23 November 2004

Mr Tony Hinton
Commissioner
Australian Government Productivity Commission
Canberra Office
Level 3, Nature Conservation House
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Dear Tony

Australia New Zealand Competition & Consumer Protection Regimes
Productivity Commission Draft Research Report

We refer to the above Report and the invitation to make further comment by 19 November 2004. Since release of the Report, Air New Zealand has also participated in the Australia New Zealand Leadership Forum (Competition Issues Working Group) and our comments also reflect issues raised in that forum.

Overview

The Report in reaching its conclusions, particularly as summarised in the "Key Points" on p.xiv is frankly, disappointing. In short, the Report concludes that "modest changes" relating to better co-ordination between regulators are all that is required. This conclusion appears based on the self-fulfilling justification that "there are at present relatively few competition and consumer protection matters having Australasian dimensions". This is akin to concluding prior to the formation of the EU, that there were few pan-European commercial matters.

The conclusions do not sit comfortably with the "potential weaknesses in the existing regimes to deal effectively with cross border economic activity" detailed on p.xviii. It would be a significant lost opportunity to progress the principles of CER if the Productivity Commission does not substantially rethink its conclusions for the final report.

The Commission must of course be governed by its terms of reference. Those terms do not appear to preclude the Commission from determining that there are wider issues than process and administration that constitute barriers to gaining economic benefits which greater harmonisation of competition law would remove.

Key among those issues is the opportunity to create, for competition regulation purposes, an Australasian common market within which the competition effects may be assessed by either regulator.

Issues

The main issues raised by the Report and discussion appear to us to comprise the following categories:

Administration/Process

- Remaining differences in the law are few, but the application of the laws by different administration regimes using different processes and with different approaches, magnifies the commercial effects of those differences in law.

Competition Assessment

- The limitations imposed on definitions of markets and public benefits by law and by regulatory interpretation restrict the abilities of business to capitalise on opportunities to better compete in increasingly global markets which often already impose unfair competition.

Compliance Cost

- The need for parallel applications in two such similar (and in global terms, small) markets inevitably raises compliance costs, probably frequently to a prohibitive degree.

The competition laws of Australia and New Zealand have been largely harmonised but are far from integrated as to their content and application and consequently their effects. This underlies each of the above issues, but the solutions need not be as radical or expensive as is supposed. The benefits of a more integrated market for competition analysis, including promotion of Australasian trade and exports from Australasia must substantially outweigh the costs when the commercial success of other trading blocs is considered.

Administration/Process

The issues are canvassed in detail in the Report but can be separated into process and approach. The different processes are self evident with the comparative informality available from the ACCC contrasting with the more structured approach of the NZCC. It is noted that the ACCC may be moving to a more formal approach in adopting recommendations of the Dawson Report. While that may add to harmonisation, the informal processes should be kept available for appropriate applications such as those below relevant thresholds as discussed below.

The Australian appellate process presents a full rehearing opportunity which again contrasts with the New Zealand appeal being heard from the NZCC record with limited updating evidence. The latter is an inadequate way to review a dynamic commercial issue which are required to be assessed in the context of imprecise economic theories and models. Ironically it seems that also at the appellate level, Australia is likely to move to the New Zealand approach. With the benefit of recent experience, this appears to be a backward step notwithstanding the increased harmonisation.

The process no doubt influences attitude. The stated objectives of the ACCC have been to shape markets, taking into account the broad range of criteria for assessing public benefit listed on p.106 of the Report. This holistic view would appear to have allowed commercial opportunities to Australian commerce which would have been denied to New Zealand businesses where the illusion of an accurately calculable economic benefit or detriment (ref: p.105) prevails over commercial common sense.

In similar vein, the ACCC has often adopted a consultative approach to creating codes of practice with industry sectors – a constructive attitude unfortunately lacking at the NZCC.

Competition Assessment

Market Definition

It is self evident that the narrower the market definition, the greater are the relative anti-competitive effects of relevant agreements, transactions or conduct.

Both New Zealand and Australia have followed a restrictive approach to market definitions as acknowledged by the Commission noting (ref: p.xviii):

- *"The objectives of each regime allow only consideration of the welfare of those in their particular country"*
- *"The market against which the impact of certain restrictive trade practices is assessed cannot geographically extend beyond the border of each country"*

Simple legislative changes to allow either regulator to assess competition effects in the context of an Australasian market must inevitably allow for greater economic efficiency of firms in both countries.

Australasian businesses compete in increasingly global markets with the crucial disadvantages of geographic location and very small home market bases. The ability to build critical mass and financial strength sufficient to compete internationally is inevitably compromised – yet we seek to disadvantage ourselves further by narrow market definitions to assess commercial conduct.

By way of example in New Zealand, it is highly unlikely that the export successes of Fonterra could have been achieved had the parties been required to submit their case to the NZCC.

This disadvantage is exacerbated by the anti-competitive tendencies of trading blocs (promoting trade within but not into their member states) and most wealthy states which continue protectionism and government subsidy.

Narrow market definitions and international unequal playing fields are both issues of serious concern to global network businesses such as telecommunications and air transport. International airlines in particular must compete against much larger enterprises with vastly greater home market bases or fortuitous geographic position. Beyond that commercial reality, competitors are frequently and openly subsidised and have access to unequally negotiated government "bilateral" international operating rights.

In short, there are businesses and industries in which the commercial reality is not adequately accommodated by narrow market definitions or artificial estimates of net public benefit.

Assessing Public Benefit

Air New Zealand has previously proposed a "one stop at either shop" solution whereby either regulator could, subject to sufficient market share or sales thresholds in each country, exercise jurisdiction on an Australasian basis. Where there is overall public benefit, approval should be granted despite there being a detriment in one country if it is outweighed by benefit in the other.

A critical element in achieving this with the confidence of governments, business and consumers in both countries is agreement on an appropriate benefits test. Experience to date suggests that a wide definition would be best in promoting economic growth and efficiency and that it should expressly avoid the need to attempt to quantify net benefit. A good starting point would be the test adopted in *Re: Queensland Co-operative Milling* quoted at p.104 of the Report as:

> *"…anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements the achievement of the economic goals of efficiency and progress."*

To this could be added (to the extent necessary) the benefits recognised by the ACCC in the past (Ref: p.106) of:

> *"economic development; fostering business efficiency, especially when this improves international efficiency; and industry rationalisation resulting in more efficient allocation of resources."*

With both regulators adopting the same benefit test in the context of an Australasian market, the regulatory and appellate processes should develop and follow consistent approaches and allow both the regulators and the appeals courts to establish a common base of precedent. Appeals would be in the national jurisdiction in which the application was made.

This begs the question of what might happen if differing approaches develop or if benefits begin to accrue significantly in one country and most of the benefits in the other?

As to the first issue, a likely concern is "forum shopping". Procedurally, applications should be made in the country in which the market concentration resulting from the proposed transaction is the highest in percentage terms. If there is no change in market concentration within either country (eg. a purely New Zealand and a purely Australian business merge), then higher market share should dictate the jurisdiction.

If the outcomes of applications for approval appear to differ materially, political considerations would become relevant and a choice would have to be made to either correct or abandon the process or possibly even move to a single regulator. While the latter is a remote possibility today, the establishment of joint decision making for a period may make that seem more desirable and achievable.

The second issue is not new in the context of CER or any other multinational trade agreement. Benefits are generally uneven between countries and the evaluation must be whether there is overall economic benefit in Australasia. Even where one country consistently suffers most of the competitive detriments of approved transactions, these are only part of the wider economic issue and are likely to be countered by enhanced international competitiveness from an Australasian base and greater benefits derived under CER.

Compliance Cost

If CER is to succeed as an economic objective, all possible must be done to limit compliance costs for Trans Tasman transactions. The fact that there are allegedly only a "small number of trans Tasman cases that are likely to arise" (Ref: p.xix) is not sufficient excuse for inaction. If the environment is created, the transactions will follow.

The inevitable need for legal, economic, accounting and industry advice and analysis makes most competition approvals extremely expensive. Possibly there should be a materiality threshold of dollar value (sales) or market share below which transactions are exempt. The guidance from a "safe harbours" policy does not provide sufficient certainty. In any event, the need not only to duplicate the advice for two applications, but to present it differently to meet two different approaches compounds the inefficiency of the present structure of two similar but different regimes.

The disincentive is not only the substantial cost. The uncertainty of outcome of any regulatory regime is a material disincentive to business. To have to run the gauntlet twice creates a high risk sufficient to deter many potentially economically beneficial transactions. In similar circumstances in the EU, businesses will generally try very hard to reach the materiality thresholds which allow access to the EC's "one stop shop" rather than have to deal with multiple national jurisdictions.

The recent farce of the Air New Zealand – Qantas Alliance applications (at an estimated combined cost for both airlines nearing $50 million) succeeding in Australia but being denied in New Zealand highlights the issue clearly enough.

Conclusions

These changes could be brought about by a few relatively straightforward legislative changes. They do not entail radical change to either regulator or to appellate processes and structures – simply the application in an Australasian jurisdiction to an Australasian market of a fully harmonised market definition and test of net public benefit.

Without a new approach which broadens our competition horizons, both countries will continue to undermine our respective and joint abilities to compete in international markets that in practice will never be equal. The development and expansion of trading blocs and the self interest of economic powerhouses like USA and China will keep Australia and New Zealand firmly “Down under”.

Yours sincerely

John Blair
General Counsel & Company Secretary