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# **Review of the Clearance and Authorisation Provisions under the Commerce Act 1986**

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**Discussion Document**

**May 2007**

ISBN 978-0-478-31044-3 (PDF)  
ISBN 978-0-478-31043-6 (HTML)  
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First published in May 2007 by the  
Ministry of Economic Development  
PO Box 1473, Wellington  
New Zealand  
<http://www.med.govt.nz>

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## Information for persons making submissions

Written submissions on the issues raised by the discussion paper are invited from all interested parties. The closing date for submissions is Friday 10 August 2007.

Submissions should be sent to:

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PO Box 1473  
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It would be useful if submissions sent in hard copy or faxed were also provided in electronic form (Adobe Acrobat, Microsoft Word 2000 or compatible format).

Submissions will be considered by officials in the preparation of advice to Ministers concerning the regulatory provisions in the Commerce Act.

Specific questions have been posed to submitters in boxes at the end of most of the Chapters. The full set of questions appears after the Executive Summary. Broader comment on the issues will also be welcomed.

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# Executive Summary

## Introduction

In April we issued a discussion document relating to the regulatory control provisions that appear in Parts 4, 4A and sections 70-74 of the Commerce Act. This latest discussion document complements the earlier discussion document by looking at Part 5 other than sections 70-74. Part 5 allows the Commerce Commission (the Commission) to clear a merger if it considers that the merger is not anticompetitive or authorise a merger or trade practice on the grounds that it is of benefit to the public. In effect, the authorisation test is primarily an efficiency exception to most of the competition tests appearing in the Act.<sup>1</sup>

This discussion document does not fundamentally question the clearance and authorisation systems. Rather, the aim is to test whether some possible changes could improve the effectiveness and efficiency of those systems. 19 issues are addressed, five relating to mergers, six to trade practices, three to legal process affecting both mergers and trade practices and five to the framework for assessing costs and benefits.

## Merger Issues

### A The statutory timeframe for merger clearance determinations

The Act states that clearance decisions shall be made within 10 working days or such longer period as the Commission and the applicant may agree. However, only one of the last 52 applications has been decided within 10 working days. We conclude that the law would be improved if it more accurately reflected reality. We tentatively conclude that the 30 working days should be adopted as the default timeframe.

### B The publication of written clearance decisions

The Act does not require the Commission to publish its decisions. However, the Commission always gives its reasons in writing, but not until some time after it makes the decision. The average gap between the decision and the written reasons in recent years has been 35 working days. Concern has been expressed that the Commission's approach of releasing its reasons some time after the decision is made does not fit well with the statutory appeal provisions. Section 91(2) states that the notice of appeal must be made within 20 working days of the determination or within such further time as the Court may allow. The issue from the potential appellant's perspective is that it can be difficult to judge whether an appeal should be lodged without having the written decision.<sup>2</sup>

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<sup>1</sup> Competition law is underpinned by the presumption that economic efficiency will be promoted if competition is workable or effective. However, occasionally this may not be true. The efficiency exception included within the public benefit test allows the presumption that competition is a good proxy for efficiency to be overturned based on an analysis of the specific circumstances relating to that application.

<sup>2</sup> While written reasons help inform the decision to appeal, the ability to appeal is not reliant on the publication of written reasons.

Our preliminary conclusion is that there is no need to change the existing law. Placing a requirement on the Commission to publish within a set number of days of the decision (e.g. 10 working days) would simply encourage the Commission to delay making decisions until they were close to finalising the written decision. Alternatively, changing the appeal right to 20 working days after the written decision was made would make no difference in practice because the Commission never objects if the applicant appeals within this timeframe. It would also mean that the Commission would be legally obliged to write up every decision.

### **C The enforcement and variation of undertakings to divest shares or assets**

There are no direct means for the Commission to enforce undertakings to divest shares or assets. The only option if a firm breaches an undertaking is to take a case to the High Court claiming that the merger substantially lessened competition. Taking such a case would be time consuming and expensive. We conclude that change is needed to allow the Commission to seek orders from the Court requiring compliance with undertakings along with the power to seek other orders to correct, punish and compensate.

In addition, there is no means for the Commission to amend an undertaking once a clearance or authorisation decision has been made. This can be an impediment to making sensible minor changes that have no bearing on competition. We consider that the original applicant should be able to ask the Commission to approve minor variations.

### **D Behavioural undertakings**

The Commission may accept undertakings to divest shares or assets as a condition for approving a merger. It cannot accept behavioural undertakings. The benefit of allowing such undertakings is that it would allow some possibly welfare-enhancing mergers to obtain immunity. However, there are a number of disadvantages. Behavioural undertakings would be tantamount to foregoing competition and replacing it with what is regulation by another name. Generally speaking, regulated monopolies do not perform as well as firms that face workable or effective competition. Allowing the Commission to decide to regulate a firm under Part 5 would also be inconsistent with the scheme of Part 4, which allocates the responsibility for determining the firms or sectors that will be regulated to government ministers.

There are other potential downsides. Market circumstances change over time and a possibly well-targeted undertaking could become ineffective or counterproductive. We also note that behavioural undertakings may not be fully effective unless they cover a wide range of potentially anticompetitive conduct and address the risks of price gouging. There could also be substantial ongoing monitoring and enforcement costs for the Commission.

Overall, our conclusion at this stage is that the Commission should not be able to accept behavioural undertakings for mergers.

## **E Informal pre-merger processes**

Parties to proposed mergers sometimes approach the Commission informally before deciding whether to submit a clearance application. This is also true in Australia. However, the Australian informal system is more formalised and the ACCC is prepared to give a conditional letter of comfort to the parties that it will not challenge a merger in court. The Commission does not go this far. The most it will do is to provide guidance that will help the parties to make their own assessment of any risks under the Act.

We conclude that the adoption of a letter of comfort system in New Zealand could result in speedier decisions in some cases compared with the formal clearance system appearing in the Act. However, that would be at the expense of some due process protections that underpin the Act and the legal system more generally. Our view is that the due process deficiencies need to be weighted heavily and our preliminary conclusion is that a letter of comfort system would not fit New Zealand's circumstances.

## **Restrictive Trade Practices Issues**

### **F A possible clearance system for trade practices**

Unlike mergers, there is no clearance process for trade practices. If there were, parties could ask the Commission to approve the practice on the grounds that it did not contravene the restrictive trade practices provisions of the Act. At present, if parties want to obtain immunity under Part 2 they must seek an authorisation and make their case on public benefit grounds. However, the authorisation process is more complex, expensive and time consuming than a clearance system would be.

We reach a preliminary conclusion that a clearance system should be introduced. It could be useful in relation to conduct that is at the margins of legality and illegality and for technical breaches of the *per se* prohibitions.

### **G A possible collective bargaining arrangement notification process**

On 1 January 2007 Australia introduced a notification system for collective bargaining agreements where the total value of the transactions for each party will not exceed \$3 million a year. The parties to a valid notification obtain immunity from challenge under the Trade Practices Act unless the ACCC issues a draft objection notice within two weeks. The system is largely intended to benefit small and medium-sized firms that have little or no bargaining power in their dealings with big business. We ask whether such a system should be introduced in New Zealand. It is possible that there are issues in monopsonistic markets, particularly in the health and agriculture sectors.

There are some risks. It would place the onus of proof on the Commission even though it has an information disadvantage. It could also divert Commission resources from important to possibly trivial investigations. The case for introducing a notification system would also be weaker if a clearance system were to be introduced.

On the other hand we do not have any information at present on the likely benefits should a collective bargaining notification system be introduced. Therefore, we have

not drawn any conclusions to date on whether a notification system should be introduced.

## **H The “lessening competition” jurisdiction test**

Authorisation is not available unless the Commission concludes that the conduct in question lessens competition. A possible concern is that the test may be denying parties the opportunity to obtain immunity from legal challenge. Since the 1996 amendments which lowered the jurisdictional threshold from a substantial lessening of competition to a lessening of competition there have been two cases where the Commission declined to grant an authorisation because it concluded that there was no lessening of competition. We have not drawn any conclusions at this stage on whether this is a sufficiently important issue to justify any change.

However, if a trade practice clearance system were to be introduced then it would be important to make sure that the clearance and authorisation systems fit well together. Our view is that the best way to do so would be to copy the interaction between clearance and authorisation for mergers. That is, a person who seeks an authorisation would obtain a clearance if the Commission assessed that the conduct would not be anticompetitive. The “lessening competition” jurisdiction test would therefore be redundant.

## **I Commission’s powers to revoke, amend or replace authorisations**

The Commission can revoke, amend or replace authorisations for three reasons. One reason is “a material change in circumstances since the authorisation was granted” (section 65(1)(b)). In effect, this provision allows the Commission to take away the protection of the authorisation because of events that were unknown at the time the application was considered. Thus, it means that a person who has been granted an authorisation may not have the degree of certainty needed to give effect to the authorised conduct. The main risks would appear to relate to major infrastructure projects with long payback periods.

Our preliminary conclusion in relation to section 65(1)(b) is that the applicant should be able to apply for a revocation, replacement or variation on public benefit grounds but that the Commission’s power to make such changes on its own motion should be removed.<sup>3</sup>

## **J Halting the conduct while the Commission considers the authorisation application**

Section 59A(2) requires all parties to an agreement to stop giving effect to the conduct while the Commission is considering whether it should be authorised. One purpose of this provision is to discourage parties from behaving anticompetitively and then seeking authorisation. However, section 59B has the same purpose. It states that the immunity does not apply to conduct that predates the granting of an authorisation.

Another purpose of this section is to protect consumers from the irreversible damage that can be associated with anticompetitive conduct. However, in some cases it may

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<sup>3</sup> No change is proposed for section 65(1)(a) or (c).

harm consumers if it is mandatory to stop the conduct. Our preliminary conclusion is that more flexibility is needed. We consider that section 59A(2) should be modified to provide the Commission with the discretion to order that the conduct be halted.

## **K Conference procedures**

The Act provides for conferences to be held by the Commission during the course of authorisation and clearance applications. A conference can be called by the Commission of its own motion or at the behest of the applicant or any person to whom a draft determination is sent. The issue is whether anyone other than the Commission should be able to call a conference.

In our view, the main purpose of the conference provisions is to provide an effective means for the Commission to obtain information that will assist it to make high quality decisions. If that view is correct the decision to hold a conference should be the Commission's alone. That is our preliminary view.

## **Joint Legal Process Issues**

### **L The right to appeal Commission determinations**

Section 92 provides appeal rights against authorisation and clearance decisions to persons who participated in a Commission conference. Our view is that conference participation is not the best way of determining whether a third party has a material interest in the outcome. Therefore, our preliminary view is that the existing approach should be replaced and that the High Court should decide depending on whether the judge considers that the person has a sufficiently strong interest in the outcome.

### **M A possible specialist competition tribunal**

We consider whether a new specialist competition tribunal should take over the role of the High Court under the Commerce Act. The tribunal would comprise a small pool of High Court judges (along with lay members) who have expertise in the area or could develop expertise over time. It appears that there are three major issues:

- Whether the quality of decisions would be higher;
- Whether it would be cost effective; and
- Whether it would be consistent with broader government policy on specialist tribunals.

This issue also needs to be considered in the context of possible changes arising from the other half of the current Commerce Act Review relating to the regulatory control provisions in Parts 4 and 4A and sections 70-74. An issue under that part of the review is whether to allow for merits review of regulatory control decisions made by the Commission under section 70.

Our preliminary view is that there would not be a good enough case for a specialist tribunal if appeal rights were to remain unchanged. However, from a court's perspective, merits review would be more complex than appeals against other Commission quasi-judicial decisions. Those other decisions are largely yes/no

decisions. Regulatory control requires an assessment of where to place a firm on a spectrum of almost infinite possibilities. Therefore, we consider that the case for a specialist tribunal would be better if merits review were to be introduced. However, it is unclear at this stage whether that case is strong enough.

## **N Wider use of lay members**

The Act describes the circumstances in which a lay member must, may and may not sit with High Court Judges. A 2006 High Court decision on an interlocutory matter pointed to an issue with one of the situations where a lay member may not sit. The Court stated that it should have the discretion to appoint a lay member whenever it has to consider the merits of a report by the Commission. We agree with this suggestion.

## **The Framework for Assessing Costs and Benefits**

The Commission's framework for assessing costs and benefits is consistent with international best practice. Nevertheless, five issues have been raised with officials relating to the way that costs and benefits are assessed by the Commission when it is considering authorisation applications. Four of those issues relate to the Commission's policies and practices. The fifth issue is whether the Act should specifically require the Commission to consider international competitiveness benefits. We have not drawn any conclusions on any of these five issues. Rather, the intention is to seek views from stakeholders on those matters and form views prior to reporting to the Government.

## **O The assessment of costs and benefits**

The Commission assesses efficiency gains and losses by defining a factual and counterfactual, comparing the outcomes and attributing the difference to the merger. The factual and counterfactual are both forward-looking hypothetical situations. The factual is the situation with the merger. The counterfactual is the situation without the merger. We ask for submissions on the way that the Commission goes about this analysis.

## **P The treatment of international competitiveness claims**

The authorisation process requires the Commission to assess whether proposed mergers or practices will or will be likely to result in a benefit to the public that would outweigh the anticompetitive detriment. International competitiveness can sometimes be a significant issue. The question we ask in this section of the discussion document is whether the public benefit test is sufficiently broad to take international competitiveness claims into consideration and give them sufficient weighting.

## **Q The balance between quantified and intangible benefits and detriments**

The Commission has been quantifying costs and benefits to the extent feasible over the last 15 years. The issue is whether there is an over-emphasis on quantification at the expense of costs and benefits that are difficult to quantify. This is a crucial issue because dynamic efficiency is the largest contributor to economic growth and yet dynamic effects are the most difficult to quantify. We are seeking views on whether the existing approach is sufficiently flexible.

## **R Timeframes over which costs and benefits are assessed**

The Commission's time horizon for assessing costs and benefits is usually 2-5 years. However, most of the impacts on innovation are unlikely to occur until much later. Trying to assess impacts beyond a 2-5 year period is likely to be speculative and, therefore, impractical. We ask whether the existing approach to timeframes raises any issues.

## **S Market definition issues**

The Commission defines markets by testing buyer and seller reactions to a small but significant non-transitory increase in price (SSNIP) in a hypothetical exercise which assumes the creation of a total monopoly. The Commission also applies a reality check to the analysis by applying the market definition appearing in the Act, i.e. to include other goods and services that, as a matter of fact and commercial common sense are substitutable for them. We are seeking views on whether this approach is working well.

## Questions for Submitters

Please give reasons in response to the questions and support those reasons with examples, where possible. We also welcome comments on such matters as:

- (a) Whether the issues have been accurately identified;
- (b) Whether there may be alternative approaches including non-legislative solutions; and
- (c) Whether there are any implications for the co-ordination of Australian and New Zealand competition laws.

### Merger issues

- Q1 What should the default number of working days for Commission consideration of merger clearance applications be?
- Q2 Is there a need to amend the Act in relation to the publication of written merger clearance decisions?
- Q3 Should the Act provide for the enforcement of undertakings to dispose of assets or shares?
- Q4 Should the original applicant be able to ask the Commission to make minor variations to undertakings to divest assets or shares?
- Q5 Should the Commission be able to accept behavioural undertakings?
- Q6 Should the Commission consider introducing an informal pre-merger letter of comfort system?

### Restrictive trade practices issues

- Q7 Should a clearance system be introduced for trade practices?
- Q8 Assuming a clearance system is introduced, should it apply to price fixing and resale price maintenance?
- Q9 Assuming a clearance system is introduced, what features should it have in relation to such matters as timeframes, undertakings, ability to vary, revoke or replace a clearance and appeal rights?
- Q10 Are SMEs inhibited from engaging in efficient collective bargaining schemes? If so, please provide real examples.

- Q11 Should a collective bargaining notification system be introduced? Would your answer be different if a trade practices clearance system were to be introduced?
- Q12 Assuming that a collective bargaining notification system were introduced, what comments do you have on the design features discussed in Table Five? In particular, what criterion or criteria should be used to define conduct or firms that will be eligible for the system?
- Q13 Assuming there will continue to be no clearance system for trade practices, should the “lessening of competition” jurisdiction test for restrictive trade practice authorisations be retained or removed?
- Q14 If there is to be a clearance system for trade practices, what implications are there for the “lessening of competition” jurisdiction test for the restrictive trade practice authorisation system?
- Q15 Should the Commission’s power to vary, replace or revoke an authorisation if there has been a material change of circumstances (i.e. section 65(1)(b)) be (i) retained, (ii) repealed or (iii) replaced by a provision that only allows the original applicant to ask the Commission to vary, replace or revoke an authorisation?
- Q16 Should the mandatory requirement to halt the conduct while the Commission is considering an application for authorisation (i.e. section 59A(2)) be retained or removed?
- Q17 If the mandatory requirement to halt the conduct is to be removed, do you consider that it would be better to repeal section 59A(2) or replace it with a provision that provides the Commission with the discretion to require that the conduct be halted?
- Q18 Should the applicant and/or any third parties have the power to require the Commission to hold a conference or should the decision be the Commission’s alone?
- Q19 Assuming the applicants and/or third parties were no longer able to require the Commission to call a conference, should the Act specify that they may request the Commission to hold a conference or does it go without saying?
- Q20 Should the statutory time limits in section 62 relating to restrictive trade practice authorisation applications be retained or removed?

### **Joint legal process issues**

- Q21 Should appeal rights for persons who participate in Commission conferences be retained or replaced?
- Q22 Assuming that the High Court will be given the discretion to decide whether a third party may appeal, what criterion or criteria should appear in the Act?

- Q23 Do you consider that a specialist competition tribunal should be established? Does your answer depend on whether there are to be appeals on the merit against regulatory control decisions by the Commerce Commission?
- Q24 Should the High Court (or a replacement tribunal) have the discretion to appoint lay members in any proceeding where it is required to consider the merits of a report by the Commission?
- Q25 Are there other circumstances in which there should be wider discretion for judges to appoint lay members?

### **The legal framework for assessing costs and benefits**

- Q26 To what extent does the Commission's analytical framework adequately take account of what would happen if a proposed merger or arrangement did not go ahead (the counterfactual)?
- Q27 Is the public benefit test sufficiently broad to take international competitiveness claims into consideration and give them sufficient weighting?
- Q28 Does quantification restrict the consideration of dynamic or other difficult to measure economic effects?
- Q29 Are the timeframes over which costs and benefits assessed appropriate?
- Q30 Is the approach used to define markets appropriate?

### **General**

- Q31 Do you have any other comments?

# Introduction

## BACKGROUND

1 The Commerce Act 1986 is a modern competition law that is an integral part of the business law framework in New Zealand. The scheme of the Act is as follows:

- Part 1 constitutes the Commerce Commission as an independent crown entity;
- Part 2 prohibits anticompetitive behaviour;
- Part 3 prohibits anticompetitive mergers;
- Part 4 describes the process for imposing regulatory control on monopolies;
- Part 4A is a regulatory system for electricity lines businesses;
- Part 5 relates to the Commission's quasi-judicial functions. It empowers the Commission to immunise from legal challenge trade practices and mergers that are or might be illegal under Parts 2 or 3 (See Appendix A for diagrammatic representations of those processes). Part 5 also empowers the Commission to set prices, revenues and quality standards for firms or sectors that the Responsible Minister has decided to regulate under Part 4;
- Part 6 relates to enforcement, remedies and appeals. It empowers the Commission and, in some cases, private parties to seek corrective, punitive, compensatory and other types of orders from the District Court and High Court. It states who has the right to appeal against quasi-judicial decisions made by the Commission under Part 5. It also provides some rights of appeal to the Court of Appeal and the Supreme Court; and
- Part 7 covers a range of other matters including the Commission's information gathering and search powers.

2 Various reviews have taken place over the years, with most of the resulting changes being aimed at gradual improvement. Arguably, the most significant changes have been as follows:

- a In 1990 the mandatory pre-merger notification system was replaced with a voluntary system; and
- b In 2001 the competition tests for mergers (section 47) and single firm conduct (section 36) were changed, a reverse burden of proof was introduced into the prohibition against exclusionary conduct and the penalties and remedies provisions were strengthened.

3 This latest review is in two parts. We have already released a discussion document on Parts 4, 4A and sections 70-74.<sup>4</sup> That part of the review has the potential to lead to some significant changes to the way that the regulatory control provisions work. This next discussion document relating to Part 5 (other than sections 70-74) is aimed at examining the efficiency and effectiveness of the clearance and authorisation provisions. Those provisions allow for:

- a A proposed merger or acquisition to be cleared if the Commission considers that it will not or will not be likely to substantially lessen competition;<sup>5</sup>
- b A proposed merger or acquisition to be authorised if the Commission considers that it will or will be likely to result in a benefit to the public that it should be permitted;<sup>6</sup> and
- c A restrictive trade practice to be authorised if the Commission considers that the conduct is likely to result in a benefit to the public either such that it should be permitted or would outweigh the lessening of competition.<sup>7</sup>

4 The effect of a clearance or authorisation is to immunise the merger or conduct from court proceedings. These processes contribute to economic growth by providing firms with the confidence they need to consummate a merger or engage in conduct that is good for New Zealand society. However, the clearance and authorisation provisions do this in slightly different ways. The clearance provisions are largely aimed at firms that are unsure whether a merger proposal is anticompetitive. Thus, the applicant is asking the Commission to allow the merger to be consummated without risk of legal challenge. The authorisation provisions are more aimed at firms that think that the merger or the conduct is probably anticompetitive but is, nevertheless, good for the economy.<sup>8</sup> Thus, although it is never explicitly stated in these terms, the applicant is usually asking the Commission to allow the conduct or merger to proceed even though it may well contravene Part 2 or 3 of the Act.

5 The concept of authorisation of mergers is particularly important in small economies like New Zealand because scale issues are more likely to be significant. However, scale can also have the opposite effect. In large economies, the anticompetitive effects of a merger may be eroded over time through market entry. In a small economy there is a greater risk that a merger will entrench monopolistic elements into a market. The authorisation process reflects this situation because it allows the competing arguments to be assessed case-by-case.

6 Most of the ideas for change in this document have come from people who have first hand experience of the clearance and authorisation processes or from the

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<sup>4</sup> *Review of Regulatory Control Provisions under the Commerce Act 1986*, Ministry of Economic Development, April 2007.

<sup>5</sup> See ss 66(3) and 67(3)(a).

<sup>6</sup> See s 67(3)(b).

<sup>7</sup> See s 61(6)-(8). There are some minor variations in the wordings but they make no substantive difference. Authorisation is not allowed in relation to sections 36 and 36A, which are purpose-based prohibitions, not effects-based.

<sup>8</sup> The public benefit test is predominantly an efficiency exception. Mergers and restrictive trade practices that can pass this test are in effect exempt from the prohibitions.

Commission. We set up a focus group to discuss the possible issues with some stakeholders who have each had several years experience of the Act. We are now broadening the debate by releasing this discussion document.

## **A description of the clearance and authorisation processes**

7 The applicant is required to formally submit an application for a clearance or authorisation in accordance with the Commission's forms. The Commission has a practice of issuing a draft determination in relation to authorisation proceedings. Conferences can be called. Appeal rights are provided for applicants and those that participate in a conference.<sup>9</sup> In addition, the vendor of the assets or the shares has the right to appeal in the case of merger clearance and authorisation applications.

8 During adjudicative proceedings, the Commission limits access to Commissioners, with the exception of formal conferences. However, Commission staff actively engage with the applicant and other interested parties to obtain and test information. The Commission releases media statements advising of any adjudicative proceeding and the procedural steps to facilitate participation by interested parties.

9 Outside of formal adjudicative proceedings, the Commission generally operates an open door policy and welcomes inquiries by parties to proposed acquisitions or arrangements. However, the Commission is unwilling to provide informal or confidential guidance or letters of comfort on the likely success of an application or whether it complies with the Act.

10 The Commission has 10 working days or such longer time as is agreed by the Commission and the applicant to grant or decline a clearance, though extensions are sought as a matter of course. For merger authorisations the Commission has 60 working days or such longer time that is agreed with the applicant. The Act does not provide timeframes for consideration of applications for restrictive trade practice authorisations although the Commission and the Responsible Minister agree time performance measures in their annual Output Agreement.<sup>10</sup> If a determination has not been made within the statutory timeframe (or the agreed extended timeframe) the clearance or authorisation application is deemed to have been declined.

## **THE ISSUES**

11 The following issues are addressed in this discussion document

### *Merger issues*

- A The statutory timeframe for merger clearances
- B The publication of written clearance decisions
- C Undertakings to divest shares or assets
- D Behavioural undertakings

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<sup>9</sup> Conferences are very rarely held for clearance proceedings.

<sup>10</sup> See the Output Agreements for recent years at <http://www.comcom.govt.nz/TheCommission/OutputAgreement/outputagreement.aspx>

E Informal pre-merger notifications

*Restrictive trade practices issues*

F A possible clearance process for trade practices

G A possible simple collective bargaining arrangement notification process

H The “lessening competition” jurisdiction test

I The Commission’s power to revoke, amend or replace authorisations

J Halting the conduct while the Commission is considering an authorisation application

K Conference proceedings

*Joint legal process issues*

L The right to appeal Commission decisions

M A possible specialist tribunal

N Wider use of lay members

*The statutory framework for assessing costs and benefits*

O Clarity and specificity in how the costs and benefits are assessed by the Commission

P The treatment of international competitiveness claims

Q The balance between quantified and intangible benefits and detriments

R The timeframes over which costs and benefits are assessed

S Market definition issues

**Criteria for assessing the issues**

12 The following criteria are used to assess the issues:

- The quality of outcomes
- Cost effectiveness
- Timeliness
- Clear and consistent legislation
- Transparency and predictability

- Opportunity for effective participation by interested parties
- Appropriate level of accountability
- Minimising the opportunity to game the legal system

## **NEW ZEALAND-AUSTRALIA BUSINESS LAW COORDINATION**

13 As stated at the beginning of the full list of questions earlier in this discussion document, we have asked for any comments on the implications for Australia-New Zealand business law coordination. A framework for considering those issues is the *Memorandum of Understanding between the Government of New Zealand and the Government of Australia on the Coordination of Business Law*.<sup>11</sup> Paragraphs 4 and 5 state the following:

4. Both Governments are aware that some existing laws and regulatory practices relating to business within each economy may impede the development of trans-Tasman business activity. Through the development of increased coordination and dialogue, both Governments will endeavour to minimise such impediments.
5. An array of approaches exists to achieve the goal of increased coordination in business law. Both Governments recognize that one single approach would not be suitable for every area, that coordination is multi-faceted and does not necessarily mean the adoption of identical laws, but rather finding a way to deal with differences so they do not create barriers to trade and investment. In working towards greater coordination, the efforts of both Governments will focus on reducing compliance costs and uncertainty, and increasing competition.

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<sup>11</sup> 22 February 2006, [http://www.med.govt.nz/templates/ContentTopicSummary\\_25649.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_25649.aspx)

## Issues A to E: Mergers

14 New Zealand has a voluntary pre-merger notification system. The parties to a merger must make their own assessment of whether a proposal might substantially lessen competition. This assessment is informed by the Commission's Mergers and Acquisitions Guidelines, including the safe harbours, and the Commission's written reasons for merger decisions. This means that the parties to the great bulk of mergers which have no adverse impact on competition have no need to notify the Commission.

15 The merger provisions are also designed to encourage the parties to seek a clearance or authorisation if the merger raises significant competition issues. The incentive effect arises because the Commission can challenge a proposed or partly or fully consummated merger in the High Court where a clearance or authorisation has not been sought or granted.<sup>12</sup> If the matter goes to court then the process will be adversarial, is likely to cost more and take longer to conclude. Therefore, it is generally in the interests of the parties to use the clearance or authorisation process where significant competition issues are likely to arise.

16 This system works largely as it should do. The Commission receives very few applications in relation to proposals that do not have some noticeable impact on the process of competition. And it is rare for parties to attempt to consummate a merger that raises serious competition issues outside of the clearance and authorisation processes. Although the merger clearance system is fundamentally sound the rest of this section considers possible improvements.

### ISSUE A: THE STATUTORY TIMEFRAME FOR CLEARANCE DETERMINATIONS

#### Background

17 Section 66(3) states that the Commission shall either clear or not clear the proposed merger or acquisition within 10 working days<sup>13</sup> or such longer period as the Commission and the applicant agree. Section 66(4) states that the proposal is deemed to be declined if the time period expires without the Commission giving a clearance.

#### The issue

18 The problem with section 66(3) is that 10 working days is unrealistically short and extensions are agreed as a matter of course. Only one of the last 52 clearance decisions made by the Commission has been decided within 10 days (See Table One). The problem dates back more than 15 years when New Zealand had a mandatory pre-merger notification system for mergers that were above specified size thresholds. Under that system, the great bulk of merger proposals had no impact on competition and 10 days was ample time for the Commission to rubber-stamp them. By contrast, the type of clearance applications the Commission now receives always raise some competition issues and therefore involve detailed analysis.

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<sup>12</sup> The Commission may also challenge a merger under the cease and desist procedure in the Act.

<sup>13</sup> Section 2 defines "working day" as any day of the week other than (a) Saturday, Sunday, Good Friday, Easter Monday, Anzac Day, Labour Day, the Sovereign's birthday and Waitangi Day; and (b) 25 December through to 15 January inclusive.

## Options

19 The options are to retain the status quo or to increase the number of days.

## Analysis

### *Clear and consistent legislation*

20 In our view it is undesirable to have legislation that works very differently to the way that one would expect based on a plain reading of the provision. The current 10 working day rule fails that test because it creates an expectation that a significant proportion of applications will be determined within that time.<sup>14</sup>

**Table One: Commerce Commission merger clearance times**

(July to June years, other than for 2006/7 which covers the nine months to 31 March)

Time Taken (working days)	2004/5	2005/6	2006/7*	Total	Cumulative total
1 to 10 days	0	0	1	1	1
11 to 20 days	2	3	1	6	7
21 to 30 days	7	7	4	18	25
31 to 40 days	3	3	6	12	37
41 to 50 days	1	1	1	3	40
51 days or more	5	6	1	12	52
Total	18	20	14	52	
Average number of days	37	37	32	35	
Percentage decided within 30 days	50%	50%	43%		48%
Percentage decided within 40 days	67%	65%	86%		71%

\* The Commission advises that the average number of days taken for the full 2006/07 financial year is likely to exceed the average for the first nine months, as some of the clearance proceedings currently underway have been open for over 32 working days.

21 It is evident from Table One that increasing the number of working days from 10 to 20 working days would not overcome the problem. 50 working days would not seem to be a good option because only three of the 15 applications that took more than 40 working days were decided by day 50. The choice would seem to be between 30 and 40 working days. The judgment to be made is whether the legislation would be clearer if extensions were to be needed about a half (30 working days) or a third (40 working days) of the time.

22 In addition, if the Act were to be changed to allow the Commission to accept behavioural undertakings (see Issue D) then the Commission may well need additional time to consider such applications.

<sup>14</sup> Law firms often provide guidance to their clients on the time they consider that the Commission is likely to take to consider applications.

### *Cost effectiveness*

23 The routine process of agreeing an extension adds an unnecessary step to the process. However, the associated cost is low.

### *Timeliness*

24 It can be argued that a challenging but realistic timeframe is better than one that the Commission could meet most of the time. It can also be argued that the longer the time period the greater the risk that the Commission will take more time over relatively simple applications. A counterargument is that the Commission has incentives to not be tardy over easier applications because its performance is monitored against the performance measures that are included in its annual Output Agreement with the Minister of Commerce.

25 Other than Australia, we do not think it is particularly useful to compare the timeframes with other countries due to the different imperatives under voluntary and mandatory pre-merger notification systems. Australia's system is very like New Zealand's. The time limit there is 40 business days with the ability to extend the timeframe with the agreement of the applicant or for a further 20 business days without agreement. Arguably, a shorter timeframe in New Zealand should not matter, given the Commission's ability to extend the timeframe.

26 Overall, from a timeliness perspective it is clear that 30 days is not going to be any worse than 40 days and it could be better. 30 days would appear to be the better option under this criterion.

### **Conclusion**

27 We conclude that 10 working days should be increased to a more realistic number. On balance, we prefer 30 working days along with retention of the powers to extend the deadline.

#### **Question**

Q1 What should the default number of working days for Commission consideration of merger clearance applications be?

### **ISSUE B: THE PUBLICATION OF WRITTEN DECISIONS**

#### **Background**

28 The Act does not require the Commission to provide reasons for its clearance decisions. However, the Commission has an administrative policy of publishing reasons at some point after every decision has been made. The Commission's policy addresses issues of natural justice by informing the applicant and other interested parties how their interests have been considered. The active policy by the Commission to release written reasons also obviates the need to respond to Official Information Act requests. Written reasons also inform the wider business community and their

professional advisors about the application of the Act and the Commission's approach to merger review. This provides valuable guidance on whether to apply for a clearance in relation to other specific merger plans or proposals.

29 Table Two shows that the average time between making decisions and publishing reasons has been 35 days in the 33 months to 31 March 2007. It also shows a significant upward trend.

**Table Two: Time after the clearance decision was made to publish reasons**  
(July to June years, except 2006/07 which covers the nine months to 31 March)

Working days	2004/05	2005/06	2006/07*	Total	Cumulative total
1 to 10 days	5	1	0	6	6
11 to 20 days	8	3	2	13	19
21 to 30 days	3	7	3	13	32
31 to 40 days	0	4	1	5	37
41 to 50 days	1	1	1	3	40
51 days or more	1	4	7	12	52
Total number of decisions	18	20	14	52	
Percentage within 30 days	89%	55%	36%		62%
Average number of days	18	33	60		35
Median (days)	15.5	29	47		24.5

\* The Commission advises that the figures for the first nine months of 2006/07 include estimates for five clearance decisions where reasons are yet to be published.

## The issue

30 Concern has been expressed that the Commission's approach of releasing its reasons some time after the decision is made does not fit well with the statutory appeal provisions. Section 91(2) states that the notice of appeal must be made within 20 working days of the determination or within such further time as the Court may allow. The issue from the potential appellant's perspective is that it can be difficult to judge whether an appeal should be lodged without having the written decision.

## Options

31 Options for change would be:

- a To require the Commission to give written reasons within a certain number of days of making decisions (e.g. 10 days); or
- b Amending section 91(2) to state that a notice of appeal must be made within 20 working days of the time the written decision is published.

## Analysis

### *Timeliness*

32 A possible consequence of Option (a) is that it will encourage the Commission to delay making decisions until the written reasons have been completed or nearly completed. We do not see how anyone would benefit from such a change. Applicants could be worse off because delay in obtaining advice about the decision could also delay implementation of the merger. Therefore, we consider that Option (a) should not be adopted.

### *Transparency and predictability*

33 An overly short mandatory timeframe under Option (a) may encourage the Commission to release more abbreviated written reasons. Interested parties could use the Official Information Act to obtain further information, but the guidance provided to the business community and their professional advisors would be reduced.

### *Clear and consistent legislation*

34 Option (b) would codify existing practice. The Commission has a policy of not objecting to appeals that are lodged outside the 20 working days providing notice is given within 20 working days of the Commission releasing its written determination. Even if the Commission were to change its policy, it is difficult to imagine that the Court would decline to allow further time in such circumstances.

## Conclusion

35 Both options for change would have the effect of changing the Commission's practice of producing written decisions into a legal requirement. Therefore, it would be more than just a technical change. In addition, the existing provisions work satisfactorily because the Court has the discretion to extend the time limit. Our preliminary view is that the status quo should be retained because there would only be a problem if one assumed that both the Commission and the Court lacked pragmatism.

### Question

Q2 Is there a need to amend the Act in relation to the publication of written merger clearance decisions?

## ISSUE C: THE ENFORCEMENT AND VARIATION OF UNDERTAKINGS TO DIVEST SHARES OR ASSETS

### Background

36 The Commission may grant a clearance or authorisation to a proposed merger, subject to an undertaking to dispose of assets or shares. The undertaking is an integral part of the decision to clear or authorise a merger. Failure to dispose of the shares or assets within the specified time limit means that the merger will not have been

protected by the clearance or authorisation and is therefore open to be challenged in the High Court.

37 There has been one example in recent years where a divestment deed of undertaking was not given effect to. A merger of Pernod Ricard and Allied Domecq was cleared by the Commission subject to an undertaking to sell various assets within 12 months of the acquisition taking place.<sup>15</sup> This undertaking was voluntarily provided with the clearance application at the outset. The Commission did not indicate to the applicant that an undertaking would be required to address competition concerns. The Commission investigated under section 47 and decided not to take further action.

## **Issues**

38 The following two issues relating to the enforcement and variation of undertakings have been brought to our attention for consideration:

### *Issue C1: Enforceability of undertakings*

39 It is not an offence to fail to comply with a divestment undertaking. Therefore they are unenforceable. The Commission can seek an order from the Court under section 85 to divest the assets or shares. However, section 85 only applies to contraventions of the substantive merger prohibition appearing in section 47. The Commission would need to prove to the Court that the merger was anticompetitive. This would be a lengthy and resource-intensive process.

### *Issue C2: Variation of undertakings*

40 There is no scope for the Commission to amend an undertaking once the clearance or authorisation decision has been made. This can mean that the acquirer will lose the protection provided by the approval if it does not implement the merger strictly in accordance with the approved undertaking. Thus, the immunity from legal challenge by a third party would be lost even if a variation would have no adverse impact on competition.

## **ISSUE C1: ENFORCEABILITY OF UNDERTAKINGS**

### **Options**

41 An option would be to allow the Commission to apply to the High Court to enforce undertakings to divest shares or assets (examples of the type of provision that might be enacted appear in Appendix B). The Commission would only have to prove that the undertaking had not been complied with for a contravention to be found. The Court would be empowered to order the merged firm to:

- a Comply with the undertaking;
- b Pay a pecuniary penalty to the Crown;
- c Compensate any other person who has suffered loss or damage; and/or

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<sup>15</sup> Decision No 553, 13 July 2005.

- d Comply with any other condition that the Court considered appropriate.<sup>16</sup>

## Analysis

### *High quality outcomes and gaming the legal system*

42 The Commission's inability to enforce undertakings provides an incentive for the parties to consummate the merger and later advise the Commission that it tried to dispose of the relevant shares or assets but was unable to find a buyer that was prepared to pay a reasonable price. However, undertakings are unconditional. The reasonableness of the price, as judged by the seller (or anyone else, including the Commission or the courts) is irrelevant. The failure to divest will mean that the objective of protecting the process of competition will probably not have been achieved.

43 Our view is that the enforcement option outlined above will discourage gaming of this type. The merged firm would lose control of the sale process if it did not sell within the deadline specified by the Commission, with a consequent risk of a "fire sale". In addition, not selling within a deadline set by the Court would be a contempt of court and would, therefore, create an additional incentive to comply.

### *Clear and consistent legislation, transparency and accountability*

44 The option of empowering the Court to impose orders is fully consistent with the scheme of the Act. That option is also consistent with changes proposed by the Ministry of Consumer Affairs to consumer protection legislation.<sup>17</sup> A requirement on the Commission to demonstrate to the Court that one or more orders should be made is also sound from a transparency and accountability perspective.

## Conclusion

45 As a general rule, law that includes provisions that cannot be enforced is unsatisfactory and not fully effective. Our view at present is that the Commission should be able to seek orders from the High Court.

### Questions

- Q3 Should the Act provide for the enforcement of undertakings to dispose of assets or shares?

<sup>16</sup> For example, the Court might appoint a receiver to dispose of the assets or shares.

<sup>17</sup> Ministry of Consumer Affairs, *Review of the Redress and Enforcement Provisions of Consumer Protection Law*, 2006 <http://www.consumeraffairs.govt.nz/policylawresearch/enforcement-review/>

## ISSUE C2: VARIATION OF UNDERTAKINGS

### Options

46 An option would be to allow the original applicant to seek a variation to an approved undertaking to divest shares or assets. The Commission would be able to approve the variation if it considered that the variation was minor or would not otherwise defeat the competition or public benefit objectives of the Act.

### Analysis

#### *Quality of outcomes, predictability, timeliness and cost effectiveness*

47 At present, an applicant who decides that compliance with the exact terms of an approved undertaking may be unnecessary or counterproductive has three choices. One is to comply with the undertaking in full. Another is to make the variations but in the knowledge that the protection of the Commission's approval will not apply. The third is to re-apply to the Commission for a clearance or authorisation subject to the proposed revised terms. The first option might result in suboptimal outcomes. The second does not rate well from a legal certainty perspective. The third is poor from a timeliness and cost effectiveness perspective. The option of allowing the applicant to seek a variation would overcome all of these problems.

#### *Gaming the legal system*

48 As a general rule the longer the time that passes after a merger is consummated, the more difficult it can be to divest assets. Premises can be closed, staff can be relocated or made redundant, and property, plant and equipment can be commingled or decommissioned. Thus, the ability to vary undertakings after the event may encourage parties to make spurious applications in the hope that it will be impractical to sell the assets by the time the Commission has made a decision.

49 We consider that this risk would be minimal as long as the undertakings could be enforced through correcting, punitive and compensatory orders.

### Conclusion

50 The inability of the Commission to approve variations to undertakings after the clearance or authorisation decision has been made appears to be unnecessarily rigid. Greater flexibility in this regard would provide the opportunity for minor variations to be made without losing the protection of the original approval.

#### Question

Q4 Should the original applicant be able to ask the Commission to make minor variations to undertakings to divest assets or shares?

## ISSUE D: BEHAVIOURAL UNDERTAKINGS

### Background

51 Section 69A(1) allows the Commission to accept a written undertaking to dispose of assets or shares as a condition of granting a clearance or authorisation. This provision ensures that the Act does not unnecessarily impede mergers. Where an application would otherwise be declined, a divestment undertaking can preserve competition if it is likely to have a lasting effect on the structure of a market.

### The issue

52 Section 69A(2) states that the Commission is unable to accept other types of undertakings. It has been suggested to the Ministry that applicants should also be able to offer behavioural undertakings to overcome problems associated with mergers that would otherwise substantially lessen competition or be of benefit to the public.

53 Some other jurisdictions allow their competition authorities to consider behavioral undertakings. However, it appears that they are rarely used and usually only in ways to support structural undertakings. The ACCC's merger guidelines state that the ACCC is unlikely to favour behavioural undertakings such as price, output, quality and/or service guarantees and obligations. Such undertakings may well interfere with the ongoing competitive process through their inflexibility and unresponsiveness to market changes. The duration of such undertakings is also highly problematic.<sup>18</sup> Last year the ACCC indicated that it was prepared to consider the use of behavioural undertakings more frequently to support structural undertakings. A senior manager of the ACCC stated that "well formulated behavioural undertakings can provide additional and potentially valuable safeguards to deal with competition concerns that have been primarily dealt with by means of structural undertakings."<sup>19</sup>

54 This speech came shortly after the ACCC's decision in 2006 to allow Toll Holdings to acquire Patrick Corporation Ltd subject to various divestments along with four behavioural requirements as follows:

- All dealings between Toll and Pacific National are to be on an arms-length basis;
- Toll will not have access to confidential customer information provided to Pacific National;
- Toll will not involve itself in the commercial operations of Pacific National; and

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<sup>18</sup> ACCC *Merger Guidelines 1999*, p75.

<sup>19</sup> Speech by Tim Grimwade (General Manager Mergers & Asset Sales, ACCC) to the Lexis Nexis Trade Practices Law Conference, 18 October 2006, *How to Obtain Approval for Difficult Mergers & Acquisitions – And How You Won't*.

- The shareholders of Pacific National will ensure that Pacific National does not discriminate in favour of Toll's downstream freight forwarding interests. Auditing provisions are included to measure compliance.<sup>20</sup>

55 The United Kingdom Competition Commission also uses behavioural remedies to support structural undertakings. Its Guidelines state that "in certain circumstances, it may also be necessary to add behavioural undertakings to a structural remedy in order to provide an effective and comprehensive solution."<sup>21</sup>

## Options

56 Two options for change would be to amend section 69A(2):

- To allow the Commission full discretion to accept any type of undertakings as it sees fit; or
- To allow the Commission to accept behavioural undertakings in support of undertakings to divest shares or assets.

## Analysis

### *The quality of outcomes*

57 The major benefit of allowing behavioural undertakings to be accepted is that it would facilitate the consummation of mergers that have net benefits and would not otherwise obtain an authorisation. However, allowing behavioural undertakings could reduce the quality of outcomes for the following reasons:

- The effect of approving a merger subject to behavioural undertakings is to forgo competition and replace it with what is regulation by another name. Regulated monopolies generally do not perform as well as firms that are subject to workable or effective competition;
- Market circumstances change over time. What might be a well-targeted behavioural undertaking at the time of the merger may later turn out to be ineffective or counterproductive;
- Behavioural undertakings may not be fully effective. Firms with high market power usually have a range of anticompetitive tools available to them;<sup>22</sup>
- Behavioural undertakings can not deal with mergers that are likely to facilitate firms coordinating their pricing and output decisions without communicating (i.e. "tacit collusion" or "conscious parallelism"); and
- The damage to the economy will be irreversible if a merged firm were to breach a behavioural undertaking.

<sup>20</sup> ACCC, Public Competition Assessment, 5 May 2006.

<sup>21</sup> *Competition Commission Guidelines*, December 2004, p5.

<sup>22</sup> A merged firm may be able to bundle monopoly and competitive products, exclusive deal, predatory price, price discriminate or otherwise increase barriers to entry or raise rivals' costs.

### *Clear and consistent legislation*

58 There are issues in relation to the way that behavioural undertakings would relate to Parts 2 and 4 of the Act.

59 If conduct is anticompetitive then it will be prohibited by Part 2 of the Act. Therefore, it is difficult to imagine why it would be necessary to design a behavioural undertaking that would require a firm to refrain from activity that is already prohibited. If the conduct is not caught by Part 2 (i.e. the conduct is not anticompetitive) it may be inappropriate to accept a behavioural undertaking that would require a business to refrain from activities that would otherwise not contravene the Act.

60 In some cases the behavioural undertakings would need to address the risks of price gouging in relation to monopolistic mergers. However, Part 4 is designed to deal with monopoly pricing issues. It sets down the process for imposing regulatory control and it divides the functions between the Commission and the Responsible Minister. The Minister is responsible for deciding whether regulatory control will be imposed. Allowing the Commission to make behavioural undertakings to counter the risks of price gouging under Part 3 would bypass many of the Part 4 processes and exclude the Minister from the decision-making process.

### *Cost effectiveness*

61 The Commission would need to monitor merged firms' compliance with the behavioural undertakings. It would also be necessary to empower the Commission to enforce the undertakings in the High Court. Unlike structural undertakings, cases involving behavioural undertakings would be likely to involve a considerable amount of subjectivity. It could be as difficult to take a case to enforce a behavioural undertaking as it is to take a case under section 36. The undertakings given in the Toll/Patrick decision illustrate these points:

- a Analysis of price discrimination requires an assessment of price relative to costs. This analysis can be complex particularly where common costs need to be allocated;
- b The assessment of whether product discrimination is occurring could require monitoring of a range of performance factors that contribute to the quality of service provided to different customers; and
- c The undertakings by a company to not involve itself in the commercial operations of a subsidiary or associate company could require monitoring of a wide range and large volume of formal and informal communication, including informal private conversations that might never be documented. Monitoring the undertaking to not allow Toll to have access to confidential customer information provided to Pacific National might also require a significant resource commitment for similar reasons.

62 Overall, there is considerable potential for large ongoing regulatory, monitoring and enforcement costs.

## Conclusion

63 Providing the Commission with the discretion to accept behavioural undertakings, could allow some mergers that are currently declined to proceed. However, even if the Commission were limited to only accepting behavioural undertakings in support of offers to divest assets or shares there are also some very significant downsides. Our view at this stage is that the Commission should not be able to accept behavioural undertakings.

### Question

Q5 Should the Commission be able to accept behavioural undertakings?

## ISSUE E: INFORMAL PRE-MERGER PROCESSES

### Background

64 The Commission has advised us that it welcomes informal notification by parties of proposed mergers. The Commission may indicate to the parties whether the proposal is likely to raise competition issues so that the parties can make their own assessment of any risk and whether they should apply for a clearance.

65 The ACCC also operates an informal pre-merger system. Unlike the Commerce Commission, the ACCC will issue a letter of comfort stating that it would be unlikely to take enforcement proceedings in relation to the merger. However, those letters are subject to significant qualifications, particularly in the case of a confidential review. The Australian system is described more fully in Table Three.

**Table Three: The Informal Process in Australia**

Feature	The Australian informal process
Information requirements	The parties are encouraged to provide information as outlined in the ACCC's merger guidelines.
Timeframes	The indicative times for considering proposals are (a) 2-4 weeks for a confidential review and (b) 2-8 weeks for a public review. These timeframes can be extended by the ACCC.
Third party involvement	Third parties are not involved in confidential reviews. The ACCC posts details of non-confidential merger reviews on its website. A preliminary assessment is made before the ACCC asks parties for formal submissions.
Confidential guidance	The ACCC will express a view on whether the transaction would be likely to be approved were clearance to be sought.
Written reasons	For non-confidential proposals, the ACCC releases a statement of issues outlining its preliminary view. Written reasons are not always provided.
Protection	Informal decisions do not provide immunity from third party proceedings.
Appeal rights	The applicant cannot appeal an informal decision.

66 Another difference in Australia is that there was no formal merger clearance system until the beginning of 2007. It might be concluded that:

- The letter of comfort-based informal system was a pragmatic response to the absence of a formal clearance system; and
- The formal process was introduced in Australia to fix a number of weaknesses in the informal system, including a lack of legal certainty and transparency.

### The issue and the option

67 It has been suggested to us that a letter of comfort process akin to the Australian system would provide a useful supplement to the formal clearance system.

### Analysis

#### *Timeliness*

68 The ACCC aims to complete confidential reviews within four weeks.<sup>23</sup> However, it can decide to convert a confidential review into a public review at a later time. The ACCC has stated that it will take up to eight weeks or longer to complete a public review of complex mergers. Outcomes in 2005/06 are summarised in Table Four.

**Table Four: Timeframes for the Australian informal process<sup>24</sup>**

Time	Percentage
Less than two weeks	54%
Two to four weeks	25%
Four to six weeks	11%
Six to eight weeks	2%
Eight weeks or more	8%

69 On the face of it, these outcomes indicate that the Australian informal process leads to more timely outcomes than the formal New Zealand clearance process (see Table One). However, our view is that Table One and Table Four should not be compared. The fact that more than half of the informal decisions are made in less than two weeks in Australia indicates that the ACCC's informal system may attract a substantial proportion of straightforward merger proposals that would never come to the attention of the Commission through the formal clearance process in New Zealand.

#### *Cost Effectiveness*

70 Having an informal clearance system in New Zealand could have two impacts with different cost effectiveness implications:

- It would divert some formal applications into the informal system – Our view is that the total cost to all parties and the Commission would be lower under the informal system. The Commission would not need to complete the analysis to the same standard under the informal system because it would be able to re-look at the same merger at a later stage and challenge it in the High Court if necessary; and

<sup>23</sup> The New Zealand definition of “working day” excludes public holidays and the Christmas-New Year period. Nevertheless, five working days in New Zealand can be treated as much the same as a week or seven days in Australia.

<sup>24</sup> op cit, Tim Grimwade, powerpoint slide.

- It would attract extra merger proposals – At present law practitioners with Commerce Act expertise “filter out” merger proposals that do not raise serious competition concerns. An informal system may well lower the filtering threshold. In some cases it might mean that lawyers would advise their client to seek a letter of comfort where they would otherwise recommend not approaching the Commission. This would have adverse implications from a cost effectiveness perspective. The Commission may need to divert resources from potentially important matters to merger investigations with only minor or no competition implications.

#### *Accountability, transparency and predictability*

71 A letter of comfort process would fare poorly under this criterion, particularly letters that have been granted following a confidential review, which would not allow for testing of the information provided by applicants with other parties. The reasons for decisions would not always be clear and it would be difficult to know whether the Commission is applying a consistent standard. The Commission would not be properly accountable. In addition, the informal process does not provide the parties with the certainty that their merger will not be challenged in the High Court.

#### *Effective participation by interested parties*

72 An informal process would sometimes provide for some level of participation by interested parties. It would not on other occasions.

#### *Clear and consistent legislation*

73 As a general rule, legislation is better if it works in the way that one would expect based on a plain reading. Thus, a letter of comfort would fare badly against this criterion. It would be a non-statutory process that would operate in parallel with the statutory clearance system.

### **Conclusions**

74 An informal letter of comfort system would, at times, reduce the amount of time for proposed mergers to be considered by the Commission. However, the time saved would be at the expense of the legal certainty that is provided by formal clearance and some due process protections that underpin the Act and the legal system more generally. Our view is that the due process deficiencies should be given a considerable amount of weight. Overall, our view is that a letter of comfort system would not fit New Zealand’s circumstances.

#### **Question**

Q6 Should the Commission consider introducing an informal pre-merger letter of comfort system?

# Issues F to K: Restrictive Trade Practices

## Background

75 Part 2 aims to prohibit the full range of anticompetitive conduct. The prohibitions are described in two ways: principles and rules. The principles (or “rule of reason prohibitions”) require an assessment of the impact on competition case-by-case. The *per se* rules prohibit the conduct outright.

76 The rule of reason provisions prohibit:

- a Agreements that have the purpose or effect of substantially lessening competition (sections 27 and 28);
- b Certain types of exclusionary provisions that substantially lessen competition (section 29); and
- c Individual firms from using a substantial degree of market power for anticompetitive purposes (sections 36 and 36A).

77 The *per se* rules prohibit price fixing (section 30) and resale price maintenance or RPM (sections 37 and 38).<sup>25</sup>

78 Section 58 empowers the Commission to authorise conduct that may fall afoul of these prohibitions, other than sections 36 and 36A.<sup>26</sup> The Commission may grant an authorisation on public benefit grounds.<sup>27</sup> An authorisation allows the firm or firms to enter into and/or give effect to the conduct without the risk of legal challenge by the Commission or a private party.

79 The purpose of the restrictive trade practice authorisation process is the same as for merger authorisations: to permit conduct that is good for New Zealand society even though it may contravene the substantive prohibitions.

## ISSUE F: A POSSIBLE CLEARANCE PROCESS FOR TRADE PRACTICES

### Background

80 The Act does not provide a clearance process for trade practices. If parties want to obtain protection from challenge under Part 2 of the Act (other than sections 36 and 36A) they must apply to the Commission for an authorisation and argue their case on public benefit grounds. Thus, unlike mergers, parties cannot apply to the Commission for a clearance on the grounds that the conduct is not anticompetitive.

81 A trade practices clearance would have much the same effect as a merger clearance. It would immunize the parties to the conduct from legal challenge. To be consistent with an authorisation for restrictive trade practices:

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<sup>25</sup> Resale price maintenance is the practice whereby an upstream firm sets the minimum or actual price to be charged in a downstream (usually a retail) market.

<sup>26</sup> Firms with high market power can nevertheless seek authorisation because their conduct will generally be given effect to by way of contracts, arrangements or understandings.

<sup>27</sup> See section 61(6)-(8).

- a Conduct predating the application would not be immune from legal action (see section 59B); and
- b There would need to be scope to vary or revoke a clearance at a later date, as is provided for by section 65.<sup>28</sup>

82 As with restrictive trade practice authorisations, trade practice clearances would not be available for the purpose-based prohibitions in sections 36 and 36A. It would be difficult for the Commission to be satisfied that a party did not have an anticompetitive purpose.

### **The issue**

83 It is possible that firms may not be engaging in activities that are not anticompetitive because of concerns that they may attract a Commission investigation, or litigation by the Commission or a private party. In addition, firms may be modifying their practices in suboptimal ways to reduce risks of noncompliance with Part 2. Although an applicant could seek an authorisation, it is a complex, time-consuming and expensive process. Clearance could be of benefit in two situations:

- a Conduct that is at the margins of legality and illegality – There is, inevitably, some uncertainty about whether some conduct is lawful or not. The availability of a clearance system may be a way of reducing some of the uncertainty; and
- b A technical contravention of a *per se* prohibition – Occasionally practices may amount to a technical infringement of a *per se* prohibition but nevertheless be competitively benign. This issue is discussed below under the subheading “**Per se offences**”.

### **Analysis**

#### *Predictability*

84 A clearance by the Commission would spur parties to proceed with conduct that they might otherwise have not given effect to. A decision by the Commission to decline a clearance application would provide greater business certainty about the risks of giving effect to the conduct.

#### *Cost effectiveness*

85 The Commission would need a substantial increase in its annual budget if there were to be a significant number of applications. Alternatively, the Commission may need to divert resources to the investigation of applications from other equally or more important matters. However, we think it is unlikely that the Commission would be flooded with trivial applications. If the conduct is clearly not illegal then there is no value in using management and staff time and paying lawyers and economists to prepare an

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<sup>28</sup> Note that we are proposing the removal of one of the three grounds for varying or revoking an authorisation. See Issue I.

application.<sup>29</sup> That said, it is possible that there would be a significant number of applications in the first year. Parties may see a new clearance system as an opportunity to obtain approval for conduct that they have wanted to give effect to for some years.

### *Clear and consistent legislation*

86 This criterion clearly favours the introduction of a trade practices clearance system. There is no difference in the main policy arguments for and against a merger clearance system and a trade practice clearance system.

## **PER SE OFFENCES**

### **Background**

87 The treatment of price fixing and RPM as *per se* offences under the Commerce Act originated from United States antitrust law via the Australian Trade Practices Act. However, there is an important difference between the US and New Zealand. In the US the *per se* rules have been developed by the courts.

88 The US Supreme Court has stated that “protection of price competition from conspiratorial restraint is an object of special solitude under the antitrust laws”<sup>30</sup> because restrictions on free and open price competition pose an actual or potential threat to the central nervous system of the economy.”<sup>31</sup> At the same time, the Supreme Court has recognised that not all arrangements among actual or potential competitors that have an impact on price are *per se* violations of the Sherman Act.<sup>32</sup> Thus agreements that involve price fixing in a literal sense can be found to not be *per se* offences. Here are two examples:

- In *Broadcast Music Inc v Columbia Broadcasting Systems*<sup>33</sup> the Supreme Court held that the rule of reason should be applied to blanket music performance licences offered by copyright holders who operated a joint venture to market such licences; and
- In *Chicago Board of Trade v United States*<sup>34</sup> the Supreme Court upheld a rule requiring that all commodities traded after the exchange had closed for the day be sold at that day’s closing price on the exchange. It held that any impact on price was ancillary to the principal and lawful purpose of regulating the exchange.

89 Overall, the position in the US is that the *per se* rule is the principal mode of analysis for restraints that have the purpose or effect of limiting price competition.

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<sup>29</sup> Any risks could be ameliorated by making the clearance system full user pays. However, that would require a change of government policy. The current fees regulations fall well short of full user pays.

<sup>30</sup> First stated in *Standard Oil Co v United States*, 221 U.S. 1, 52 (1911) and repeated in several other cases such as *United States v Trenton Potteries Co* 272 U.S. 392, 397-8 and *General Motors Corp*, 384 U.S. 127, 148 (1966). See *Antitrust Law Developments (Second)*, American Bar Association, 1984, 29.

<sup>31</sup> *United States v Socony-Vacuum Oil*, 310 U.S. 150, 224-26 (1940).

<sup>32</sup> *Broadcast Music Inc v Columbia Broadcasting Systems Inc*, 441 U.S. 1, 23 (1979).

<sup>33</sup> *ib id.*

<sup>34</sup> 246 U.S. 231 (1918).

However, in limited situations the courts have reviewed the facts and undertaken a market analysis to decide whether the rule of reason should be applied.<sup>35</sup> This provides the flexibility in the US to categorise agreements on price in a targeted way in special circumstances.

## The issue

90 The Commerce Act provides some flexibility in relation to the *per se* offences by providing scope for the Commission to authorise restrictive trade practices. However, as already noted elsewhere authorisation applications must be argued on public benefit grounds. They are more complex, time consuming and expensive than a clearance system would be.

91 If the Act were to be amended to allow for clearance of the *per se* offences, then the anticompetitive presumption in sections 30, 37 and 38 would need to be set aside by the Commission. As is the case when the Commission is considering the detriments pursuant to an authorisation application, the conduct would be analysed on its actual rather than presumed effect.<sup>36</sup>

## Analysis

### *Quality of outcomes*

92 In our view the most important issue is whether the availability of clearances would weaken the effectiveness of the *per se* prohibitions in Part 2. Looking at section 30 first, it is essential for the Act to send a strong signal that cartel activity is unacceptable. As the OECD Committee on Competition Law and Policy stated in 1998, hard core cartels are “the most egregious violation of competition law and hence a principal focus of competition policy and enforcement.”

93 In addition, an OECD survey concluded that the parties to cartel agreements are not honest business people who inadvertently become involved in a technical violation. Rather, they realise that their conduct is harmful and unlawful, and they sometimes go to great lengths to keep their agreements secret.<sup>37</sup> We agree with this statement. Parties to cartels would take no comfort from a clearance system because they would know that there would be no prospect of obtaining a clearance. They would also know that alerting the Commission to their activities would almost inevitably lead to an investigation by the Commission, followed by the risk of court action, punishment and considerable harm to the firms’ reputations.

94 The case for RPM clearances is, if anything, a little stronger, because modern economics literature is mixed on the costs and benefits of RPM.<sup>38</sup>

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<sup>35</sup> *op cit*, American Bar Association, p30.

<sup>36</sup> This approach was taken in Decision 356, *The Number Administration Deed*, 17 May 1999, paras 232-234.

<sup>37</sup> Cited by the Commerce Commission in Media Release 122 *Koppers Arch to pay a record \$3.6 million in cartel penalties*, 7 April 2006.

<sup>38</sup> The United States Supreme Court is currently considering whether to move from *per se* to rule of reason for RPM in *Leegin Creative Leather Products, Inc v PSKS, Inc* No 06-480.

### *Clear and consistent legislation*

95 It can be argued that a merger clearance is a ruling by the Commission that it is satisfied that the proposed merger is unlikely to contravene the Act. Mergers that are likely to contravene the Act can only be authorised. Therefore, the same approach should be applied in relation to any clearance system for trade practices. If the Commission assesses that a practice is price fixing or RPM as defined by the Act then it contravenes the Act and should, therefore, only be able to be considered under the authorisation system.

96 Another way of looking at it is that a merger clearance is a ruling by the Commission that it is satisfied that the proposed merger is unlikely to be anticompetitive. Therefore, the scheme of the Act will not be harmed if *per se* offences could be cleared.

### **Conclusions**

97 Our preliminary views are that:

- a A clearance system should be introduced for trade practices; and
- b Conduct that falls within the definitions of the *per se* offences should be able to be cleared.

### **Questions**

- Q7 Should a clearance system be introduced for trade practices?
- Q8 Assuming a clearance system is introduced, should it apply to price fixing and resale price maintenance?
- Q9 Assuming a clearance system is introduced, what features should it have in relation to such matters as timeframes, undertakings, ability to vary, revoke or replace a clearance and appeal rights?

## **ISSUE G: A POSSIBLE COLLECTIVE BARGAINING ARRANGEMENT NOTIFICATION PROCESS**

### **Background**

98 The restrictive trade practice authorisation process can be expensive, complex and time consuming. The main costs to the applicant are as follows:

- a An application fee of \$10,000 plus GST;
- b The cost of obtaining expert legal and economic advice – This cost is difficult to estimate because there are few applications, but a reasonable estimate would be \$250,000;
- c The opportunity cost of senior management's time;

- d The cost associated with the Commission, competitors and others obtaining some information about the applicants' conduct; and
- e In the event that:
  - i The application is declined, the cost of appealing to the High Court and possibly the Court of Appeal; or
  - ii The application is approved, the cost of joining the Commission to defend a possible appeal by a third party.

99 The scale of costs associated with the above processes is likely to be a significant hurdle for small and medium sized firms (SME).

### **The issue**

100 The main issue in this section is whether the Act impedes SMEs from engaging in conduct that is either not anticompetitive or would result in net public benefits. It would seem unlikely that conduct which is subject to a competition test (i.e. sections 27-29) will be an issue for SMEs.<sup>39</sup> A contravention of those sections will not occur if the group of firms do not, together, have sufficient market power to harm the process of competition.

101 However, there may be an issue for SMEs in relation to a collective bargaining scheme where the buyer is a monopsonist. This can be an issue because a monopsonist can lower prices and restrict the volume of the good or service purchased. Although consumers can benefit through lower prices in the short run, in the long run it can lead to an under-supply of the good or service and discourage innovation by sellers. That said, we are not suggesting that there is a general issue in relation to imbalances of bargaining power between weak sellers and strong buyers. In many cases the imbalance will be market forces operating in an appropriate manner.

102 A collective bargaining arrangement may be a way of reversing the adverse impacts of monopsony market power. However, such an arrangement may fall within the definition of price fixing and would, therefore, be prohibited. If there are issues, they would seem to arise mainly in the agriculture and health sectors.

### **Option**

103 It has been suggested that the Act could be improved by adopting a process akin to the collective bargaining notification system for small business that was recently introduced in Australia on 1 January 2007. That system provides immunity from court action in certain circumstances. An agreement can be eligible for the notification system providing that the expected total value of the transactions for each party to the agreement does not exceed \$3 million (or such higher amount as set under regulations) over a 12 month period.

104 At present, immunity from legal action in Australia will begin 28 days after a valid notification is lodged as long as the ACCC has not issued a draft objection notice within

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<sup>39</sup> SME collective boycotts would not appear to be an issue in New Zealand given that there is a competition test in the Commerce Act prohibition on exclusionary provisions under section 29.

that time.<sup>40</sup> If the ACCC issues a draft objection notice after the 28 day period, the protection from legal action will continue until the revocation is complete. If the ACCC subsequently issues a final objection notice, the immunity from court action will expire 31 days after the date of the objection notice or such later date that the ACCC might specify. Decisions made by the ACCC to revoke immunity can be reviewed by the Australian Competition Tribunal. Any immunity that might have been in place continues until the appeal process concludes. Table Five summarises the features of the Australian notification system. Appendix A includes a diagrammatic description of the process.

**Table Five: The Australian collective bargaining notification system<sup>41</sup>**

<b>Issue</b>	<b>Comment</b>
What does a collective bargaining notification do?	Business can gain immunity from legal challenge under the Trade Practices Act for collective bargaining agreements including those that have a price and/or collective boycotting elements. Protection is given to the applicant, any third party representing the bargaining group and the target business.
How long is immunity for?	Immunity lasts for three years from the date it was lodged. However, the ACCC is able to remove protection if satisfied that the proposed collective bargaining agreement is not in the public interest.
Who can lodge a notification?	A notification can be lodged by any business in the collective bargaining group or a nominated representative who is not a member of the group (e.g. an industry representative body).
What is the criterion?	Each party must reasonably expect that the value of the transaction it will conduct with the target will not in exceed \$3 million over a 12 month period. This threshold can be made higher under statutory regulations. For example, a \$15 million threshold has been made for petrol retailing.
Process for considering notifications	There is a formal notification process and the Act requires a public register to be maintained. The ACCC conducts a public assessment process. The ACCC will contact interested parties and invite submissions on the proposed collective bargaining arrangement.
Analysis	The ACCC considers the benefits and detriments of the conduct.
Onus of Proof	To impose a final objection order, the ACCC must be satisfied that the arrangement would or would likely to result in a substantial lessening of competition and that the agreement is not likely to result in a benefit to the public.
Revocation	The Commission could revoke the immunity if it subsequently assessed that the conduct is not of benefit to the public.
Appeal rights – applicants	The applicant would be able to appeal against a decision by the ACCC to issue a final objection notice or revoke an immunity.
Appeal rights – third parties	The Act does not provide for appeals against a decision by the ACCC to not take action against a notification. However, the ACCC can review a notification at any time (e.g. if new information comes to hand, there is a change in market circumstances or there are complaints from third parties).
Application fees	\$1,000.

<sup>40</sup> Once the system has been in place for a year, immunity will begin 14 days after notification, rather than 28 days.

<sup>41</sup> For a detailed account of the Australian collective bargaining notification process refer to the *Australian Competition and Consumer Commission: Guide to Collective Bargaining Notifications*, (January 2007).

## **Analysis**

### *The quality of outcomes*

105 The notification system may provide a more effective and practical means of allowing weak sellers to collectively negotiate with monopsonies without the risk of contravening the Act. On the other hand, the Australian notification system is not clearly targeted at this problem. It would seem to have the potential to have much wider application. Therefore, there may be significant risks of unintended consequences. For instance, consumers and suppliers may be harmed by collective bargaining groups across a wide range of industries where monopsonies might not necessarily exist.

### *Clear and consistent legislation*

106 The onus of proof would be on the Commission to demonstrate that the immunity should not be allowed. However, the Commission will never know as much about an agreement as the applicant and it may not be possible for the Commission to make an informed judgment before the immunity is due to start. Therefore, a notification system may be susceptible to immunities incorrectly being allowed to stand.

107 On the other hand, if the combined size of the transactions involved is small, the cost to the economy is likely to be low even if several immunities were allowed when they should not have been, particularly bearing in mind that an immunity could later be revoked by the Commission. That said, clearly the Australian system has not been designed exclusively for SMEs or small amounts of commerce. For example, the total amount of revenue involved in relation to a collective bargaining agreement involving 50 parties could be as high as \$150 million a year.

### *Cost effectiveness*

108 A notification process would be lower cost for applicants than an authorisation or a possible clearance system. However, the total cost to the economy may not be any lower. The analysis will absorb a considerable amount of professional staff and contractor time at the Commission if the conduct in question raises complex competition or public benefit issues. Thus, the Commission would bear many of the costs that would normally be borne by the applicants.

109 The main issue in relation to cost effectiveness would appear to be whether a notification system would be put to good use. If not, then there would be little point in adding it to the Act. We would like submitters to provide real examples of issues that have arisen and that could be dealt with under a notification system. We also note that no notifications had been lodged at the time of writing (mid-May) under the Australian system. This may be an indication that a notification system would not be useful in New Zealand.

### *Accountability and transparency*

110 The absence of third party appeal rights would be a departure from the usual approach taken under the Act.

## *Timeliness*

111 A notification process could provide for considerably faster immunity from the Act than authorisation or a possible clearance system. However, depending on the complexity of the issues, it might take the Commission as long to complete the substantive analysis as an authorisation takes.

112 Although the Australian process will provide immunity within 14 days from 2008 onwards, our preliminary view is that 40 working days or such shorter time as the Commission might permit would better fit New Zealand's circumstances for the following reasons:

- It is unlikely that any great harm would be done if parties to a collective bargaining agreement had to wait 40 working days to obtain immunity; and
- The Commission is much smaller than the ACCC and has less flexibility to manage peaks and troughs in workloads. In busy times (e.g. when the Commission is investigating several complex merger proposals at once) the Commission could be faced with the choice of doing nothing more than a cursory analysis of the notified practice within the 14 working days or delaying potentially urgent merger decisions.

## *Gaming the legal system*

113 A Commission power to revoke immunities would mean that the parties will not have as much business certainty as they would like. However, in our view it would be essential for the Commission to be able to revoke an immunity given the information disadvantage and the short period for analysis prior to the immunity becoming valid. The absence of a revocation safety valve would also provide parties with the incentive to not fully cooperate with the Commission. Non-cooperation would increase the likelihood that the applicant could obtain immunity for anticompetitive conduct forever.

## **Notification in the context of a trade practices clearance system**

114 As noted elsewhere, a trade practices clearance system would be less complex, faster and lower cost than the authorisation system. A clearance system could provide greater accessibility for SMEs or industry associations representing SMEs. Our preliminary view is that the case for a notification system would be much weaker if a trade practices clearance system were to be introduced.

## **Conclusion**

115 The notification process would allow for a speedier and less costly process and would, in some cases, encourage efficient business practices. But speed and costs need to be weighed against the risks of unintended consequences, error, reduced participation by interested parties, uncertainty about whether the system would be used to any significant extent, or alternatively, diverting Commission resources from other more urgent investigations from time to time.

116 We have not formed a view on whether a notification system should be implemented at present. We would like to obtain submissions on real examples where issues have arisen. In addition, we will monitor the Australian system with the aim of

providing advice to the Government on its effectiveness when we report to ministers later this year.

### Questions

- Q10 Are SMEs inhibited from engaging in efficient collective bargaining schemes? If so, please provide real examples.
- Q11 Should a collective bargaining notification system be introduced? Would your answer be different if a trade practices clearance system were to be introduced?
- Q12 Assuming that a collective bargaining notification system were introduced, what comments do you have on the design features discussed in Table Five? In particular, what criterion or criteria should be used to define conduct or firms that will be eligible for the system?

## ISSUE H: THE “LESSENING COMPETITION” JURISDICTION TEST

### The issue

117 In 1987 the Commission took the view that it did not have the jurisdiction to grant an authorisation unless in the first instance, the relevant contract, undertaking, arrangement or provision would or would be likely to result in a substantial lessening of competition. The Commission gave the following reasons:

- a Minor wording differences between the Commerce Act and the Australian Trade Practices Act 1974 meant that the law was different in the two countries;
- b Granting an authorisation in the absence of a substantial lessening of competition would be tantamount to a clearance procedure; and
- c Concern that public resources would be wasted in circumstances where the risk of infringing the Act was low.<sup>42</sup>

118 The Commission acknowledged that it was for the courts, not the Commission, to decide whether conduct contravenes the Act. However, the Commission did not give a significant weighting to this point. Nor did it attach much importance to the argument that declining an application for this reason had the effect of denying the applicant the certainty that the authorisation process was designed to provide, with a consequent risk that conduct that was of benefit to society would not be implemented.

119 This issue was considered by the Government in the mid-1990s, and Parliament lowered the jurisdictional threshold from “substantial lessening of competition” to

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<sup>42</sup> Decision 205, *Re Weddel Crown Corp Ltd* (1987) 1 NZBLC (Com) 104,200. Decision dated 22 July 1987.

“lessening of competition.”<sup>43</sup> This change has made it easier for parties to meet the test and obtain protection from challenge under the Act.

## Option

120 The options are to retain or remove the “lessening of competition” jurisdiction test. The issue needs to be considered from each of the following perspectives:

- a If there were to be no trade practice clearance system; and
- b If there were to be a trade practice clearance system.

## Analysis – Assume no trade practice clearance system

### *The quality of outcomes*

121 The Commission has advised us that for every seven approaches to discuss whether an authorisation is needed only one of these results in an authorisation application. In addition, there is no jurisdiction test in Australia and the ACCC appears to receive applications for authorisation that would not raise significant competition concerns in New Zealand. These factors may suggest that the jurisdiction test serves a useful filtering purpose. On the other hand, it can be argued that cost is the main reason that firms are reluctant to seek authorisations, not the jurisdiction test.<sup>44</sup>

### *Predictability*

122 There have been two authorisation applications subsequent to the 1996 Amendments inserting section 61(6A) where the Commission concluded that there was no lessening of competition.<sup>45</sup> The effect of those decisions was that the applicants did not get the legal immunity that they were seeking.

## Analysis – Assume a trade practice clearance system is introduced

### *Clear and consistent legislation*

123 If a trade practice clearance system were to be introduced then it would be important to make sure that the clearance and authorisation systems fitted well together. The way this is done in relation to mergers is as follows:

- The Commission has two choices when a clearance is sought. It grants a clearance if it concludes that the conduct is not anticompetitive. Otherwise, it declines the application; and
- The Commission has three choices when an authorisation is sought. It grants a clearance if it concludes that the conduct is not anticompetitive. The Commission

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<sup>43</sup> Section 61(6A).

<sup>44</sup> The main costs are paying for advice from lawyers and economists, the opportunity cost of senior management time, the risk of providing information that might be useful to the firm’s competitors and the risk of exposing the firm’s practices to the competition “policeman”.

<sup>45</sup> Decision 474, *The Marketplace Company* relating to bid and offer information in the wholesale electricity market (23 December 2003) and Decision 256, *The number Administration Deed* (17 May 1999) in relation to authorising the arrangement under section 27.

grants an authorisation if it concludes that the conduct is anticompetitive but there is a benefit to the public in all the circumstances. Otherwise the application is declined.

124 This interaction works well for mergers and we can think of no reason for adopting a different approach for trade practices. Therefore, the lessening competition jurisdiction test would become redundant.

## Conclusions

125 We have not reached any conclusions on whether the jurisdiction test should be retained or removed in the event that there is no trade practice clearance system. However, if there is to be a trade practice clearance system, the interface between clearance and authorisation should be the same as it is for mergers.

### Questions

Q13 Assuming there will continue to be no clearance system for trade practices, should the “lessening of competition” jurisdiction test for restrictive trade practice authorisations be retained or removed?

Q14 If there is to be a clearance system for trade practices, what implications are there for the “lessening of competition” jurisdiction test for the restrictive trade practice authorisation system?

## ISSUE I: THE COMMISSION’S POWERS TO REVOKE, AMEND OR REPLACE AUTHORISATIONS

### Background

126 Section 65(1) states the Commission may revoke, amend or replace an authorisation if it is satisfied that:

- a It was granted on information that was false or misleading in a material particular; or
- b There has been a material change in circumstances since the authorisation was granted; or
- c A condition upon which the authorisation was granted has not been complied with.

127 The Commission has varied or revoked an authorisation on two occasions:

- In 1989 the Commission revoked an earlier decision to authorise a national collective pricing agreement for kiwifruit under section 65(1)(b).<sup>46</sup> In effect, the original authorisation enabled growers to collectively negotiate with coolstorers in relation to kiwifruit intended for export.<sup>47</sup> A two season time limit was imposed on

<sup>46</sup> Decision 238, 13 September 1989.

<sup>47</sup> Decision 221, 15 September 1988, para 6.2.

the authorisation.<sup>48</sup> The material change was the establishment of the Kiwifruit Marketing Board in 1988 under the Kiwifruit Marketing Regulations 1977. Those Regulations empowered the Board to be a single seller of New Zealand-produced kiwifruit intended for export. The Board substituted for the growers and exporters in agreements with the coolstorers. Thus, the kiwifruit industry structure moved from one in which primary coolstorers were able to negotiate the terms of sale of their own services to one in which the sale became dictated to them by the Board.<sup>49</sup> The weak seller argument underpinning the authorisation had gone.

- In 2006 the Commission revoked an authorisation granted to four companies to jointly market and sell gas produced from the Pohokura natural gas field.<sup>50</sup> When applying for the original authorisation, the parties had stated that joint marketing and sale would be required in order to achieve early production from the field. In the event the parties chose not to jointly market and embarked instead on separately marketing and selling the gas. The Commission concluded that there had been a material change of circumstances and that the authorisation was granted on information that was false or misleading in a material particular. The Commission concluded that it had jurisdiction under subsection (b), and in the alternative, subsection (a), to reconsider the earlier authorisation decision.<sup>51</sup>

## The issue

128 The reasons for subsections (a) and (c) are obvious and they should be retained. However, the Pohokura decision has brought into focus the issue of whether (b) should be retained, repealed or replaced. The issue is whether the power to amend, revoke or replace an authorisation due to events that were unknown at the time the authorisation was granted is fully consistent with the policy intent of encouraging efficient conduct that would not otherwise take place.

129 The major risks associated with retaining subsection (b) would appear to relate to infrastructure development because the payback periods can be lengthy and authorisation might be a way of significantly reducing business risk. This is a potentially major issue because effective infrastructure in energy, transport, communications and water distribution is crucial to New Zealand's productive capacity and growth prospects. Subsection (b) may discourage firms from going ahead with major investments if they need the certainty of a long-lasting authorisation to make the investment viable. A hypothetical example appears in the box below.

## Options

130 Other than retaining the status quo, two options would be:

- a To repeal section 65(1)(b); or
- b To replace section 65(1)(b) with a provision that would allow the applicant to ask the Commission to revoke, vary or replace the authorisation. The person could request:

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<sup>48</sup> ib id, para 7.11

<sup>49</sup> Decision 238, paras 35-36.

<sup>50</sup> Decision 581, 2 June 2006.

<sup>51</sup> ib id, page 5.

- i A minor variation to the authorisation (e.g. to fix a small mistake in the original application);
- ii The substitution of the authorisation with a new authorisation, if the proposed variation is more than minor; or
- iii That the authorisation be revoked.

#### **Hypothetical long term contract**

- Firm A intends to construct a gas pipeline to the premises of a major industrial user. There are no other major customers on or near the route of the proposed pipeline.
- The payback period is 15 years. A long term take-or-pay contract is needed to justify making the investment.
- Firm A decides not to seek authorisation because of the risk that the Commission could withdraw it under subsection (b) before the payback point has been reached.
- Firm A decides not to build the pipeline.

## **Analysis**

### *The quality of outcomes*

131 The main trade off is between the benefits to the economy of encouraging a greater amount of efficient conduct from the outset against the risk to the economy that approved conduct could later become inefficient due to a material change in circumstances.

132 The kiwifruit authorisation could be used to support or oppose the subsection (b) power. On one hand, it demonstrates how quickly market circumstances can change, especially when the government uses statutory powers to reshape a market. On the other hand, it would not have mattered if the authorisation had continued for the second season. It had fallen into disuse.

133 The kiwifruit decision also highlights the fact that the Commission has the ability to guard against risks by imposing time limits and other conditions on an authorisation. Therefore, it can be argued that there would be no great harm if subsection (b) were repealed. However, it can also be argued that it might encourage the Commission to impose a wider range of conditions to guard against the possibility of unknown adverse future events.

134 It could also be argued that the circumstances associated with our hypothetical example or something similar would be so rare that there is unlikely to be a real problem. An alternative view is that even if it is a rare situation, the adverse impact of infrastructure deficits on the economy can be very high. Therefore, it is essential to acknowledge the risk.

135 It can also be argued that there are parallels between trade practices and mergers. The Commission does not have the power to require a firm to de-merge in the event of a material change of circumstances. The Commission makes a decision based on the best information available to it at the time even though circumstances might change for the worse later on. However, it could also be argued that the risks of an adverse material change are much lower for mergers.

#### *Opportunity for effective participation*

136 If the Commission is to lose the power to act on its own motion under section 65(1)(b) then there is a strong case for modifying the power rather than removing it. It is important to provide the applicant with the flexibility to apply for a revocation, replacement or variation, with the Commission considering the application on public benefit grounds. We also consider that minor variations should be able to be sought.<sup>52</sup>

### **Conclusions**

137 In our view *ex ante* business certainty is the issue that needs to be given the greatest weighting. In some authorisation cases subsection (b) will not be a major issue for the parties to the application. However, it may be an issue in other cases, especially where a long term contract is at the heart of an application. The risks of losing the authorisation under subsection (b) due to events that could not have been anticipated at the time an authorisation was granted may be enough to discourage parties from giving effect to the conduct in the first place.

138 Our preliminary view is that the Commission should not have the power to vary, replace or revoke an authorisation on its own motion under subsection (b). However, the original applicant should be able to apply for a revocation, replacement or variations, including minor variations.

#### **Question**

Q15 Should the Commission's power to vary, replace or revoke an authorisation if there has been a material change of circumstances (i.e. section 65(1)(b)) be (i) retained, (ii) repealed or (iii) replaced by a provision that allows the original applicant to ask the Commission to vary, replace or revoke an authorisation?

### **ISSUE J: HALTING CONDUCT WHILE THE COMMISSION IS CONSIDERING AN AUTHORISATION APPLICATION**

#### **Background**

139 Section 59A(1) allows the Commission to grant authorisations to parties who have already entered into agreements. This provision recognises that markets can change and that conduct which may not have breached the Act when first entered into

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<sup>52</sup> Section 91A of the Australian Trade Practices Act illustrates this approach.

may subsequently fall afoul of the Act. Section 59A(2) requires all of the parties to the agreement to discontinue giving effect to the provision of the contract in question until the authorisation is granted. Section 59A(3) empowers the Commission to waive this requirement if stopping the conduct would be likely to result in exceptional hardship to any of the parties.

## **The issues**

140 A purpose of subsection (2) is to protect consumers from the damage of anticompetitive behaviour. Another purpose is to encourage parties to apply for an authorisation before entering into an arrangement that may breach the Act. However, section 59B has the same purpose. It states that an authorisation does not provide retrospective immunity from Part 2 of the Act. Therefore, it is questionable whether section 59A(2) is needed. In addition, there are some potentially more serious problems:

- The requirement to stop giving effect to the conduct may be discouraging parties from seeking authorisation. If the cost of stopping the conduct is significant but does not meet the very high “exceptional hardship” test, then the parties might prefer to keep their heads down and risk being investigated than seek an authorisation;
- Section 59A(2) could be used for strategic purposes because all parties must stop giving effect to the conduct. A party to the conduct who does not like the agreement could force a temporary halt by submitting an application for a variation or revocation; and
- It is unclear what the legal consequences are if the parties do not stop giving effect to the agreement. For example, it is unclear whether the Commission would be able to decline the application if the parties to the arrangement refused to comply with section 59A(2).

## **Options**

141 The alternatives to the status quo are:

- a To repeal section 59A(2) – Applicants would not be required to stop giving effect to the relevant provisions while an application is being considered;
- b To replace section 59A(2) with a provision that gives the Commission the discretion to order that the conduct be stopped while the application is being considered; and
- c To lower the “exceptional hardship” test in section 59A(3).

## **Analysis**

### *The quality of outcomes*

142 Our view is that section 59B provides sufficient incentives to discourage parties from engaging in anticompetitive conduct and that section 59A(2) does not contribute anything extra in that regard. In addition there may be occasions where halting the

conduct could harm consumers. Given the other potential detriments outlined above, we do not favour the status quo or Option (c). The choice is between Options (a) and (b). An advantage of option (b) over option (a) is that it provides the flexibility of an additional safeguard against anticompetitive behaviour if necessary.

### *Transparency, predictability and gaming the legal system*

143 The main argument for Option (a) is that it provides greater legal certainty to the applicants and may provide better incentives to applicants to apply for an authorisation where they have a good case. On the other hand, it may be appropriate for the Commission to order a halt to the conduct in question if it considers that there would be a significant risk of irreparable harm to consumers.

## **Conclusions**

144 We consider that there is a need for change. Our preliminary view is that Option (a) is too inflexible. The Commission should have the discretion to require conduct to be halted while it is considering the application and therefore option (b) is preferred.

### **Questions**

Q16 Should the mandatory requirement to halt the conduct while the Commission is considering an application for authorisation (i.e. section 59A(2)) be retained or removed?

Q17 If the mandatory requirement to halt the conduct is to be removed, do you consider that it would be better to repeal section 59A(2) or replace it with a provision that provides the Commission with the discretion to require that the conduct be halted?

## **ISSUE K: CONFERENCE PROCEDURES**

### **Background**

145 The Act provides for Commission conferences to be held in relation to clearance and authorisation applications. The relevant provisions are as follows:

- Section 64, which describes the procedures for conferences;
- Section 62, which relates to restrictive trade practice authorisation applications; and
- Section 69B, which relates to merger clearance and authorisation applications.

146 Sections 62(6) and 69B(1) allow the Commission to call a conference of its own motion. Sections 62(3)-(5) allow the applicant or any other person who has been sent the draft determination to require the Commission to hold a conference, but only in relation to trade practice authorisation applications.

147 The main purpose of a conference is to provide the Commission with an effective means for obtaining information that will help it make a high quality decision. To this

end, section 64(3) states that the Commission shall provide for as little formality and technicality as the requirements of the Act and a proper consideration of the application permits. This provision is aimed at ensuring that the Commission can make good use of the time available by avoiding the adversarial processes that are generally associated with more formal hearings and focusing conferences on the competition and public benefit issues.

## **The issues**

148 There are two issues, both of which relate only to the trade practices authorisation process. One is whether the applicant and/or third parties should be able to require the Commission to hold a conference. This issue needs to be assessed conceptually because there have been no cases where this has happened. The other issue relates to whether the timeframes that are specified for two of the steps of the restrictive trade practice authorisation system are useful.

### **ISSUE K1: THE RIGHT OF THE APPLICANT AND SPECIFIED THIRD PARTIES TO CALL FOR A CONFERENCE**

#### **Options**

149 Other than the status quo, three options are:

- a To limit the right to call a conference to the Commission;
- b To limit conference rights to the Commission and the applicant; and
- c To allow the applicant and/or a person to whom the draft determination has been sent to ask the Commission to call a conference, but leave it to the Commission to decide.

#### **Analysis**

##### *The quality of outcomes, timeliness and gaming the legal system*

150 As already stated, the main purpose of the conference is for the Commission to gather information that will help it make a high quality decision. If the Commission does not think that a conference would be helpful, then holding one would merely seem to delay a decision.

##### *The opportunity for effective participation by interested parties*

151 The case for allowing the applicant to require a conference is stronger than the case for third parties because he or she will have a greater interest in the outcome. In addition, an applicant is very unlikely to have an incentive to delay the process.

152 Compared to the status quo, Options (a)-(c) would all reduce the number of opportunities for parties with an interest in the restrictive trade practice to participate by one. However, the key issue is whether interested parties have the opportunity to participate in a meaningful way, not the number of opportunities to participate. We consider that this is the case. Consultation with the applicant, competitors, customers

and suppliers is an essential part of the Commission's analysis of a trade practice authorisation application.

153 An argument for Option (c) is that it would ensure that interested parties could ask for a conference to be held. However, our view is that such a provision would make no difference in practice. The applicant and third parties could suggest that a conference be held even if there were no explicit provision in the Act to that effect.

#### *Clear and consistent legislation*

154 There is a contrast between restrictive trade practice and merger authorisation provisions insofar as they relate to conferences. For mergers, the Act provides the Commission full discretion as to whether to hold a conference. The only explanation we can think of to justify the distinction is that there may be a greater likelihood that time will be of the essence in relation to a merger application. However, we do not consider that to be a particularly good explanation. Timeliness can also be an issue in relation to restrictive trade practice authorisation applications. Our view is that the provisions should be fully consistent.

#### **Conclusion**

155 The status quo has not been a problem to date. However, we do not think that the relevant provisions are conceptually sound and it would not do any harm to remove them. We tend towards the view that decisions about whether to hold a conference should be the Commission's alone.

#### **Questions**

Q18 Should the applicant and/or any third parties have the power to require the Commission to hold a conference or should the decision be the Commission's alone?

Q19 Assuming the applicants and/or third parties were no longer able to require the Commission to call a conference, should the Act specify that they may request the Commission to hold a conference or does it go without saying?

### **ISSUE K2: THE TIMEFRAMES FOR RESTRICTIVE TRADE PRACTICE AUTHORISATIONS**

#### **Background**

156 Section 62 outlines the following process for conferences in relation to restrictive trade practice authorisation applications:

- a The Commission prepares a draft determination and a summary of the reasons and sends them to the applicant and various third parties;
- b The recipients of the draft determination are required to notify the Commission within 10 working days of a date fixed by the Commission (not being a date earlier than the day on which the draft determination is

sent) if they require a conference to be held. The Commission can also decide to hold a conference of its own motion; and

- c If a conference is to be held, the Commission must appoint a date for the conference and that date must be within 20 working days of the expiry of the 10 working day period referred to in (b).

### **The issue and option**

157 The issue is whether the timeframes serve any purpose or are unduly rigid.

### **Analysis**

#### *Clear and consistent legislation*

158 There are timing inconsistencies between the merger and restrictive trade practices authorisation processes:

- The merger process has an overall timeframe of 60 working days or such longer period agreed between the Commission and the applicant. There is no overall timeframe for restrictive trade practices. However, targets are included in the annual statement of intent between the Responsible Minister and the Commission. Those targets are the same for mergers and trade practices; and
- There are no time limits on any components of the merger process.

159 The lack of consistency on timeframe issues can be a problem where an application or two or more related applications have both Part 2 and 3 implications. The Commission has advised us that this was an issue in relation to the Air New Zealand/Qantas strategic alliance authorisation application. The differences made it difficult to operate the merger and restrictive trade practice procedures in parallel.

160 A final legal consistency issue is that there is a minimum of prescription of processes under Part 5. The time restrictions on two components of the trade practices authorisation process are inconsistent with that broader philosophy.

#### *Timeliness*

161 Having time limits on two parts of the process but not the process as a whole does not, in our view, contribute to timely decision making.

### **Conclusion**

162 Our preliminary view is that the 10 and 20 working day requirements are arbitrary, unnecessary and, at times, impractical. It should be left to the Commission to decide on the timing of specific parts of the restrictive trade practice authorisation process as it sees fit. The same should apply if a trade practices clearance system were to be introduced.

**Question**

Q20 Should the statutory time limits in section 62 be retained or removed?

# Issues L to N: Joint Legal Process Issues

## ISSUE L: THE RIGHT TO APPEAL COMMISSION DETERMINATIONS

### Background

163 The Commission is both an enforcement agency and a quasi-judicial body. It is held accountable in different ways depending on which of those roles it is performing. The Commission is accountable by way of judicial review and appeal to the High Court (and subsequently to the Court of Appeal) when it is performing a quasi-judicial function.

164 Section 92(a) states that trade practice authorisation decisions can be appealed by the applicant or any person who participated in a Commission conference. Section 92(c) provides appeal rights for three groups of persons in relation to merger clearances or authorisations: the applicant, any person whose shares or assets would be acquired and any person who participated in a Commission conference.

### The issue

165 The provisions in sections 92(a) and (c) that provide appeal rights to anyone who participated in a conference appears to be an arbitrary rule. This may cause excessive uncertainty for the applicant. It may also discourage the Commission from calling conferences when it could be helpful to do so.

### Options

166 It is clear that the following parties should have appeal rights:

- The applicant in relation to all classes of applications, including those who apply for clearances of trade practices, should such a system be introduced; and
- A person whose shares or assets are to be acquired in relation to a merger application.

167 Third parties with a material interest in the outcome should at least be entitled to seek leave of the High Court to appeal. Therefore, the options are limited to considering the statutory test that the courts would apply. Two options are:

- a A general test – A third party would be allowed to appeal if the High Court thought fit;
- b A more specific test – A third party would be able to appeal if it has demonstrated that it has a material interest. An example is the “sufficient interest” criterion in section 47(3) of the United Kingdom Competition Act 1998.

## Analysis

168 In our view the outcomes would probably be the same under either option. However, it could be argued that Option (b) would provide greater legal certainty for third parties.

## Conclusions

169 We consider that the linkage between participation at a conference and third party appeal rights is arbitrary and should be replaced. However, we have not formed a view on the test that should be applied by the Court.

### Questions

- Q21 Should appeal rights for persons who participate in Commission conferences be retained or replaced?
- Q22 Assuming that the High Court will be given the discretion to decide whether a third party may appeal, what criterion or criteria should appear in the Act?

## ISSUE M: A POSSIBLE SPECIALIST COMPETITION TRIBUNAL

### Background

170 The application of competition law can involve complex analysis often based on economic concepts which are subject to considerable debate between experts. The degree of specialist expertise required explains why the Act allows the Court to sit with one or more expert lay members in some types of cases. The statutory provisions relating to the cases and whether lay members take part fall into three categories:

- a At least one lay member is required if the case is an appeal against a restrictive trade practices authorisation decision or a merger clearance or authorisation decision by the Commission;<sup>53</sup>
- b The judge has the discretion to appoint one or more lay members in cases involving alleged contraventions of the substantive prohibitions in Parts 2 and 3; and
- c Lay members may not participate in cases involving procedure, orders that are not opposed, where the parties agree that the matter should be heard by a judge alone, proceedings where the issue is substantially a question of law only and when the Court is deciding whether to allow an appeal to the Court of Appeal.

171 The lay member concept is unusual in competition law jurisdictions. This option is not available in Australia and some other jurisdictions for constitutional reasons.

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<sup>53</sup> The same would apply if a trade practices clearance system were to be introduced.

Australia has, instead, established a specialist tribunal, the Australian Competition Tribunal. Some other countries also have specialist competition tribunals.

## **The issue and option**

172 The issue to consider is whether the lay member approach works sufficiently well, or whether a specialist tribunal could provide higher quality outcomes in a cost effective manner.

173 A low cost way of establishing a tribunal would be to limit the hearing of Commerce Act cases to a small pool of High Court Judges (along with lay members) who have experience in the area. The tribunal would effectively operate in the same way as the High Court in all other respects. The tribunal would consider all cases that are or would otherwise become the responsibility of the High Court due to other changes that may be implemented as a result of this review. As is the case with the High Court at present, appeals against decisions of the tribunal would be considered by the Court of Appeal.

## **Analysis**

### *Quality of outcomes*

174 There would be no point in establishing a specialist tribunal unless there were good reasons to expect that it would lead to a noticeable improvement in the quality of decisions. We have not received any information to date to suggest the current approach fails to adequately deal with the complexity of cases brought before the Court. Hence there is no apparent need for change should the range of cases that can come before the Court remain unchanged or be modified in a minor way only.

175 However, this issue needs to be considered in the context of possible changes that could arise from the other half of this review of the Act (i.e. the Review of Parts 4 and 4A). At present, the Commission's regulatory control decisions made under section 70 can only be appealed on matters of law. In the discussion document we released on Parts 4 and 4A in April 2007, we canvassed the possibility of introducing merits review of regulatory control decisions made by the Commission.<sup>54</sup> We stated that a specialist tribunal may be more appropriate.<sup>55</sup>

176 From the appellant body's perspective merger and trade practice cases are likely to be less complex because they are usually yes/no decisions. The appellant body will need to decide whether to uphold or reverse the decision made by the Commission. By contrast, merits review of decisions made under section 70 will require the appellant body to determine the position that a controlled firm shall be placed on a spectrum of almost infinite possibilities. The appellant body might need to consider such things as the firm's weighted average cost of capital, how to allocate common costs, product and service quality standards and how to split efficiency gains between the regulated firm and the consumer. In our view there are stronger arguments for a specialist tribunal from a quality of outcomes perspective if merits review of the Commission's regulatory control decisions were to be allowed.

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<sup>54</sup> Ministry of Economic Development, *Review of [the] Regulatory Control Provisions under the Commerce Act 1986*, April 2007, Chapter 12.

<sup>55</sup> *ib id*, para 241.

### *Cost effectiveness*

177 The fixed cost of having additional bodies is proportionately higher in small countries like New Zealand. There are only a small number of Commerce Act court cases each year and it may not be cost effective to establish a specialist tribunal even if merits review of section 70 decisions were to be allowed. However, the cost in this case would be minimised because the tribunal would be the High Court with a minimum of modifications.

### *Timeliness*

178 A tribunal comprising a small pool of judges could lead to delays in hearing cases. Other commitments may mean that no judge would be available to hear a case in a timely fashion. This could be particularly unfortunate for appeals against merger decisions, because time is often of the essence. There also may be occasions when the tribunal is fully committed to other cases.

### *Consistent legislation*

179 The general principle applied by the Ministry of Justice is that there must be compelling reasons to depart from the general court system. This policy is aimed at avoiding having a fragmented, complex and costly judicial system. We consider that this test would not be met if the range of matters heard by judges and lay members together were to remain unchanged. The case would be stronger if merits review of regulatory control decisions were to be introduced. However, it is unclear whether the “compelling reasons” test would be met.

## **Conclusion**

180 Our preliminary view is that there is no case for creating a specialist tribunal if the scope of appeals were to remain unchanged. The arguments would be better if there were to be a broadened right of appeal in relation to regulatory control decisions made by the Commission under sections 70-74. However, it is not clear whether those arguments would be strong enough.

### **Question**

Q23 Do you consider that a specialist competition tribunal should be established? Does your answer depend on whether there is to be appeals on the merit against regulatory control decisions by the Commerce Commission?

## **ISSUE N: WIDER USE OF LAY MEMBERS**

### **The issue and option**

181 As noted in relation to Issue M, the High Court may not appoint lay members in certain cases. However, in *Powerco Ltd v Commerce Commission* (HC Wellington, CIV 2005 485 1066, 9 June 2006 at para 25) Justice Wild stated, in the context of an interlocutory matter prior to a judicial review hearing, that as part of the review of Parts

4 and 5 he hoped consideration could be given to the Court being able to equip itself with expert lay member assistance whenever it had to consider the merits of a report by the Commission.

### **Analysis**

182 The *Powerco* decision is a clear indication that the Court would find it helpful to have the discretion to appoint lay members in the circumstances described. We can not think of any disadvantages.

### **Conclusion**

183 We agree with the High Court's suggestion.

#### **Questions**

- Q24 Should the High Court (or a replacement tribunal) have the discretion to appoint lay members in any proceeding where it is required to consider the merits of a report by the Commission?
- Q25 Are there other circumstances in which there should be wider discretion for judges to appoint lay members?

## Issues O to S: The Framework for Assessing Costs and Benefits

184 Competition law is underpinned by the presumption that economic efficiency will be promoted if competition is workable or effective. However, occasionally this may not be true. The public benefit test allows a merger or practice to be approved even if it would otherwise contravene Part 2 or 3 of the Act. Although the Act leaves open the possibility of considering anything that is of value to New Zealand society, it is well established that the public benefit test is primarily an efficiency exception. That exception allows the presumption that competition is a good proxy for efficiency to be overturned based on an analysis of the circumstances relating to the application in question.

185 The statutory framework for considering applications for clearance and authorisation applications is as follows:

- a Merger Clearances – Under section 66(3), the Commission is required to assess whether the proposed merger will or is likely to substantially lessen competition; and
- b Merger Authorisations – Under section 67(3), the Commission is required to carry out the same analysis as for merger clearances. If it concludes that the merger is likely to substantially lessen competition then it must assess whether the merger will result or be likely to result in a benefit to the public such that it should be permitted.
- c Restrictive Trade Practice Authorisations – Under section 61(6)-(8), the Commission is required to apply the public benefit test discussed in relation to merger authorisation applications.<sup>56</sup>

186 Part 5 broadly empowers the Commission to carry out these roles. It does not specify analytical techniques and keeps the prescription of processes to a minimum. Five issues have been brought to our attention about the frameworks used by the Commission for assessing costs and benefits. These issues are discussed below.

### ISSUE O: THE ASSESSMENT OF EFFICIENCY GAINS AND LOSSES

#### Background

187 The Commission assesses efficiency gains and losses by defining a factual and counterfactual, comparing the outcomes and attributing the difference to the merger.<sup>57</sup> The factual and counterfactual are both forward-looking hypothetical situations. The factual is the situation with the merger. The counterfactual is the situation without the merger.

188 Establishing a counterfactual is a critical step for the subsequent analysis because it forms the benchmark against which any changes arising from the proposed

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<sup>56</sup> There are differences in the way that the public benefit analysis is described, but they are the same in substance.

<sup>57</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004, p 21.

merger are to be measured. In framing a suitable counterfactual, the Commission states that it bases its views on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.<sup>58</sup>

189 The Commission's Merger Guidelines also state that the status quo cannot necessarily be assumed to continue in the absence of the merger, although that may often be the case. It may be, for example, that an acquisition is expected to extinguish the prospect for greater competition through the elimination of a vigorous recent entrant, or it may involve a business that would not otherwise continue in the market.

### The issue

190 The issue to consider is whether the analytical approach described above is well-targeted.

### The approach used in other jurisdictions

191 Other countries' merger guidelines tend to be less direct about the approach to be used in relation to the counterfactual. Nevertheless, the Commission's approach appears to be fully consistent with that of other competition authorities. The ACCC states that "where there is a reasonable likelihood that prices in the relevant market will be maintained at a significantly greater level than they would be in the absence of the merger, or where competitive outcomes would otherwise be distorted, the Commission will consider there to be a substantial lessening of competition."<sup>59</sup>

192 The Canadian Competition Bureau guidelines state that the "Bureau assesses whether any of the following alternatives to the merger exist and are likely to result in a materially greater level of competition than if the proposed merger proceeds."<sup>60</sup>

193 The UK Competition Commission states that in many cases the counterfactual will relate to "the existing, pre-merger, competitive conditions." The UK Commission also states that in certain circumstances it may need to take into account other factors, such as "expected changes in the structure of the market or alternative developments that may be expected in the absence of the merger."<sup>61</sup> When assessing merger efficiencies, the UK Office of Fair Trading states that "the key issue is that the analysis is incremental, so that efficiencies must be judged relative to what would have happened without the merger."<sup>62</sup>

### Question

Q26 To what extent does the Commission's analytical framework adequately take account of what would happen if the proposed merger or arrangement did not go ahead (the counterfactual)?

<sup>58</sup> ib id, quoting *Decision No 277: New Zealand Electricity Market*, 30 January 1996, especially p16.

<sup>59</sup> ACCC, *Merger Guidelines*, June 1999, Para 5.15.

<sup>60</sup> Competition Bureau, *Merger Enforcement Guidelines*, September 2004, para 9.7.

<sup>61</sup> Competition Commission, *Merger References: Competition Commission Guidelines*, June 2003, para 1.22.

<sup>62</sup> Office of Fair Trading, *Mergers: Substantive Assessment Guidance*, May 2003, para 4.34.

## **ISSUE P: THE TREATMENT OF INTERNATIONAL COMPETITIVENESS CLAIMS**

### **The issue**

194 The authorisation provisions would not be operating in a fully effective manner if some types of benefits to the economy could not be considered or given a sufficient weight under the public benefit test. It has been suggested to us that it would be useful to test with stakeholders whether international competitiveness claims are being given proper consideration. This issue can be crucial for small countries like New Zealand because the benefits of obtaining minimum efficient scale may be a crucial factor in determining whether New Zealand companies can participate in some industries. Those benefits need to be weighed against the costs to the economy associated with the possible loss of competition domestically. Like the benefits associated with achieving scale in a small economy, the risks of entrenching a monopoly for a longer period of time are also greater in a small economy because new entry is less likely.

### **Option**

195 If there is a problem, a possible solution would be to add a provision similar to section 90(9A) of the Australian Trade Practices Act which explicitly requires the ACCC to have regard to the following as public benefits:

- A significant increase in the real value of exports;
- A significant substitution of domestic products for imported goods; and
- All other matters that relate to the international competitiveness of any Australian industry.

### **Analysis**

196 An argument for inserting such a provision in the Act is that it should be as clear as possible that mergers which are likely to increase New Zealand's international competitiveness should be treated favourably. A contrary argument is that no specific types of benefit should be singled out for special attention. There is a risk that identifying particular types of benefits may encourage the Commission and courts to conclude that a dollar of benefit to the economy arising from those sources should be weighted more highly than a dollar of benefit from other sources.

### **Conclusion**

197 The main issue to consider is whether international competitiveness arguments can be and are being properly considered by the Commission under the public benefit framework provided by the authorisation provisions in the Act. We are seeking submissions on this matter.

#### **Question**

**Q27** Is the public benefit test sufficiently broad to take international competitiveness claims into consideration and give them sufficient weighting?

## **ISSUE Q: THE QUANTIFICATION OF COSTS AND BENEFITS**

### **Background**

198 In 1992, the Court of Appeal suggested that the Commission should quantify costs and benefits insofar as it is feasible.<sup>63</sup> The Commission has consistently done so since and its practice is to produce a range of numbers based on different assumptions. The main advantage of quantification is that it places greater discipline on the Commission to think carefully about its assumptions, which in turn means that there is greater transparency about those assumptions. In addition, quantification enables the Commission to value and explicitly compare disparate factors.

### **The issue**

199 A risk associated with quantification is that it can place too much emphasis on the things that are less important. Of the three types of efficiency (allocative, productive, dynamic), dynamic efficiency is by far the most important, because innovation drives most economic growth. However, dynamic efficiency is by far the hardest form of efficiency to measure. If quantification is relied upon too much then it may give a false sense of reliability and accuracy in relation to uncertain facts and conclusions. Disagreement over particular input values may prevail over the competition analysis. It may also be difficult to overturn a presumption for or against an authorisation application based on the quantifiable gains and losses. The need to quantify benefits can also be relatively expensive and time consuming for applicants as compared to a qualitative approach.

200 The issue that we wish to test with stakeholders is whether the Commission has the scope to exercise judgments in relation to dynamic efficiency factors along with other costs and benefits that are not easily quantified.

### **Question**

Q28 Does quantification restrict the consideration of dynamic or other difficult to measure economic effects?

## **ISSUE R: TIMEFRAMES OVER WHICH COSTS AND BENEFITS ARE ASSESSED**

### **The issue**

201 The Commission usually assesses the benefits and detriments of an authorisation application looking forward no more than two to five years. This reflects the fact that there is a trade off between the length of time over which detriments and benefits are assessed and the likely reliability or accuracy of the costs and benefits. It is clear that some experts consider that rigorously incorporating dynamic efficiencies in

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<sup>63</sup> Telecom Corporation of New Zealand Ltd v Commerce Commission (1992) 3 NZLR 429 at 447.

a trade off analysis is beyond the capabilities of known techniques.<sup>64</sup> The risk is that the Commission would simply be guessing if its timeframes were to be longer.

202 Nevertheless, there is a question about whether the Commission's timeframes are sufficiently long to take dynamic efficiency into account. The broad consensus reached in recent literature surveys does not support the Schumpeterian hypothesis that big monopolistic corporations are particularly more active in innovation.<sup>65</sup> Some of that research indicates that innovation levels are lower in markets that have very little competition or very intense competition. Oligopolistic firms have the strongest incentives to innovate because they have the best opportunities to earn post-innovation rents by "escaping the competition".<sup>66</sup>

203 If these types of views are accurate then it would seem to be reasonable to presume that the innovation objective will usually be achieved even if the Commission's focus continues to be on the short and medium term costs and benefits, provided there is the flexibility for the Commission to consider any reliable evidence of longer term dynamic effects.

#### Question

Q29 Are the timeframes over which costs and benefits are assessed appropriate?

### ISSUE S: MARKET DEFINITION

#### Background

204 A market should be defined by identifying which products are sufficiently good demand substitutes for the product in question to be regarded as being in the same market. The feasibility of substitution is also the crucial question in the other elements of market definition such as the geographic dimension.

205 The Commission defines a market to include all suppliers and buyers between which there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce those goods or services.<sup>67</sup> The Commission uses the internationally accepted 'small but significant and non-transitory increase in price' (SSNIP) test. The Commission tests buyer and supplier reactions to a given price increase (usually 5-10 percent sustained for a year),

<sup>64</sup> Gerard Damien, *Merger Control Policy: How to Give Meaningful Consideration to Efficiency Claims?* 40 Common Market Law Review 1367 (2003).

<sup>65</sup> Sanghoon Ahn, *Competition, Innovation and Productivity Growth: A Review of Theory and Evidence*, OECD, Economics Department Working Papers NO 317, 2002, pp 14-15; G. Symeonidis, *Innovation, Firm Size, and Market Structure: Schumpeterian Hypotheses and Some New Themes*, OECD Economic Studies, No. 27, 1996/II, pp35-70; F.M. Scherer, *Schumpeter and Plausible Capitalism*, *Journal of Economic Literature*, Vol 30, 1992, pp 1416-33; and Philippe Aghion & Rachel Griffith, *Competition and Growth: Reconciling Theory and Evidence*, 2005, Section 1.2, Massachusetts Institute of Technology.

<sup>66</sup> ib id, Aghion & Griffith, p 85.

<sup>67</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, 2004, p 14.

when all other prices remain constant, in a hypothetical exercise, which assumes the creation of a total monopoly. The smallest space in which such market power may be exercised is then defined.

206 That said, this is not the full extent of the analysis that the Commission carries out when defining markets. Section 3(1A) requires the Commission to define a market to “include other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.” Hence, the Commission needs to do a reality check. We are seeking stakeholders’ views on whether the Commission’s approach, including using the SSNIP test is sufficiently flexible.

**Question**

Q30 Is the approach used to define markets appropriate?

## **Appendix A: Diagrammatic Representations of Actual and Possible Commerce Act Processes**

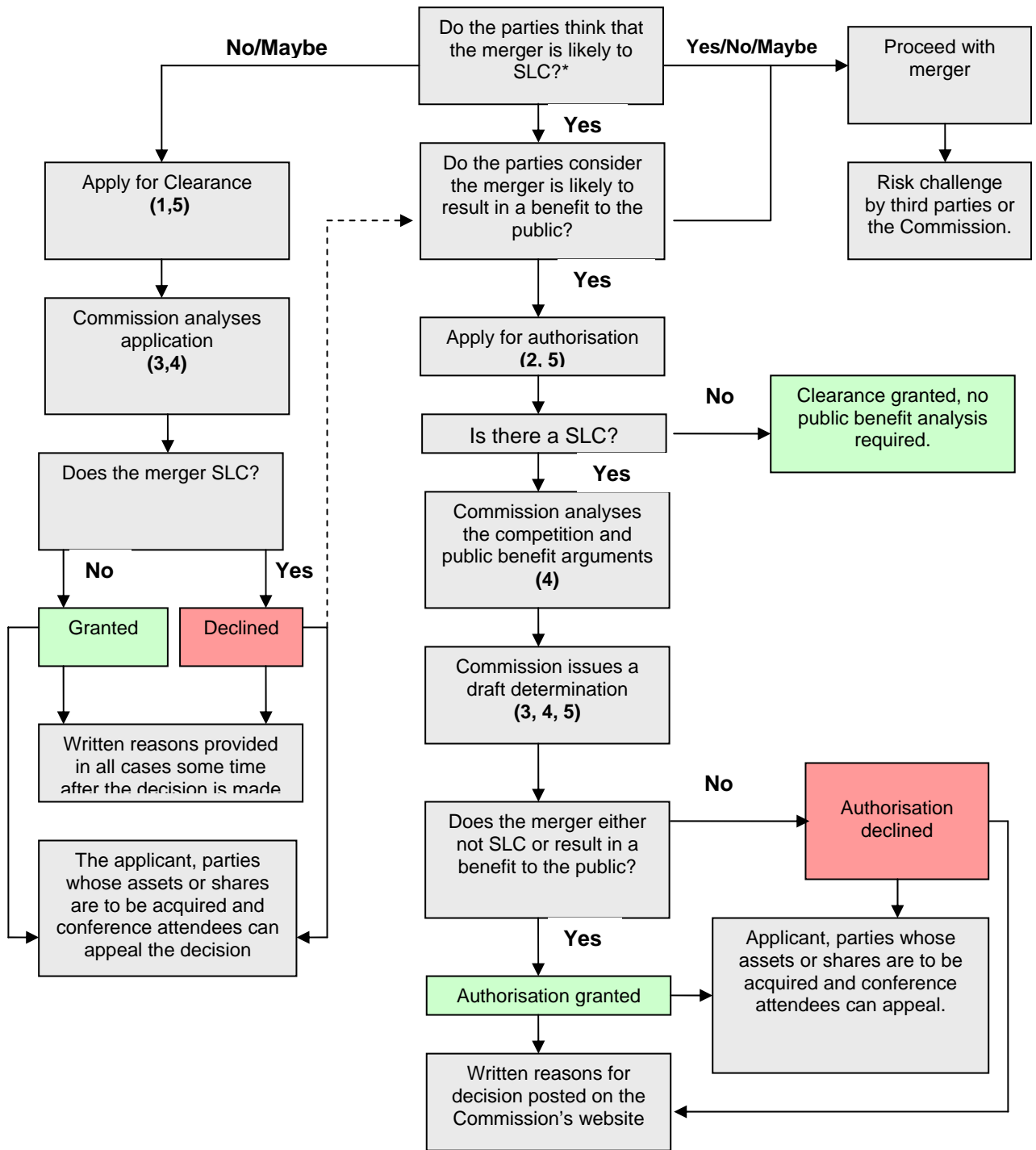
Diagram One: Processes for Merger Clearance and Authorisation

Diagram Two: Processes for Restrictive Trade Practices Authorisation and Proposed Clearance

Diagram Three: Assessment Process for Australian Informal Merger Reviews

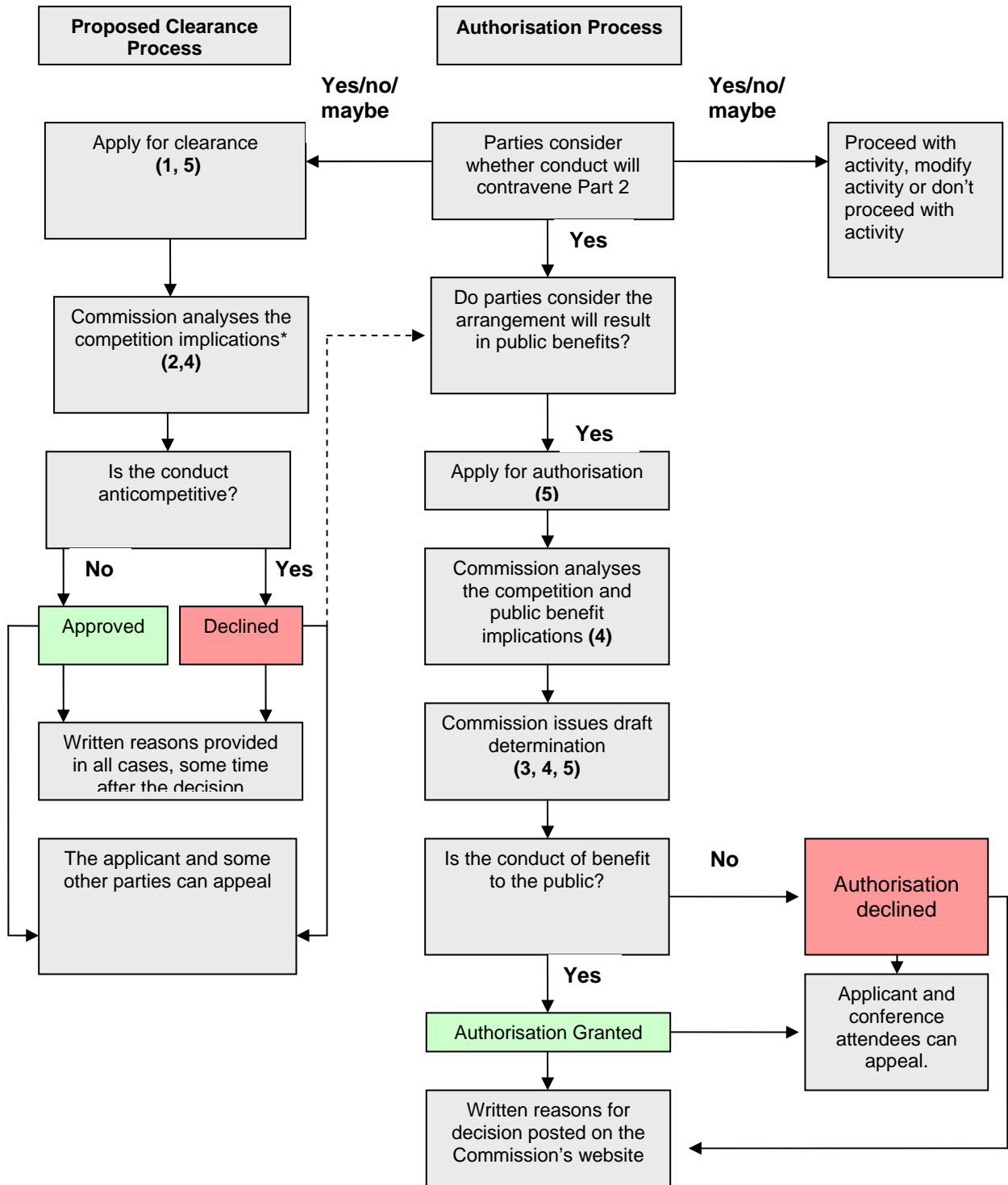
Diagram Four: The Australian Collective Bargaining Notification Process

## Diagram One: Processes for Merger Clearance and Authorisation



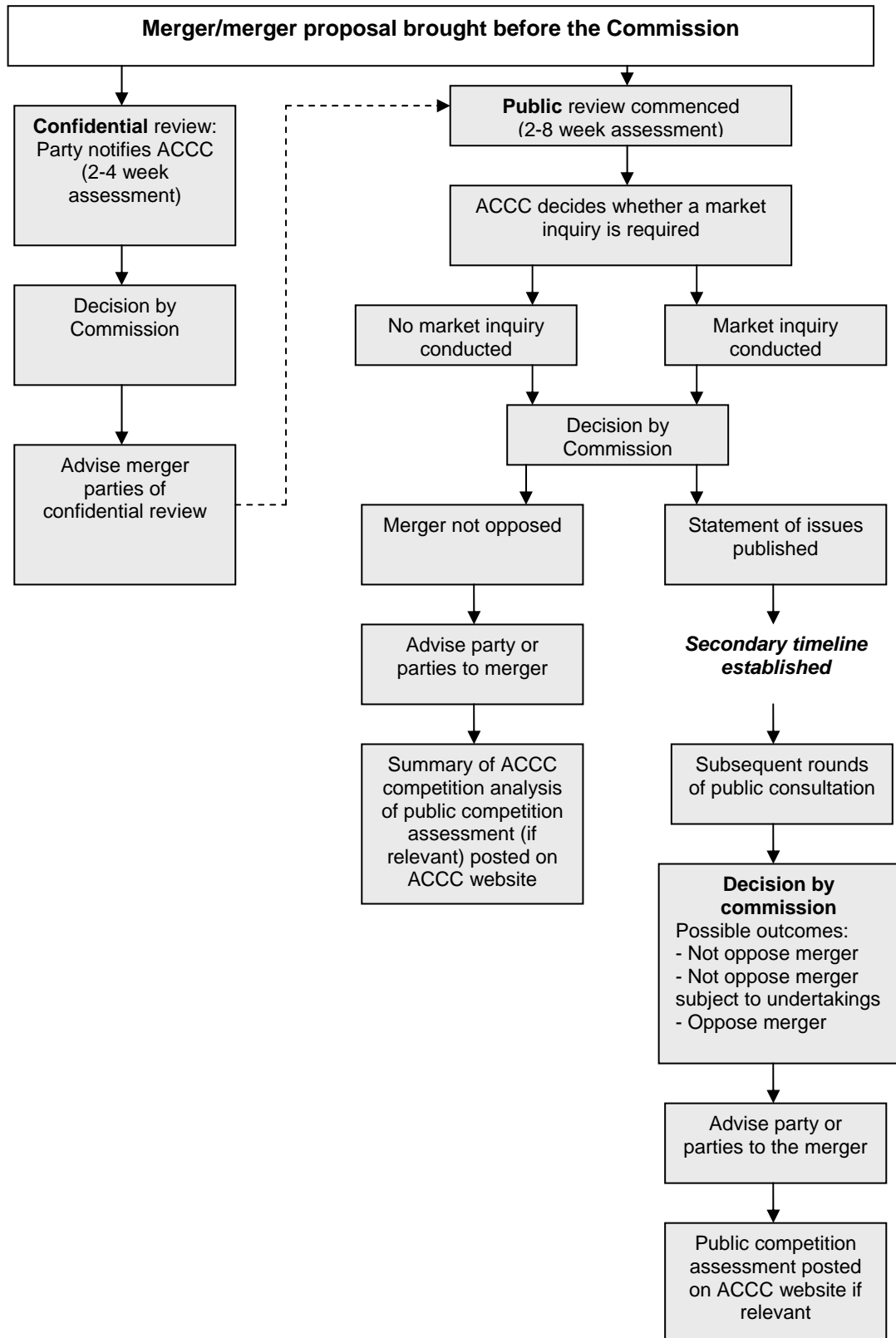
1. Statutory timeframe of 10 working days. Can be extended
  2. Statutory timeframe of 60 working days. Can be extended
  3. Conference if called by the Commission (unlikely)
  4. Obtain from interested parties
  5. Undertakings may be offered
- \* Substantial Lessening of Competition  
 ---- The applicant can apply for an authorisation

**Diagram Two: Processes for Restrictive Trade Practices**



1. Statutory timeframe of 30 working days. Could be extended
  2. Conference if called by the Commission
  3. Conference may be called by Commission or recipients of draft determination
  4. Obtain information from interested parties
  5. Undertakings can be offered
- \* Substantial Lessening of Competition

### Diagram Three: Assessment Process for Australian Informal Merger Reviews

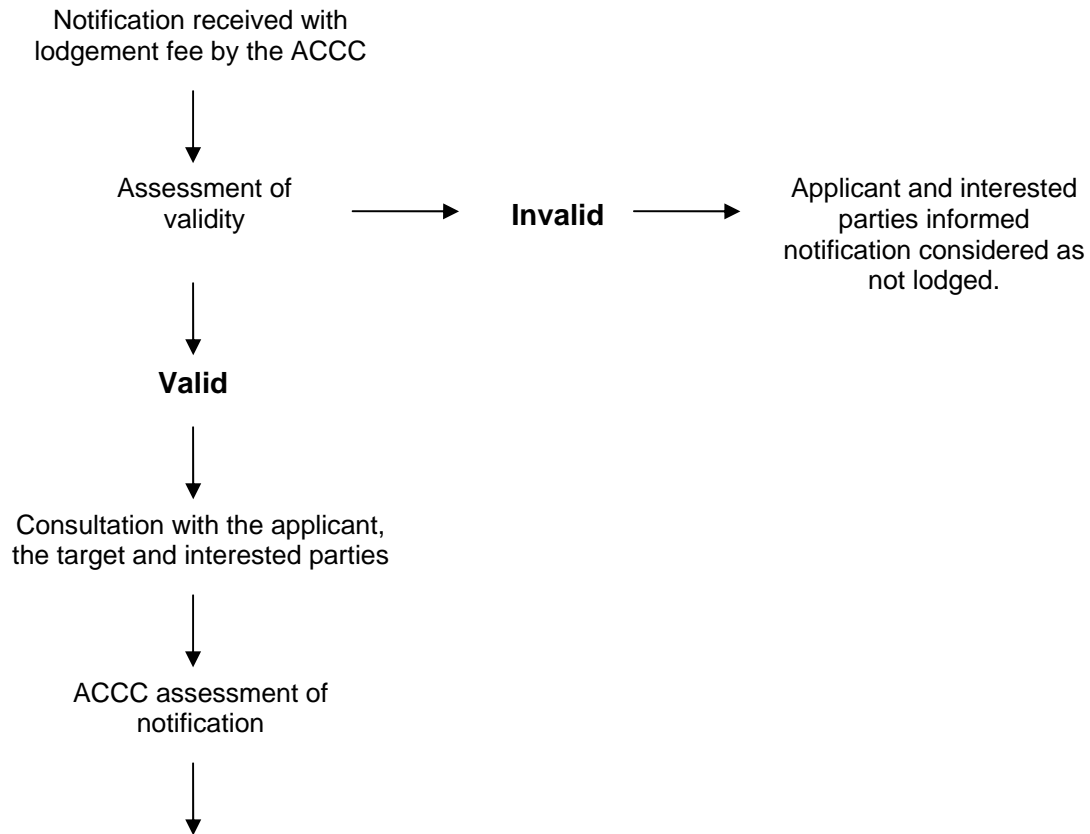


## Diagram 4: Australian Collective Bargaining Agreement Notification Process

Preliminary discussions with ACCC

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### Day 1-5



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### Day 14(28)

When ACCC has not issued draft objection notice in 14(28) days, protection from legal action is automatically provided by the notification.

## **Appendix B: Enforcement of Undertakings**

### **The Securities Act 1978**

Section 69J of the Securities Act 1978 allows the Securities Commission to accept undertakings and allows a person to withdraw or vary an undertaking with the consent of the Commission. Section 69K(2) states that the Commission may apply to the High Court for an order if it considers that a person has breached a section 69J undertaking. The Court may make any of the following orders:

- a An order directing the person to comply with that term;
- b An order directing the person to pay the Crown an amount not exceeding the amount of any financial benefit that the person has obtained directly or indirectly and it can be reasonably attributable to the breach;
- c Any order that the Court thinks appropriate directing the person to compensate any other person who has suffered loss, injury, or damage as a result of the breach;
- d An order for consequential relief that the Court thinks appropriate.

### **The Australian Trade Practices Act 1974**

Section 87B allows the ACCC to apply for any of the following orders:

- a An order directing the person to comply with that term of the undertaking;
- b An order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach;
- c Any order that the Court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach;
- d Any other order that the Court considers appropriate.