

The Chair
CABINET ECONOMIC DEVELOPMENT COMMITTEE

**REVIEW OF THE CLEARANCE AND AUTHORISATION PROVISIONS UNDER THE
COMMERCE ACT 1986**

PROPOSAL

- 1 This paper seeks approval to progress certain issues identified as part of the Review of the Clearance and Authorisation Provisions under the Commerce Act 1986 through the Regulatory Improvement Omnibus Bill.

EXECUTIVE SUMMARY

- 2 On 22 May 2006 the Minister of Commerce announced that the clearance and authorisation provisions under part 5 of the Commerce Act will be reviewed. The overall objective of the Review is to ensure that these provisions are operating as efficiently and effectively as possible.
- 3 The Review of the Clearance and Authorisation Provisions under the Commerce Act 1986 ('Part 5') is being done in tandem with the Review of the Regulatory Control Provisions of the Commerce Act 1986 ('Parts 4 and 4A'). Final policy proposals on Parts 4 and 4A are to be delivered to Cabinet in October 2007 and final policy proposals on Part 5 are due in November 2007.
- 4 Submissions on the review of Part 5 indicate that while there are some administrative and low level policy issues that can be progressed quickly, there are several issues that are more contentious than originally envisaged and require additional time to develop robust policy proposals. The main areas requiring further research, consultation and analysis relate to collective bargaining by small businesses, whether a clearance system for trade practices is needed more generally and the linkages between these two issues. This combined with a lack of detailed information and clarity from the submissions as to the existence and extent of the problem means that the original timeframe of November 2007, for delivery of policy proposals around Part 5, cannot be met.
- 5 Thus, it is proposed to separate the review of Part 5 into two stages, with the uncontroversial policy proposals within the review being addressed this year through the Regulatory Improvement Omnibus Bill, and final policy proposals on the outstanding issues being delivered by 30 June 2008.
- 6 Three amendments to the Commerce Act 1986 have been identified for inclusion in the Regulatory Improvement Omnibus Bill. These are:
 - Providing for the effective enforcement of undertakings that have been approved as part of a merger clearance or authorisation decision;

- Allowing the Commission to approve variations to undertakings;
 - Removing the 20 day statutory timeframe for holding conferences for restrictive trade practice authorisation proceedings.
- 7 A further issue, whether the court cases in which lay members can be appointed should be widened, has also been analysed within this review, with the conclusion that the current provisions remain the most suitable and appropriate.

BACKGROUND

- 8 In 2006, a comprehensive review of Parts 4, 4A and 5 of the Commerce Act was announced. The review was split into two streams, but with the intention that both streams would be carried out concurrently. The first stream is the Review of the Regulatory Control Provisions of the Commerce Act 1986. Final policy decisions that have come out of this stream of the review are due by October 2007. The second stream is the Review of the Clearance and Authorisation Provisions under the Commerce Act 1986. Final policy proposals on the Part 5 review are due in November 2007 [EDC Min(07)10/5].
- 9 It is generally accepted that New Zealand's clearance and authorisation processes are of a high standard. Thus, the aim of the review of Part 5 is to draw on the experiences of regulators and practitioners to further improve these processes. In particular, the review is looking to ensure that the application of the Act achieves an appropriate degree of accountability and transparency of decision making, participation by interested parties, analytical rigour, due process, and timeliness of decision making.
- 10 A discussion document on the Part 5 review was released in May 2007 and 33 submissions were received by the Ministry of Economic Development. It has become clear that, while there are some administrative and low level policy issues that can be progressed quickly, there are several issues that are more contentious and require more time to develop robust policy proposals for the more contentious issues. These include the possibility of introducing a collective bargaining notification system and/or a trade practice clearance process. On these issues in particular, there is a significant lack of quality information and clarity from the submissions as to whether there is a real problem to be addressed.
- 11 Given these key factors, it is recommended that the review of Part 5 be split into two streams:
- Phase 1: uncontroversial proposals to be progressed through the Regulatory Improvement Omnibus Bill of the Quality of Regulation Review; and
 - Phase 2: final policy proposals on the complex issues to be delayed until 30 June 2008 to allow for targeted research, consultation and analysis of the issues.

The Regulatory Improvement Omnibus Bill

- 12 A review of regulatory frameworks, the Quality of Regulation Review (QRR), was announced in May 2006, with the aim of ensuring that the regulatory environment for business is supportive of the Government's economic transformation agenda. The mechanism of an omnibus bill has been an important part of this review, providing an administratively efficient method to address uncontroversial but important amendments identified by the QRR.
- 13 The Regulatory Improvement Omnibus Bill provides a suitable vehicle to progress the administrative policy issues within Phase 1 of the Part 5 review. Including these issues within the Bill is consistent with its general purpose, to address uncontroversial issues as expediently as possible.

PROPOSED PHASE ONE AMENDMENTS

- 14 The proposed amendments to the Commerce Act 1986, to be included in the Regulatory Improvement Omnibus Bill, are:
- i Enabling the Commission to apply to the High Court to enforce undertakings to divest shares or assets approved as a part of a clearance or authorisation of a merger;
 - ii Allowing the Commission to consider and accept minor variations to approved undertakings to divest shares or assets; and
 - iii Remove the 20 day statutory timeframe within which the Commission is required to hold a conference.
- 15 A further issue, whether the cases in which lay members can be appointed should be widened, has also been analysed within this review, with the conclusion that the current provisions remain suitable and appropriate.

ANALYSIS

Enforceability of undertakings

- 16 Under section 69A the Commission may accept undertakings to divest shares or assets as a condition for approving a merger. However, it is not an offence to fail to comply with divestment undertakings and there are no direct means for the Commission to enforce them. The Commission can seek an order from the Court under section 85 of the Act to divest the assets or shares. However, in doing so the Commission must prove that the merger substantially lessened competition, which would be both time consuming and expensive.¹

¹ 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 loses its protection and can be challenged in the High Court.

- 17 The inability of the Commission to directly enforce undertakings given under section 69A provides an opportunity for parties to game the legal system as they can consummate a merger that was approved based on an undertaking, and later advise the Commission that they tried to dispose of the relevant shares or assets but were unable to find a buyer that was prepared to pay a reasonable price. This means that a merger would have occurred that the Commission may have otherwise declined if it were not for the undertaking.
- 18 To address this problem it is proposed that the Commission, upon seeking an order from the High Court to enforce undertakings to divest shares or assets, would only have to demonstrate that the undertaking had not been complied with for a contravention to be found. Third parties will be able to join an action initiated by the Commission.
- 19 The enforcement role of the Court will be narrow. The Court will not be required to consider whether there has been a contravention of s 47. The Court would be empowered to order those who agreed to the undertaking to comply with the undertaking, pay a pecuniary penalty to the Crown, compensate any other person who has suffered loss, injury or damage as a result of the breach and/or comply with any other condition the Court considered appropriate.²
- 20 The submissions were largely supportive of making undertakings enforceable. Only one submitter did not support this proposal, stating that the current application of the law whereby a divestment should only be required if it substantially lessens competition, is satisfactory. It is unlikely that the Commission would apply to the Court to enforce an undertaking in cases where non compliance has not led to an adverse effect on competition. The proposal (outlined below) to amend the Act to allow the Commission to approve an amended variation if it were considered that the variation was minor or would not otherwise defeat the competition or public benefit objectives of the Act will also alleviate this risk.
- 21 Improving the effectiveness of the Act to enforce an undertaking will make it easier for the Commission to accept undertakings. This will improve the efficiency of the application process and may also result in more favourable decisions for applicants.
- 22 As a general rule, law that includes provisions that cannot be enforced is unsatisfactory and ineffective. 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. It will also result in consistency with other legislation that provides for the separate enforcement of undertakings, for example, the Securities Act 1978.
- 23 I recommend that the Commerce Act be amended to allow the Commission to apply to the High Court to enforce undertakings given under section 69A to divest shares or assets, if the Commission can show that the parties failed to comply with such an undertaking.

²Applications to the Court would only be able to be made by the Commission and not third parties.

Variation of undertakings

- 24 The Commission does not have the ability to amend an undertaking once a merger 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, immunity from legal challenge by a third party would be lost even if a variation involved only minor changes that had no bearing on competition.
- 25 Presently, an applicant who decides that compliance with an approved undertaking may be unnecessary or counterproductive has three choices. It could comply with the undertaking in full, although this may result in assets being divested unnecessarily. It could vary the undertaking with the knowledge that the protection of the Commission's approval will not apply. This option does not rate well from a legal certainty standpoint. Lastly, the applicant could re-apply to the Commission for a clearance or authorisation with the proposed revised terms. This option rates poorly in terms of timeliness and cost effectiveness for a firm, and poorly in terms of the efficient use of the Commission's limited resources.
- 26 Allowing the original applicant to seek a variation to an approved undertaking to divest shares or assets would overcome the above problems. 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. Submissions were largely in favour of this proposal.
- 27 Thus, it is recommended that the Commerce Act be amended to allow the Commission to consider and accept variations to approved undertakings to divest shares or assets in the case of merger clearances or authorisations.

Timeframes for restrictive trade practices authorisations

- 28 Currently, section 62 of the Act provides time limits within which the Commission would be required to hold a conference following the release of its draft determination for restrictive trade practice authorisation proceedings. After the Commission sends a summary of the reasons to the applicant and various third parties, the recipients are required to notify the Commission within 10 working days of a date fixed by the Commission, if they require a conference to be held. The Commission can also initiate a conference. If a conference is to be held, the Commission must appoint a date for the conference which must be within 20 working days of the expiry of the initial 10 working day period.
- 29 The issue is whether these timeframes serve any purpose. The process is inconsistent with the timing for merger authorisations, which has an overall timeframe of 60 working days³, but has no time limits on any components within the merger process. Conversely, there is no overall timeframe for authorisation of restricted trade practices.

³ Or such longer period agreed between the Commission and the applicant.

- 30 The 10 day time limit for recipients to notify the Commission is useful because it prevents conferences being requested late in the process which can unnecessarily delay proceedings. The 20 day period for when a conference must be held, in contrast, serves no such purpose.
- 31 This lack of consistency between the two processes can be problematic when an application has both merger and trade practice implications, as it can be difficult to operate the procedures in parallel. The timeframes thus appear arbitrary, unnecessary and, at times, impractical.
- 32 The time restrictions on components within the trade practices authorisation process are also inconsistent with the broader philosophy of Part 5 of the Act - to achieve a minimum of prescription of processes. Most submitters either did not express a view, or were generally supportive of the removal of these timeframes.
- 33 I therefore recommend to remove the requirement to hold a conference within 20 working days of the expiry of the 10 working day notification period.

Widening the use of lay members

- 34 At present, where there are appeals against determinations of the Commission (for example, in connection with clearances and authorisations under Part 5 of the Act) then at least one lay member must sit with the Judge in terms of s 77(9). The Judge has discretion in certain matters to sit without a lay member under s 77(14). The High Court also has discretion to sit with a lay member in certain other types of cases under s 78 of the Act. These provisions do not provide for the discretion to appoint a lay member for judicial review proceedings.
- 35 Submitters were asked whether the High Court should have the discretion to appoint lay members beyond the existing powers under s 77 of the Commerce Act, for instance, for judicial review proceedings. The majority of submissions either did not address the issue or were supportive of the proposal, seeing lay members as a useful and helpful resource for the Court.
- 36 In judicial review proceedings, the Court is concerned with matters of process and legality. It does not enter upon the merits as occurs in appeals. Judges are experienced in dealing with these questions. To permit the Court to be assisted by a lay member outside the context of merits based appeals is likely to encourage parties to invite the Court to enter upon the merits of the case in a way which is inappropriate for judicial review. Therefore, I have decided that the current provisions are suitable and appropriate and no change is required.⁴

⁴ The Review of the Regulatory Control Provisions of the Commerce Act will consider whether expert lay assistance should be made available to a High Court if merits review of Part 4 decisions by the Commerce Commission became available by way of law reform.

CONSULTATION

- 37 A discussion document on the Part 5 review was released in May 2007 and 33 submissions were received by the Ministry of Economic Development. Officials have consulted with the Treasury, the Commerce Commission and the Ministry of Justice regarding the administrative and low level policy issues within the Part 5 review that are proposed to be progressed through the QRR.

FISCAL IMPLICATIONS

- 38 As the recommended changes outlined in this paper are largely low level administrative changes to the operation of the Commerce Act, it is not expected that the changes will have any negative fiscal impact.

HUMAN RIGHTS

- 39 There are no human rights implications.

LEGISLATIVE IMPLICATIONS

- 40 These amendments will be implemented through the Regulatory Improvement Omnibus Bill and will require changes to the Commerce Act.
- 41 Proposals arising from the Review of the Clearance and Authorisation provisions (Part 5) of the Commerce Act were to be progressed through the Commerce Amendment Bill scheduled for introduction in 2008, which will also include proposals arising from the review of the regulatory provisions of the Commerce Act. The proposed change to the timeframes will mean that it is no longer possible to progress the Part 5 proposals through this mechanism. A request will be made to include a Bill in the 2008 legislative programme to progress the remaining proposals arising from the Part 5 review of the Commerce Act.

Regulatory Impact Analysis

- 42 The Ministry of Economic Development confirms that the principles of the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements have been complied with. A RIS was prepared and the Ministry of Economic Development considers it to be adequate. The final RIS was circulated with the Cabinet paper for departmental consultation.

Publicity

- 43 Announcements on decisions taken pursuant to this paper will be made as part of the Regulatory Improvement Omnibus Bill announcements.

RECOMMENDATIONS

- 44 It is recommended that the Committee

- 1 **Note** On 22 May 2006 the Minister of Commerce announced that the clearance and authorisation provisions under part 5 of the Commerce Act will be reviewed;
- 2 **Note** Final policy proposals on the Part 5 review were due in November 2007 [EDC Min (07)10/5];
- 3 **Note** Submissions on the review of Part 5 indicate that while there are some administrative and low level policy issues that can be progressed quickly, there are several issues require additional time to develop robust policy proposals;
- 4 **Agree** that the following issues be progressed through the Regulatory Improvement Omnibus Bill;
 - 4.1 Allow the Commerce Commission to seek the following types of orders from the High Court in relation to undertakings that have been approved as a condition of a merger clearance or authorisation decision and have not been complied with:
 - 4.1.1 to comply with the undertaking;
 - 4.1.2 to pay a pecuniary penalty to the Crown;
 - 4.1.3 to compensate any other person who has suffered loss, injury or damage as a result of non compliance; and/or
 - 4.1.4 to comply with any other order the Court considers appropriate;
 - 4.2 Enable third parties to join an action by the Commerce Commission to enforce an undertaking;
 - 4.3 Enable the Commission to approve minor variations of undertakings upon application from parties;
 - 4.4 Remove the requirement to hold a conference within 20 working days of the expiry of the 10 working day notification period;
- 5 **Agree** that the current provisions under the Commerce Act for the use of lay members in Commerce Act cases are suitable and appropriate and no change is required;
- 6 **Agree** that officials will report to the Minister of Commerce on other issues relating to the efficiency and effectiveness of the merger and trade practices clearance and authorisations systems by 30 June 2008;
- 7 **Agree** that this Cabinet paper should be made publicly available on the Ministry of Economic Development's website;
- 8 **Invite** the Minister of Commerce to issue drafting instructions to Parliamentary Council to give effect to the above proposals.

Hon Lianne Dalziel
Minister of Commerce

Date signed: _____

REGULATORY IMPACT STATEMENT

EXECUTIVE SUMMARY

- 1 The objective of the Review of the Authorisation and Clearance Provisions of the Commerce Act is to improve the effectiveness and efficiency of the authorisation and clearance processes. Three issues have been identified as suitable for inclusion in the Regulatory Improvement Omnibus Bill.⁵ The following amendments are being considered:
 - Providing for the enforcement of undertakings that have been approved as part of a merger clearance or authorisation application;
 - Allowing the Commission to approve variations of undertakings; and
 - Remove the 20 day statutory timeframe within which the Commission is required to hold a conference.

ADEQUACY STATEMENT

- 2 The Ministry of Economic Development has reviewed the RIS and considers that the RIS is adequate according to the adequacy criteria.

STATUS QUO AND PROBLEM

- 3 The objective of the review is to test whether some possible changes to Part 5 of the Commerce Act could improve the effectiveness and efficiency of the authorisation and clearance systems. The following issues have been identified:

Weak enforcement provisions for section 69A undertakings to divest assets or shares

- 4 The inability of the Commission to separately enforce undertakings given under section 69A is unsatisfactory. Weak enforcement provisions provide an opportunity for parties to game the legal system as they can consummate a merger that was approved based on an undertaking, and later advise the Commission that they tried to dispose of the relevant shares or assets but were unable to find a buyer that was prepared to pay a reasonable price. This means that a merger would have occurred that the Commission may have otherwise declined if it were not for the undertaking. There has only been one example in recent years where a divestment deed to undertaking was not given effect to. While the magnitude of the problem is small there is an opportunity to improve the effectiveness of the status quo.

⁵ Note that proposals on the more substantial issues arising from the Review will be presented to the Minister of the Commerce by June 2008.

Inefficient processes

- 5 The Commission does not have the ability to amend an undertaking once a merger 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, immunity from legal challenge by a third party would be lost even if a variation involved only minor changes that had no bearing on competition.
- 6 Section 62 of the Act provides time limits within which the Commission would be required to hold a conference following the release of its draft determination for restrictive trade practice authorisation proceedings. The process is inconsistent with the timing for merger authorisations. This lack of consistency between the two processes can be problematic when an application has both merger and trade practice implications, as it can be difficult to operate the procedures in parallel.

OBJECTIVE

- 7 The objective of the review is to provide for a regulatory regime that provides clarity, certainty and transparency of decision making, encourages participation of interested parties and timeliness of decisions, and reduces business and administrative costs.

ALTERNATIVE OPTIONS

- 8 The retention of the status quo in each case is unlikely to result in significant harm and were considered as viable options. However, on balance, the preferred options present an opportunity to improve the efficiency and effectiveness of the authorisation and clearance processes and are unlikely to result in additional costs to government, businesses and society.

PREFERRED OPTION

- 9 The following options were identified to address the problems outlined above.

Providing for the enforcement of undertakings that have been approved as part of a merger clearance or authorisation application

- 10 It is proposed to allow for the Commission to apply to the High Court to enforce undertakings given under section 69A to divest assets or shares if the Commission can show that the parties failed to comply with the undertaking. The objective of the proposal is to provide a strong incentive to comply with undertakings and reduce the administrative burden of enforcement.

Analysis

- 11 The proposed option strengthens the current incentives for firms to comply with an undertaking and will reduce the risk of potential gaming. It will also reduce the costs and improve the timeliness of enforcing undertakings and will enable the Commission to have greater confidence in accepting undertakings

offered. This amendment is also consistent with other jurisdictions such as Australia, that provide for the separate enforcement of undertakings.⁶

- 12 As a general rule, law that includes provisions that cannot be easily enforced is unsatisfactory and ineffective. 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.
- 13 Under this option the affected parties would not be able to put forward the defence that the merger did not breach section 47 of the Commerce Act 1986 as the question for the court will be whether the parties complied with the agreed undertaking only. One submission identified the risk that the Commission may apply to the Court to enforce an undertaking in cases where non compliance has not led to an adverse effect on competition.
- 14 The risk outlined above is small. The Commission is unlikely to make an order to the Court to enforce an undertaking for an activity that clearly does not raise competition concerns. The proposal (outlined below) to provide for the Commission to accept minor variations to an undertaking will also alleviate this risk.

Allowing the Commission to approve minor variations of undertakings

- 15 It is proposed to amend the Act to allow the original applicant to seek a variation to an approved undertaking to divest shares or assets as part of a merger clearance or authorisation application. The Commission would be able to approve the variation if it were considered that the variation was minor or would not otherwise defeat the original decision, or the competition or public benefit objectives of the Act.

Analysis

- 16 Presently, an applicant who decides that compliance with an approved undertaking may be unnecessary or counterproductive has three choices. It could comply with the undertaking in full, although this may result in assets being divested unnecessarily. It could carry out a variation to the undertaking with the knowledge that the protection of the Commission's approval will not apply. This option does not rate well from a business or legal certainty standpoint. Lastly, the applicant could re-apply to the Commission for a clearance or authorisation with the proposed revised terms. This option rates poorly in terms of timeliness and cost effectiveness for a firm, and poorly in terms of the efficient use of the Commission's limited resources. Greater flexibility would provide the opportunity for minor variations to be made without losing the original protection.
- 17 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. This risk is

⁶ Note that the Australian Trade Practices Act provides for the enforcement of a wider range undertaking than is being proposed here.

considered to be minimal as long as the undertakings could be enforceable through correction, punitive and compensatory orders.

Removing the statutory timeframes for holding conferences for restrictive trade practice authorisation proceedings

- 18 It is proposed to remove the 20 day time limit within which the Commission would be required to hold a conference following a request for a conference to be held.

Analysis

- 19 The current timeframe is arbitrary, unnecessary and does not serve any purpose. There is a lack of consistency between the timeframes for the merger authorisation process (there are no interim timeframes within the merger authorisation process) and this can be problematic when both processes must be considered as part of one application.

Implementation and review

- 20 These amendments will be implemented through the Regulatory Improvement Omnibus Bill and will require changes to the Commerce Act. The Ministry of Economic Development is responsible for reviewing the effectiveness of the Commerce Act.

CONSULTATION

- 21 A discussion document on the authorisation and clearance provisions within the Commerce Act was published and 33 submissions on the issues raised within this document were received. Officials have also consulted with the Treasury, the Commerce Commission and the Ministry of Justice regarding the administrative and low level policy issues within the Part 5 review that are proposed to be progressed through the QRR. The majority of the submissions supported the proposals.