Competition law and cartel conduct.

Nobbling the Commerce Commission for cosy capitalism?

In May this year Minister of Commerce Craig Foss snarled at people who extract monopoly rents instead of competing. Welcoming the Select Committee's report on the Commerce (Cartels and Other Matters) Amendment Bill criminalising restrictive collusion, he said:

> *"hard-core cartel conduct like price fixing and bid rigging… will not be tolerated and anyone engaging in them will be treated the same way as tax evaders, fraudsters and other white collar criminals."*

That sounds tough. But despite criminalisation the Bill probably protects cartel conspirators more than current law. The Bill fosters what it calls "pro-competitive collaboration". The difference between such collaboration and criminal collusion could land you in prison for seven years. The difference is your "dominant purpose". Bluntly, conspirators should be safe if they can look as if any diminishing of competition is just an unfortunate by-product of a legitimate other purpose, like efficiency or upholding common standards.

Oddly, there has been little public attention to the "pro-collaboration" side of the Cartel Bill, despite its potential usefulness to 'crony capitalism'. It fits with government procurement policy changes that seem contemptuous of long-standing competition law concerns, and the Commerce Commission's enforcement.

The NZ Transport Agency is developing a new 'collaborative' procurement policy for road maintenance. It is not secret – the September issue of Contractor, the civil contracting industry magazine cites NZTA's Mark Kinvig saying "we would like to see more collaboration across the suppliers, within our own organisation, and between [NZTA] and others…if we are to be successful in the future".

We've seen nothing, however, to indicate how they will counter the consequent risks of cartel behaviour, especially using the proposed new shield against prosecution for "hard core cartel conduct".

The policy has caught no media radar. When we last enquired the Commerce Commission seemed unaware of it. An OIA response from the Commerce Commission confirmed they have "*provided no 'advice' to any person on competition issues related to the proposals*".[1]

NZTA is expressly working to concentrate road construction and maintenance contracts in fewer hands. It follows a Road Maintenance Taskforce which recommended last year that contracts should be "aggregated and bundled"..

The Task Force brought together representatives of NZTA, LGNZ, Roading Controlling Authorities (RCAs), and the trade associations which live off road construction and maintenance (the Association of Consulting Engineers NZ, the New Zealand Contractors' Federation and Roading New Zealand).

Pushing all these groups together seems to be an example of collaborative process. Their stated objectives are to increase the effectiveness and to reduce the costs of road maintenance. The question remains whether that intention outweighs the risk that they use the chance to collude to raise

[1] The Commission said that at the date of our request on 13 June they had had "*no contact with NZTA regarding the proposals*", but that on 24 June the Commission contacted NZTA to obtain information to discuss a range of matters "*including but not limited to the proposals*". The NZTA told us in their OIA response that "*the views of the Commerce Commission were obtained at the NZ Contractors Federation Conference in August 2012*" and that "*the Commission expressed concern about potential collusion leading to reduced competition*". We are not sure what to make of this difference, except that the Commission is aware of the NZTA proposals.

prices and exclude competitors. Is NZTA gullible in going along with the advice from its suppliers? Is it opting for an easier life for itself, at the risk of more cost for less roading in the long term?

For Adam Smith the sceptic, each trade association alone is a conspiracy against the public. On that view the new NZTA approach looks set to become a conspiracy of conspiracies.

For NZTA fewer bigger contracts would cut their costs of letting and administering contracts. Major contractors say that bigger longer contracts would enable them to invest more, and save tendering costs.

All the background papers we have seen acknowledge the risks of damaging competition. PWC describe the "*possibility of 'hollowing out' the structure of the industry through a small number of major players and a large number of small sub-contractors with no contractors in the middle. This will reduce the likelihood of a small player having a legitimate chance to grow to be a mid-tier firm and then to step up to winning a major contract".*

The published reports all talk of the need to find an appropriate balance between the expected efficiency of fewer contracts, and the risk of lost competitive tension. But none say how they pick that balance point. None even propose tests for it. For example, a working paper by the Taskforce "Maintenance Cost Drivers Report" said:

> *"Optimising of contract size and scope is an obvious approach given that smaller contracts have higher overheads, but in considering economies of scale there is also the need to ensure the benefits of greater levels of competition are not lost. The target should be optimisation of size, volume and length of contracts to get a balance and optimum mixture of both approaches around competition and cost. There is a need to avoid the recreation of monopolies (or duopolies) that might end up controlling the market".*

PWC must have been searching for justifications, because they record the extraordinary view that the then current level of concentration was not problematic because the Commerce Commission had not been investigating the industry.

The Cartels Bill could spur the Commerce Commission into action. They could need to form a view on the dominant purpose of the trade associations that have been involved. That may not be straightforward. The estimated savings from the aggregation model seem very small, at least in comparison to what would be lost if completion is nobbled. One NZTA adviser calculates an expected 7.7% gain from the recommended extension of the kilometres covered by each road maintenance contract. That seems meagre when the margin between the winning tender and the next is often larger than that. In other words if reduced tender competition raises prices, the theoretical aggregation savings could be consumed in fatter margins for the contractors.

The estimated savings on annual expenditure range between 3% and 11% depending on the aggregation model is used and how much the number of contracts are reduced by.

The papers we've seen show no attempt to estimate the tender price effects of the aggregation model. They are instead focussed on the theoretical efficiencies of "*enhanced capability building across the industry through more strategic allocation of people and expertise* ". Planners have always expected to be able to do better than "wasteful competition". Our competition law does not agree.

Whether or not the current procurements practices are healthy, it is odd to find no serious investigation in the reports to NZTA of the Auditor-General's advice of September 2011 on NZTA procurement. The Auditor General recommended that NZTA encourage more suppliers into maintenance and renewal work, not fewer, to minimise barriers to entry.

The NZTA seems to be heading in precisely the opposite direction.

Ordinarily a regulator would be all over a buyer developing what seems to be a cartel model in collusion with trade associations. One association, Roading NZ, is dominated by two huge contractors

and the five in the next tier. Its members contract up to 90 percent of New Zealand Transport Agency roads work (state highways) and around 70 percent of local authority roads work.

The Contractors Federation were also represented on the Task Force. They seem to have an overlapping membership with Roading NZ but they are recorded as being less comfortable about where things are headed. Perhaps their medium-sized and smaller members are more concerned about being shut out of opportunities to grow to challenge the bigger players, under aggregation and bundling.

NZTA collaboration with Roading NZ and the Contractors' Federation goes beyond membership of the Task Force. It is not secret – they each have disclosed Memoranda of Understanding with NZTA.

Perhaps it is innocuous, though it seems astonishingly comfortable for an industry that the Commerce Commission has had to warn already, for lack of awareness of the laws against bid rigging.

In 2010 the Commission commissioned research on non-residential contractor awareness of competition law. The Commission found "anti-competitive, cartel and collusive behaviours" including collaborating with others to put in cover bids in tendering. The Commission said then it would work proactively with the industry to raise levels of compliance.

There might be more than sour grapes in continuing whispered stories of understandings about bid rigging, and threats by the dominant contractors through whom the smaller contractors are being forced to contract. This industry is not known for attracting the pure of heart. Current investigations of corruption in Auckland Council contracting seem not to have surprised anyone.

Even if the collaborative discussions fostered by NZTA have been focussed exclusively on efficiency and cost saving, it looks naïve on the part of NZTA to proceed without any specific protections against abuse of the opportunities. The government, which has probably paid little attention, could be made to look more sinister in hindsight. The lack of attention to the issue by the Commerce Commission could seem to be a reflection of government pressure.to look the other way.

For NZTA to be working with big contractors to concentrate more power in fewer contracts for longer makes it hard to believe the government really thinks cartel bid riggers and price fixers are just like tax evaders and fraudsters.

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