue that any review into s36 should begin after the Australian review is completed, so that we have a better understanding of any trans-Tasman implications.

Also, we are conscious of the fact that the size of the New Zealand economy compared with of the many countries we typically compare ourselves with may, on balance, justify taking a different stance to various aspects of competition law. While the Report mentions this on page 73 by stating that *"the review needs to acknowledge the small size of and limited competition in the New Zealand economy"*, we do not think it has been given sufficient weighting in the discussion. Overall, the Government has to be very sure not to penalise the New Zealand economy unnecessarily by reason of its scale.

Recommendation: That any review into section 36 of the Commerce Act takes into account the points raised in our submission.

Thank you for the opportunity to comment, and we look forward to further discussions.

Kind regards,

Phil O’Reilly
Chief Executive
BusinessNZ