Wigley+Company solicitors

Memorandum: Response to Vodafone's *"Test for Clearance"*, and to its submissions on FMCA and related obligations

Public version

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1. Introduction and summary

1.1 At Part A of its 11 November 2016 submission, Vodafone submits as to the required approach to be taken by the Commission, including as to proof and evidence. Some of the elements Vodafone refers to are broadly correct in isolation but they are not put into the correct context and therefore lead to some incorrect conclusions.

1.2 For example, Vodafone conclude at [2.5] that *"There is no evidence to support a real and substantial prospect that the Proposed Transaction will give rise to an SLC".* The applicants almost exclusively rely upon evidence of what is happening in the status quo to show what will happen in the future, in the face of considerable information in submissions as to the future state that differs from the present. This implies that largely only evidence of the current position is considered by Vodafone as being admissible/relevant in the Commission's considerations.

1.3 Such an approach is contrary to well established authority, and the Commission's own guidelines. But as the issues have been raised by Vodafone, and they are particularly relevant to a central issue in this matter – the future state of markets and technology – we will outline what we submit to be the correct approach to burden and standard of proof, admissible/relevant evidence, and the value judgment assessment required of the Commission. Primarily this entails extending the analysis of the judgment on which Vodafone relies, namely, *Commerce Commission v Woolworths.*[1]

1.4 In relation to the passage from the Vodafone submission quoted above, this has the onus of proof stated in reverse from the correct position. As it happens, where the onus of proof lies was at the heart of the *Woolworth's* appeal, with the Court of Appeal reversing the High Court's decision on onus of proof.

1.5 Additionally, the facts under review in the *Woolworths* judgment, and their treatment by the Court of Appeal, demonstrate a major flaw in the applicants' submissions, namely the predominant focus on the current market conditions, when the markets are going through substantial change in the future.

Applicants cannot now resile from their position

1.6 Importantly, the applicants have had ample opportunity over multiple submissions to address the information, which includes ample admissible and relevant evidence, as to the future market and technology conditions. It is

[1] [2008] NZCA 276; (2008) 12 TCLR 194

submitted that the applicants have no answer to that information and evidence, including inferences from that material.

1.7 That can be inferred from the lack of dealing with the material which clearly had to be addressed, the onus being on the applicants as outlined below. It is submitted that is the proper approach for the Commission and that the Commission should assume that the applicants concede the points as to future markets and technologies.

Summary of applicable principles

1.8 The material applicable principles can be summarised as follows (the quotes are from the *Woolworths* judgment which Vodafone relies on, unless stated otherwise):

(a) *"A substantial lessening of competition is "likely" if there is a "real and substantial risk" that it will occur…. Another way of putting it is that there must be a "real chance" that there will be a substantial lessening of competition";*

(b) *"if the Commission is "in doubt", it should decline a clearance." "… the existence of a "doubt" corresponds to a failure to exclude a real chance of a substantial lessening of competition."*

(c) The burden of proof is on the applicants and the standard of proof is the civil standard, namely, balance of probabilities;

(d) *"…acquisitions can harm competition. Because a decision to permit an acquisition is irreversible, it might be thought sensible to be cautious."*

(e) The SLC assessment *"typically involv[es] the application of economic theory, previous experience (in the market or other markets having shared characteristics) and known facts about the structure of the market and the behaviour of competitors and potential competitors. Such predictions have often been referred to as 'value judgments'…"*[2]

(f) The required value judgment by the Commission deals with "*The problem of uncertainty…Both factual and counterfactual are forward looking. They are incapable of accurate assessment."*[3]

(g) *"…care needs to be taken in relation to evidence of past market behaviour in this context. …The analysis is a forward-looking one, comparing the likely state of competition if the merger or acquisition proceeds with the likely state of competition if it does not. Evidence of past conduct may be relevant… But to the extent that behaviour within a market is discretionary, it can change, and so may not be a reliable indicator for the future…"*[4]

(h) *"…the Court must exercise what has often been called a value judgment … [T]he Court must predict what is likely to happen in the future, with the aid of abstract economic principles applied to what frequently are not primary facts."*[5]

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[2] *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347, at [117]
[3] *Commerce Commission v Woolworths* (supra) at [75]
[4] Arnold J *in NZ Bus v Commerce Commission*
[5] *NZ Bus v Commerce Commission* (2006) 11 TCLR 679 at [160]

Observation

1.9 The last cited passage conveniently summarises that there must be a value judgment as to what is likely to happen in the future, applying economic principles and a broad range of evidence from which inferences can be drawn. To limit this to just "primary" evidence such as actual mobile usage today would be to fall into error. (In fact, that is not primary evidence: rather, it has the appearance of being robust when in fact it is largely irrelevant). So long as the evidence is sufficiently cogent and reliable, it can and should be taken into account by the Commission, applying usual credibility and value assessments, in coming to a value judgment on the future circumstances.

FMCA and NZX obligations on applicants and others

1.10 We will also address the relevance of statements, from an evidential perspective, made in Sky's Explanatory Memorandum (EM) on the merger and the Grant Samuel report. We address how they are relevant from an evidential perspective. Vodafone claims that the Commission can rely on a statement in the EM as it has been given under statutory and other obligations.

1.11 To put that in context, we summarise before then the applicants' duties, as outlined in our 11 November submission, including pursuant to the certificate given to the Commission on behalf of the applicants, and arising out of the offence at s103(2) of the Commerce Act.

1.12 From submissions opposing the merger, the disconnect between what is said to the Commission and what is said elsewhere by the applicants, is emerging as a central issue, it is submitted. Therefore, in our submission, the points below take on particularly relevant significance.

1.13 Further, based on many of the points raised in submissions, it may be valuable that Vodafone states firmly, in its 11 November submission, the veracity and reliability of its statements in the EM and other shareholder materials. The submissions by opposing parties point to positions and views as to the future markets and technologies that differ from what is in material provided by the applicants to the Commission.

1.14 In common with how courts and tribunals assess evidence, the Commission can and should treat with substantial force, as against the applicants, any statements made by the applicants, where those statements are against their interests on this application. Where the statements favour the applicants, particularly where they are inconsistent with other evidence, a contrary approach should be taken. From the submissions by the parties, that is emerging as, it is submitted, a major consideration.

1.15 We turn now to the body of this memorandum.

2. Applicable principles

Real and substantial risk/real chance

2.1 At [63], the Court in *Woolworths* summarised the initial issue as to whether or not there is, or is likely to be, SLC:

> A substantial lessening of competition is "likely" if there is a "real and substantial risk" that it will occur, see *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 at 562-563 (CA). Another way of putting it is that there must be a "real chance" that there will be a

> substantial lessening of competition, see *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 27 ALR 367 at 382 (FCA).

If in doubt…

2.2 As the Court confirmed, "*if the Commission is "in doubt", it should decline a clearance.*"[6] The Court summarised the point as follows (and this conclusion is applicable in the current circumstances too):

> For the present purposes, the existence of a "doubt" corresponds to a failure to exclude a real chance of a substantial lessening of competition.

Burden and standard of proof

2.3 The Court of Appeal in *Woolworths* confirmed that the burden of proof is on the applicants and the standard of proof is the civil standard: balance of probabilities.[7] The Court expanded on the standard of proof:[8]

> A hypothesis is established on the balance of probabilities if it is more likely than not to be true. So this means that s 66(3)(a) should be construed as applying if the Commission is of the view that it is more likely than not that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market. So we have "more likely than not" on top of "will not have, or would not be likely to have" along with the test of substantial lessening of competition, which also necessarily involves questions of degree.

"The problem of uncertainty"

2.4 A major focus of the Court of Appeal was on "*The problem of uncertainty… Both factual and counterfactual are forward looking. They are incapable of accurate assessment.*"[9] In addressing that problem it broadly agreed with the High Court's view, as follows:

> The High Court judgment noted that there are competing policy considerations in terms of where the burden of this uncertainty should lie:
>
> > (a) On the one hand, acquisitions can harm competition. Because a decision to permit an acquisition is irreversible, it might be thought sensible to be cautious.
> >
> > (b) On the other hand, acquisitions can increase efficiency and benefit the public and thus should be permitted unless there is a good reason to prevent them. A starting at shadows approach to what constitutes an anti-competitive effect might thus be inimical to the public interest.

[6] *Commerce Commission v Woolworths* (supra) at [98]. In that paragraph the Court also recorded that the "doubt" is not intended to adopt the criminal law standard of reasonable doubt.
[7] *Commerce Commission v Woolworths* (supra) at [96] and [97]
[8] *Commerce Commission v Woolworths* (supra) at [97]
[9] *Commerce Commission v Woolworths* (supra) at [75]

> We agree that this is so, at least broadly. But it is right to recognise that efficiency considerations are more material to an authorisation than a clearance.

The value judgment

2.5 In *Air New Zealand v Commerce Commission (No. 6)*,[10] the Court observed, as to predicting the likely behaviour of firms in a dynamic market, as:

> …typically involv[ing] the application of economic theory, previous experience (in the market or other markets having shared characteristics) and known facts about the structure of the market and the behaviour of competitors and potential competitors. Such predictions have often been referred to as 'value judgments'…

Forward looking assessment

2.6 Arnold J in *NZ Bus v Commerce Commission* noted the need for care in applying past market behaviour to the forward-looking market assessment:[11]

> First, care needs to be taken in relation to evidence of past market behaviour in this context. As the Australian Trade Practices Tribunal said in *Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481 at 516, "whether firms compete is very much a matter of the structure of the markets in which they operate". …The analysis is a forward-looking one, comparing the likely state of competition if the merger or acquisition proceeds with the likely state of competition if it does not. Evidence of past conduct may be relevant – it may, for example, cast light on market structure, indicate the likely response of an incumbent to new entry or provide pointers to likely future developments within the market. But to the extent that behaviour within a market is discretionary, it can change, and so may not be a reliable indicator for the future.

What evidence can the Commission take into account?

2.7 In *Commerce Commission v New Zealand Bus Ltd*, Miller J concluded at first instance, citing the above passage from *Air New Zealand v Commerce Commission (No 6)*, that:[12]

> …the Court must exercise what has often been called a value judgment: [*Air New Zealand v Commerce Commission (No. 6)*] at [117] … the Court must predict what is likely to happen in the future, with the aid of abstract economic principles applied to what frequently are not primary facts.

The Commission's guidelines

2.8 That conclusion is reflected also in the passage from the Commission's Merger and Acquisition guidelines cited by Vodafone (we add the paragraph following that cited paragraph too):[13]

> 2.35 We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the merger. This assessment is

[10] (2004) 11 TCLR 347, at [117]
[11] [2007] NZCA 502, at [237]
[12] (2006) 11 TCLR 679 at [160]
[13] Footnotes omitted. The passage in Vodafone's 11 November submissions is a [2.3]

> based on the information we obtain through our investigation and takes into account factors including market growth and technological changes.
>
> 2.36 Often the best guide of what would happen without the merger is what is currently happening (ie, the status quo). However, where a market is likely to undergo changes that will affect competition in the without-the-merger scenario, we take these changes into account.

Primary and other evidence

2.9 Miller J's reference to reliance on what *"frequently are not primary facts"* reinforces that the Commission can and should look widely for evidence beyond primary or direct evidence. In this regard the Commission is not bound by the rules applicable in Court as to primary and secondary evidence, hearsay evidence, etc. It must rely upon cogent evidence when coming to the required value judgement, and make an assessment of the evidence, undertaking a credibility assessment if necessary, or an assessment to prefer one conclusion over another based on the evidence. This is the more so as the Commission is making value judgments as to a future and therefore uncertain state.

2.10 Thus, while the applicants' reliance on more direct/primary evidence such as current data usage and current customer surveys has a superficial attraction, it must quickly be discounted where there is broader evidence, and economic theory and conclusion, pointing away from such evidence. In that respect, the current usage data and customer surveys in fact have little relevant and are not primary evidence.

2.11 An important point is that what the applicants themselves say and plan as to future conditions is relatively direct or primary evidence. Often it will be the best evidence, with the important caveat that regard must be had to ability and incentive: what is possible, rather than more limited statements by the applicants. We elaborate on that issue below when we turn to disclosure obligations on the applicants. Essentially, statements in the EM and elsewhere by the applicants, which are against its interests in this application, are among the strongest evidence that is available. That is different from statements that accord with their interests, for they may be self-serving.

3. Why the Court of Appeal's treatment in *Woolworth's* is relevant in this case

3.1 The judgment involved the 3:2 proposed acquisition where the Warehouse's Extra operation entailed the disputed prospect that it would provide competition to the 2 major supermarket companies if an acquisition did not take place.

3.2 The High Court had reversed the Commission's refusal to clear the transactions, in large measure due to the High Court's reliance, in contrast with the Commission, on empirical evidence as to actual market performance over a relatively limited period of time. The High Court concluded its view on the future market circumstances based largely on that empirical evidence.

3.3 The Court of Appeal disagreed and reverted to refusing the clearance application, in large part because it was not prepared to rely on the empirical evidence of the status quo. It noted, for example:

> [192] Further, we do not share the High Court's confidence that the evidence of Extra's impact on Woolworths and Foodstuffs to date demonstrates that it is likely to have little competitive impact in the

future. While we accept that the evidence shows little impact to date, we do not consider that evidence generated so soon after the Warehouse has introduced what is a new concept, both for it and for New Zealand markets, provides a reliable predictor of likely future impact. As noted earlier, the fact that the clearance applications of Woolworths and Foodstuffs were under consideration may have contributed to the level of competitive response from them. Nor do we share the High Court's confidence that, to the extent that there is competition between Woolworths and Foodstuffs at present, it can reliably be predicted that such competition will continue in the future absent Extra. ….

[195] It is true that the results achieved by the Extra stores were, up to July 2007, very disappointing. The Extra stores did not provide the competition that Woolworths had expected. Hence the decision was made not to change pricing in the Whangarei Countdown following the opening of the Extra store. But it seems to us to be unsound to assess the competitive impact of Extra primarily by reference to its initial performance. …

[205] We do not put the same weight on the empirical data as the High Court did, for the reasons we have already given. We see the foreclosure of the one stop shop innovation before it has had a chance to prove itself as a matter for concern, especially as this concept is the only realistic source of ongoing competition to Woolworths and Foodstuffs in the near future. While the competitive effect of supercentres in New Zealand markets will likely be at a considerably lower level than in the United States for the reasons identified above, we believe there is a real chance that the concept will succeed, as it has in many other countries. ..

[207]..(b) As is apparent, the High Court approached the case largely on the basis of "what has happened following entry and what can be inferred from that" (at [233]). We have a more substantial body of information as to what has happened "following entry". But more importantly, we consider that the combination of the Court's approach to problems of uncertainty and its firm focus on what, after all, was very limited empirical evidence, resulted in it overlooking what we consider to be a real prospect of substantial competitive constraint imposed by Extra stores in one or more of the local markets in which they now operate.

4. [ ]

4.1 [

4.2

4.3

]

5. The FMCA and other obligations

5.1 At [17.4], Vodafone's 11 November submission notes, in relation to the Explanatory Memorandum and other shareholder materials, that:

> There are legal obligations on the parties to ensure the accuracy and validity of the statements included in the shareholders' materials, including the Explanatory Memorandum. In particular, both Vodafone and SKY, and their managers and directors face potential liability in relation to the shareholder materials, including under the Takeovers Code, the Financial Markets Conduct Act, the NZX and ASX listing rules and the Companies Act.

5.2 We note, however, that as outlined in Para 4 above, the applicants, at least, also have extensive obligations, including statutory, to provide sufficiently fulsome and accurate information under the Commerce Act including under the certificate.

5.3 There is a number of submissions maintaining that what is disclosed in the EM and elsewhere substantially differs from what has been disclosed to the Commission. It has been submitted that the EM and other documents show information that ought to have been disclosed to the Commission but that has not happened.

5.4 Where there is a difference, as between (a) what is said by the applicants in different places, it is not enough to say, as Vodafone appear to be saying, that what is said in the merger documents must be right. The Commission may have a credibility and value judgment assessment to make.

5.5 However, in common with how courts and tribunals assess evidence, the Commission can and should treat with substantial force, as against the applicants, any statements made by the applicants, where those statements are against their interests. Where the statements favour the applicants, particularly where they are inconsistent with other evidence, a contrary approach should be taken. From the submissions by the parties, that is emerging as, it is submitted, a major consideration.

The Commission's scope differs from the scope of the EM and Grant Samuel reports

5.6 The submissions against the merger point out that the EM and other documents such as the Grant Samuel report demonstrate that the factual and counterfactual circumstances are, in reality, substantially different from what the applicants are stating to the Commission. That would be so even in the more constrained exercise required in the EM and the Grant Samuel report.

5.7 Both the Commission and the shareholder exercises involve counterfactual analyses but for overlapping yet different purposes. We now outline why that is so.

5.8 As noted above, the Commission is making a value judgment whether there is a "real and substantial risk" that SLC will occur. If the Commission is "in doubt", it should decline a clearance. Thus, the Commission will base its conclusions on counterfactuals and factuals that are more remote and more varied than Vodafone and Sky must consider (and Grant Samuel) for the purposes of reports to the market and shareholders.

5.9 Further, the broad policy of the various obligations to which Vodafone refers (eg FMCA and NZX rules) is to ensure that promoters do not overclaim the merits of the transaction at issue and that shareholders are fairly informed: the need to avoid misleading and deceptive statements by promoters to investors drives a more conservative focus.[14]

5.10 Against that background, the ultimate scope of relevant factuals and counterfactuals is not limited to what is in the EM or the Grant Samuel report. It is however submitted in the various opposing submissions that even on the different and more conservative approach in the merger documents, there is considerable more evidence of SLC and what happens in the factual and the counterfactual, than what flows from the information provided to the Commission.

5.11 The applicants cannot resile from any such statement against their interest, as noted above.

[14] See for example the purposes of the FMCA at s 3, and Sections 19 and 23; see also the description of the approach under various rules at Para 2 of the Grant Samuel independent appraisal report