

The Chair
CABINET ECONOMIC DEVELOPMENT COMMITTEE

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

PROPOSAL

- 1 This paper reports back on the outcome of the review of the Clearance and Authorisation Provisions under the Commerce Act 1986 ('the Act'). It also seeks agreement to defer the drafting of the proposals requiring legislative change until a suitable legislative vehicle can be identified in 2009.
- 2 This paper also seeks approval to make public the Cabinet papers in relation to the Commerce Commission (International Cooperation and Fees) Bill, introduced to Parliament on 9 September 2008.

EXECUTIVE SUMMARY

- 3 The review considered whether there were ways to improve the effectiveness and efficiency of the clearance and authorisation regime under the Act. Overall, it concludes that the provisions are of a high standard and work well for our small economy and given resource constraints on the Commerce Commission ('the Commission'). In particular, the Commission's analytical framework for assessing public benefits and detriments is widely regarded as best practice.
- 4 A discussion document outlined issues for consideration across four general themes: merger processes, trade practices, legal process and the framework for assessing costs and benefits.
- 5 Four legislative changes are recommended relating to the Commission's processes and third party appeal rights against Commission determinations:
 - a The statutory time frame for the Commission to make merger clearance determinations should be increased from 10 to 40 working days, broadly reflecting current practice.
 - b The requirement that parties halt conduct while the Commission is considering an application for authorisation of that conduct should be repealed, thus requiring the Commission to seek court orders if it considers the conduct is harmful to competition. This provision may remove a barrier to parties applying for authorisation.

- c Subject to (d) below, the right of an applicant and third parties¹ to call a Commission conference in the course of considering an application should be repealed (conferences will be called at the initiative of the Commission only). In addition, the Commission should be able to call a conference at any time during its proceedings and not just after the release of a draft determination.
 - d Standing of third parties to appeal against Commission determinations (currently linked to participation at a conference) should be amended as follows:
 - i for authorisation determinations, third parties will have standing if they can satisfy the court that they have a significant interest, for example, in the determination and they participated in the Commission's proceedings on that determination; and
 - ii for clearance determinations, third parties should not have standing to appeal. These parties must instead rely upon judicial review.
- 6 Some of the concerns raised by submitters with the Commission's merger process can be better addressed through non-legislative means. The outcomes of the Commission's recent best practice review of its merger clearance process should enhance the transparency and timeliness of the Commission's process within the existing statutory framework. Key features include a new pre-notification discussion option for merger parties, and the codification of the intention to release a 'letter of issues' and a 'letter of concern' at pre-specified, timely points in the clearance process.
- 7 Concerns with regards to the perceived uncertainty around trade practices can also primarily be addressed through a number of non-legislative means, such as improving existing processes, rather than investing resources into developing new processes, such as a clearance regime for trade practices. The Commission has instigated a review to consider the merits of developing a 'streamlined authorisation' regime. If adopted such a process may address business requests for a more cost effective means of authorising arrangements that lessen competition but are otherwise in the public interest. Applications for collective bargaining arrangements could also be considered under this streamlined regime.
- 8 Finally, given that there are only four legislative changes recommended, none of which are urgent, officials recommend that these changes be included in the next suitable legislative vehicle rather than developing a specific bill.

BACKGROUND

- 9 The Commerce Act 1986 ('the Act') empowers the Commission to grant clearance and authorisation for transactions following receipt of an application. A 'clearance' may be granted for merger proposals if the Commission is satisfied

¹ 'Third parties' in the context of this paper refers to any party other than the applicant and/or target subject to, as taken part in, or has an interest in, a Commission procedure.

that the merger is unlikely to substantially lessen competition. An 'authorisation' may be granted for merger proposals and restrictive trade practice arrangements if the Commission is satisfied that the public benefits of the arrangement outweigh the competition detriments. Both a clearance and authorisation confer immunity for the transaction or conduct from the prohibitions under the Act.

- 10 In September 2006, Cabinet considered the terms of reference for the review of the clearance and authorisation provisions within the Act [EDC (06) 105 refers]. The terms of reference acknowledged that it is generally accepted that the provisions are of a high standard. Thus the intention of the review was to draw on experience to test whether changes to the provisions would improve the effectiveness and efficiency of the overall regime.
- 11 In May 2007, Cabinet approved the release of a discussion document, *Review of the Clearance and Authorisation Provisions under the Commerce Act 1986* for public consultation [EDC Min (07) 10/5 refers]. Thirty three submissions were received.
- 12 In November 2007 Cabinet agreed to split the review into two tranches and extended the deadline for report back on the second tranche. [EDC Min (07) 25/6 refers]. As part of the first tranche, Cabinet agreed to amend the Act to provide for varying and enforcing undertakings and to simplify conference procedures for trade practice authorisations. These amendments were included in the Commerce Amendment Bill, which was enacted in the first week of September 2008. In addition, it agreed that no change was required to widen the use of lay members to sit as part of the High Court to consider appeals.
- 13 The issue of establishing a specialist tribunal to determine appeals against Commission decisions was considered separately as part of the Parts 4 and 4A review provisions. Cabinet determined that appeals should continue to be heard by the High Court, sitting with lay members. [POL Min (07) 26/7 refers].
- 14 This paper reports back on the second tranche of issues.

COMMENT

- 15 The discussion document outlined issues for consideration across four general themes: merger processes, trade practices, legal process and the framework for assessing costs and benefits. These issues are discussed below.

Theme One: Merger Issues

- 16 New Zealand has a voluntary pre-merger clearance regime. The prospective merger parties determine whether to apply to the Commission for clearance and, if it is desirable, to offer divestment undertakings to address any competition concerns. The Commission may clear the merger if it concludes that it is not anti-competitive. If the Commission declines to grant a clearance, the parties may proceed with the merger but in doing so they risk legal proceedings by the Commission or third parties.

Merger clearance processes

- 17 Section 66(3) of the Act currently provides that the Commission shall determine a clearance application within 10 working days or such longer period as the Commission and the applicant agree. If the time period expires without the determination, the application is deemed declined. This time frame is too short and extensions are agreed as a matter of course. Consideration was given to amending the Act to provide a new statutory time frame that was both challenging but achievable.
- 18 Submissions responded with a wide range of concerns relating to a perceived lack of transparency in the Commission's process and concerns with timeliness. Consequently, the Commission's scheduled best practice review of its clearance process has been very timely.
- 19 Based on an external review of its clearance regime² the Commission has developed and released for consultation a draft set of guidelines³ aimed at increasing the transparency and timeliness of the clearance regime. Many of the options suggested by submitters to enhance the process have been picked up by the Commission. In particular, a new pre-notification merger procedure, the release of a 'letter of issues' and 'letter of concerns', a shortened process for straightforward merger proposals, and early notification of likely time frames and regular updates on any changes are all to be adopted.
- 20 In regard to time frames, officials recommend that the Act should be amended to extend the time frame for merger clearance determinations from 10 to 40 working days. This brings the statutory time frame in line with the Commission's current performance measure and it is consistent with international practice.

Written reasons

- 21 The Commission is not required under the Act to provide reasons in writing for its clearance determinations. However, it does so as a matter of course, although this may be some time after it has made its determination. Some submitters outlined concerns that the delay impaired their ability to appeal in a timely manner, given that the reasons were important to inform such an appeal.⁴
- 22 Officials consider that mandating a time frame for the release of the Commission's reasons could extend the total time the Commission takes to make determinations while it also completes written reasons for release. This delay would affect all clearances, not just those that might be subject to appeal. It may also delay the consideration of new applications for clearance due to resourcing constraints. This runs counter to the timeliness concerns expressed and thus a trade-off is required between the benefits of the timely release of written decisions to reduce uncertainty businesses face around a decision to appeal, and the overall incentives to provide timely decisions to merging parties.

² A Best Practice Review of the New Zealand Merger Clearance Regime, Alan Lear, August 2007.

³ Draft of Mergers and Acquisitions Clearance Process Guidelines: 30 May 2008.

⁴ Section 91(2) states that notice of appeal must be made within 20 working days of the determination or within such further time as the Court may allow.

- 23 Moreover parties can apply to the Court for an extension to the time frame for within which they can appeal a decision, or lodge an appeal without the availability of a written decision. In the latter situation the High Court can order the Commission to produce an affidavit outlining its decision (but the parties bear some risk that they will need to amend the grounds for appeal once the reasons are available).⁵ Thus no further change is required.

Behavioural undertakings for merger determinations

- 24 The Commission may accept undertakings to divest assets or shares from applicants to address competition concerns as part of its merger determinations. However, it cannot accept behavioural undertakings. Behavioural undertakings include restrictions on prices charged or the conduct of the merged entity. Consideration was given to allowing the Commission to also accept behavioural undertakings.
- 25 International experience shows that behavioural undertakings are poor at addressing structural problems. Such undertakings amount to allowing an anticompetitive merger to proceed subject to ongoing regulation by the Commission. As a form of company-specific regulation, behavioural undertakings impose significant monitoring and enforcement costs on the Commission and create a risk of market distortions. While the submissions generally supported allowing behavioural undertakings, I consider that the Act should not be amended to provide for them.

Informal 'letter of comfort' procedure

- 26 The discussion document sought views on whether the Commission should adopt an informal 'letter of comfort' procedure similar to the Australian Competition and Consumer Commission (ACCC) to supplement the statutory clearance process. Under that approach, an ACCC letter of comfort does not provide statutory immunity for the merger.
- 27 There was mixed support in submissions. However, an informal pre-merger process could raise legal risks for the Commission and would lack transparency and accountability. The Commission has introduced a new pre-merger discussion process within the current statutory clearance framework. This will allow for applicants to hold confidential talks with the Commission prior to submitting an application, which should address the submitters' concerns. No further change is required.

Theme Two: Restrictive Trade Practices

Clearance of restrictive trade practices

- 28 The review considered whether a clearance regime should be established in the Act for restrictive trade practices.

⁵ The Court made such an order in the Woolworths Limited appeal against the Commission decision not to clear the acquisition of the Warehouse Group Limited.

- 29 Currently a business cannot apply to the Commission for a clearance of an arrangement in order to test the presumption that the arrangement is not likely to be anti-competitive. Businesses must instead apply for an authorisation and argue their case on net public benefit grounds.⁶
- 30 The arguments raised in submissions for a clearance regime essentially relate to addressing the following problems:
- a a clearance regime would enable business to address uncertainty as to whether the restrictive trade prohibitions apply to transactions; and
 - b a perception that the *per se* prohibitions⁷ capture some conduct that is either pro-competitive or competitively neutral, and as such, a new modified clearance regime should be established (as an alternative to the current section 58 authorisation procedure) to exempt conduct caught by these prohibitions if there is no likely substantial lessening of competition (i.e. create a competition defence).
- 31 These concerns can be addressed by other more cost effective and efficient means than creating new approval regimes in the Act. A clearance regime for trade practices would require the Commission to substitute for the role of professional advisers. There is also a risk that the Commission would be drawn into rubber-stamping clearance applications for trade practice activity that does not substantially lessen competition. Alternatively, if the Commission grants clearance, there would be additional ongoing costs of monitoring compliance and ensuring that the clearance does not confer immunity to arrangements that subsequently harm competition as market conditions change.
- 32 One of the issues being addressed in the current baseline review of the Commission is the extent to which it should engage in education and produce guidelines to inform businesses on the application of the Act. Increasing the Commission's efforts in this way may be a more effective means of addressing business concerns regarding uncertainty.
- 33 No further change is required.

Collective bargaining notification regime

- 34 The review carried out extensive analysis of the possibility of introducing a new collective bargaining notification regime, similar to the regime added to the Australian Trade Practices Act in 2007.
- 35 The purpose of a collective bargaining notification regime (notification regime) is to allow a group of competitors acting in a collaborative manner to exercise a

⁶ This is not consistent with the procedure in place for proposed mergers. The test for a clearance of a merger is whether the merger would or would be likely to have the effect of substantially lessening competition. If the Commission is satisfied that the merger is unlikely to contravene the Act, the Commission can approve it. By having obtained approval a business has secured immunity from legal action. This mechanism provides for increased certainty for businesses merging, which is important as mergers are one-off structural changes to a market that cannot be reversed.

⁷ A *per se* prohibition refers to an act that is illegal without having to demonstrate the effects of the act on competition.

degree of countervailing market power against the large organisation whom they are negotiating with. A notification regime would provide immunity for the notified conduct if the Commission did not object to it within a certain timeframe.

- 36 There are two distinct features that characterise a notification regime as different from an authorisation process:
- the onus of proof being on the competition authority; and
 - the shorter time frame for decision making.
- 37 The problem that arises from the reverse burden of proof imposed by a notification regime is that the Commission would be making quick decisions in short time frames on arrangements that may require reasonably complex analysis. It is the parties to the notification process that have the best information, not the Commission, and thus the risk that if the regime is too permissive then anticompetitive conduct will be immunised.
- 38 Because of the information problem outlined above, driven by the reverse burden of proof aspect, the Commission would necessarily be incentivised to only allow easy cases. This appears to be what has occurred with the Australian regime.
- 39 In the 18 months since its introduction, the ACCC has received seven notifications of collective bargaining arrangements (only one in 2008), of which one has been opposed and one has been withdrawn. Consultation undertaken with interested parties in Australia has indicated a general dissatisfaction with the Australian regime. For the notifications that the ACCC has allowed to stand, the composition of the groups have been very small relative to the total size of the markets considered, and thus the arrangements are likely to have very little impact on competition. Because of the onus of proof issue, this is an inevitable outcome of any notification regime.
- 40 The Commerce Commission has initiated a project to explore means to improve its authorisation process and reduce the costs to applicants by introducing a streamlined process. Therefore, the Commission should be able to deal with any easy cases in an effective and timely manner. The Australian experience tends to support this view. The ACCC has adopted a 'short form' authorisation process and this has been used by some parties as an alternative to the collective bargaining notification regime. Over the same time frame that the notification regime has been in place, the ACCC has made determinations on at least nine applications for collective bargaining through its authorisation process.⁸
- 41 Overall I consider that creating a collective bargaining notification regime would not generate sufficient economic benefit to warrant devoting limited time and resource to it.

⁸ Note that the ACCC's authorisation register does not distinguish between those applications put through the long form authorisation or the streamlined authorisation process.

Jurisdiction test

- 42 Section 27 of the Act prohibits agreements that have the purpose, effect or likely effect of substantially lessening competition. Section 58 allows a person to seek authorisation of such conduct if that person considers that section 27 would or might apply. The Commission holds the view that the Act also includes a jurisdiction test in which it must first determine whether the conduct in question lessens competition. If the Commission concludes there is no lessening of competition then it returns the application.
- 43 The main advantage of the jurisdiction test is that it is a useful means of filtering applications that do not raise substantial competition issues.
- 44 Those submitters in favour of revoking the test argued that authorisation should be available to applicants to address uncertainty, regardless of whether the Commission considers that the proposal lessens competition. They argue that this is particularly desirable for arrangements requiring large sunk investments and where market conditions may subsequently change raising competition concerns.
- 45 However, if the Commission has found that an arrangement is unlikely to lessen competition, it would be unusual for the courts to reach a view that the conduct substantially lessens competition. Consequently, the risk of successful third party action will be low. The review was unable to identify evidence supporting the claim that the Commission's use of a jurisdiction test deters certain beneficial conduct.
- 46 If market conditions change over the life of the arrangement, the parties should have incentives to modify the arrangement to address any competition concerns in the first instance. Alternatively, the Act (section 59A(1)) currently provides that parties may apply for authorisation of an existing arrangement if competition concerns subsequently arise. This would enable a more informed assessment of the public benefits and detriments. I consider that no change is necessary.

Reopen an authorisation due to material change

- 47 The Commission is empowered to revoke, amend or replace an existing authorisation if there has been a material change in circumstance. 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.
- 48 The review considered whether this provision has deterred long-term investment by creating regulatory uncertainty. Of the three occasions where the Commission has used this power, only one was on the Commission's own initiative (the others were at the request of the parties to the arrangement). In that one case, the authorisation was largely redundant due to a change in circumstances and the effect of its revocation was minimal.
- 49 An ability to reopen authorisations, if there has been a material change in circumstances, is a useful safety valve. As markets are dynamic, there is a risk

that significant public detriments could result from a material change in circumstances. Before intervening in any authorisation, the Commission would carry out a public benefits and detriments analysis, and therefore it would only intervene if the public harm outweighs the costs. In addition, removing the ability of the Commission to intervene may cause it to be risk averse and impose additional conditions on the authorisation in the first place. As identified by submitters, the benefits of an authorisation may become less clear cut if the Commission does not have the safeguard of intervention if it should become necessary to protect competition. I consider that no change is needed.

Halting conduct while authorisation application to be determined

- 50 Section 59A(1) of the Act empowers the Commission to authorise arrangements that are already in effect. However, section 59A(2) requires that the applicants stop giving effect to the arrangement while it is considering the application. This requirement to halt minimises the harm that might arise from arrangements that by definition ‘lessen competition’, by requiring the parties to halt conduct until the claimed public benefits had been substantiated.
- 51 The Commission states that the provision is unenforceable, but even if it was, the requirement that conduct could only proceed if the parties could demonstrate exceptional hardship (section 59A(3)) is a very high test which would be difficult to meet. The concern raised in the discussion document is that this provision could discourage genuine parties from applying for authorisation or, alternatively, it could be used by disgruntled parties to arrangements for strategic purposes.
- 52 The problem with section 59A(2) is that it is underpinned by the presumption that an arrangement subject to an authorisation application will be harmful to the public. However, there is no rationale to underpin that presumption. In addition an effect of the presumption is that the parties are required to halt the conduct, which in turn means that parties will have significant disincentives to apply to the Commission for an authorisation.
- 53 Parties should be able to use this provision where market conditions have changed after the arrangement came into force, but where the parties consider the public benefits of the arrangement continue to outweigh the detriments.
- 54 I consider that this provision should be repealed. This would mean that the Commission would have to apply to the court for orders to stop the conduct if it has competition concerns.
- 55 The Commission does not support the repealing of this provision. In the Commission’s view there is a reasonable case for a presumption that conduct for which an authorisation is sought would harm competition. From this perspective, the Commission feels that it is not unreasonable that there be an expectation that the conduct should stop unless there is a good reason for it to continue.
- 56 In addition the Commission believe that repealing this provision increases the scope for ‘gaming’ of the authorisation process. It could create an incentive for businesses to enter into potentially anti-competitive arrangements, and then

apply for an authorisation because the onus would then be on the Commission to initially show competitive harm.

- 57 However I consider that the gaming risks are minimal. The parties to the agreement remain at risk of court action in relation to conduct that precedes the date of authorisation. The fact that authorisations can not apply retrospectively strongly deters such conduct.

Commission conferences

- 58 The Act provides for applicants and third parties to call a Commission conference in relation to clearance and authorisation applications. The main purpose of a conference is to enable the Commission to obtain information and test views with the parties. The other benefit of a conference is that it enables the parties to appear and be heard before the Commissioners.
- 59 With regards to the right of applicants and third parties to call a conference, I consider that this power should be removed. However, this recommendation is conditional on Cabinet's agreement to a subsequent recommendation in this paper relating to de-linking appeal rights from participation in a Commission conference.
- 60 The Commission is best able to make the assessment of whether a conference is desirable to gather and test information relative to other more cost effective means. In addition, the Commission is subject to administrative law requirements to follow due process and hence it will have incentives to ensure that sufficient consideration is given to the parties' views. This change also has the potential to see quicker, more efficient information gathering and decision-making as a result, particularly relevant if a 'streamlined or short-form authorisation' process is eventually implemented.
- 61 I consider that the discretion to call a conference should be the Commission's alone and that the Commission should be able to call a conference at whatever point it considers would be most beneficial (such as upon the release of 'issue papers'), and not just after the release of a draft determination.

Theme Three: Legal Processes

- 62 The only remaining issue under this theme is third parties' right to appeal Commission clearance and authorisation determinations. The other issues were considered by EDC on the 6 November 2007 [EDC (07) 212 refers]. Third party appeal rights should not be linked to whether a person has participated in a Commission conference.
- 63 Linking third party appeals rights to participation in a conference means that the creation of appeal rights becomes a consideration as to whether the Commission holds a conference in the course of a proceeding. Consequently it may result in the under use of conferences as a means of obtaining and testing information relative to other measures. In addition, third parties are effectively denied appeal rights in relation to time-sensitive proposals, such as clearances, while a broad

class of persons are conferred standing in other cases. It is preferable that the statute be explicit on what appeal rights are intended.

- 64 The choice of appeal rights for third parties is a balance between ensuring timely and cost effective determinations versus natural justice and quality of regulatory outcomes. Given these considerations, officials consider that a distinction should be made between merger clearances and authorisations.
- 65 In relation to clearances I consider that the current practice should be codified such that third parties do not have standing to appeal. Rather, their rights would be limited to judicial review and, in the case of those who participated in the Commission proceedings, a right to join an appeal. Allowing third parties to appeal a Commission determination may undermine the integrity of the voluntary clearance regime, the purpose of which is to reduce the risk of litigation and thus provide certainty. If the scope of appeal rights widens so that more appeals occur, applicants may choose to opt out of the process altogether.
- 66 For authorisations which are generally less time-sensitive, I consider that third parties should have standing to appeal if they have a significant interest, for example, in the determination (as demonstrated to the court). In addition, the person should have participated in the Commission's proceedings, such as by a written submission. The two elements ensure that the parties have a direct and significant interest in the matter and continue to have incentives to participate in the Commission's processes, thus reducing the risk of 'forum shopping'.

Theme Four: Framework for assessing costs and benefits

- 67 The review considered a number of issues relating to the analytical framework applied by the Commission when assessing public costs and benefits as part of its authorisations procedure.
- 68 I consider that the framework is sound and consistent with international best practice. The Commission adopts a total welfare approach, which is neutral in relation to wealth transfers between consumers and producers. Costs and benefits incurred offshore can be taken into account to the extent that they flow back to New Zealand. Such an approach makes sense in a small economy which is dependent on its domestic companies having scale to compete internationally. Claims that the Commission is not able to take into account international competitiveness issues are not well-founded.
- 69 In addition, the Commission's approach to the assessment of costs and benefits is becoming more sophisticated and is informed by feedback from the courts. Recent court cases have clarified the importance and use of counterfactuals and market definitions, which will provide useful guidance to competition practitioners. Quantification used appropriately, ensures that the Commission's assessments are transparent and objective. Overall, submissions were supportive of the Commission's approach.

CONSULTATION

70 The Commerce Commission, the Ministry of Justice, the Judiciary and the Treasury have been consulted on the issues presented in this paper. The Ministry of Justice, the Judiciary and the Treasury support the recommendations in this paper. The Commerce Commission does not support repealing sections 59A(2) and (3), as set out in paragraphs 50 to 57 of this paper.

FISCAL IMPLICATIONS

71 Some of these legislative and non-legislative proposals will have implications for the volume of work for the Commission. A streamlined authorisation process may result in more authorisation applications. The amendments to third party appeal rights may result in more appeals. However the new merger process guidelines and practices and the ability of the Commission to call a conference at any point in the assessment of an authorisation application will tend to save work. Overall, it appears that the changes can be funded from existing baselines.

HUMAN RIGHTS

72 There are no human rights implications.

LEGISLATIVE IMPLICATIONS

73 A Commerce (Clearances and Authorisations) Amendment Bill currently has priority 5 (instructions to PCO to be provided during the 2008 year) on the 2008 legislative programme. However, fewer legislative changes than originally envisaged are proposed as an outcome of this review. As the four legislative changes are not urgent, I recommend that these changes be included in the next suitable legislative vehicle rather than developing a specific bill now.

REGULATORY IMPACT ANALYSIS

74 The Ministry of Economic Development (MED) confirms that 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 MED considers the RIS and the RIA analysis undertaken to be adequate. A draft RIS was circulated with the Cabinet paper for departmental consultation purposes.

PUBLICITY

75 There will be some limited public interest in the outcome of this review. I will make an announcement on the outcome of the review once Cabinet decisions have been made, and MED officials will place the Cabinet paper on the MED website.

OTHER MATTER

76 The Commerce Commission (International Cooperation and Fees) Bill was introduced to Parliament on 9 September 2008. The Bill makes amendments to

the Commerce Act, Fair Trading Act and Credit Contracts and Consumer Finance Act to encourage greater cooperation between the Commerce Commission and equivalent overseas regulators. It also makes amendments to enable fee exemptions for clearance or authorisation applications under the Commerce Act.

- 77 I would like to seek approval for the Cabinet papers [EDC (05) 68, EDC (05) 111, CAB (07) 188 and CBC 08(339)] on which this Bill is based, to be made public on the Ministry of Economic Development's website.

RECOMMENDATIONS

It is recommended that the Committee

- 1 **note** that the Commerce Act clearance and authorisation processes are generally working effectively and efficiently;
- 2 **agree** to amend the Commerce Act to:
 - a extend the statutory time frame for merger clearance determinations from 10 to 40 working days;
 - b repeal the requirement that parties must halt conduct while the Commerce Commission is considering an authorisation application for that conduct and ensure that the Commerce Commission is able to apply to the Court to seek an injunction to halt the conduct in appropriate circumstances;
 - c subject to agreement to (e) below, remove the right of an applicant and any third parties to require the Commerce Commission to call a conference;
 - d allow the Commerce Commission to call a conference at any point in its proceedings (and not just following the release of a draft determination);
 - e replace the current provisions granting standing to appeal for third parties against Commission determinations if they participated in a Commission conference, with the following:
 - i in relation to merger clearance determinations, third parties shall not have the ability to initiate an appeal but in the case of those who participated in the Commission's proceedings, will be able to join an appeal; and
 - ii in relation to authorisation determinations, third parties shall have standing to appeal if the person participated in the Commission's proceedings in relation to the determination and they have a significant interest in the determination (as determined by the High Court);
- 3 **note** that the outcomes of the Commerce Commission's review of its merger clearance processes, and its release of draft guidelines for consultation, will enhance the transparency and timeliness of its merger clearance process;

- 4 **agree** to no change in relation to the following matters:
- a the Commission should retain discretion as to if and when it releases its written reasons for its clearance determinations;
 - b the Commission should not be invited to introduce an informal pre-merger process to operate alongside the statutory clearance regime;
 - c the Commission should not be able to accept behavioural undertakings in relation to applications to clear or authorise mergers;
 - d the 'lessening competition' jurisdiction test in relation to trade practice authorisation applications; and
 - e the power for the Commission to revoke, amend or replace existing authorisations if there has been a material change in circumstances since the authorisation was granted;
- 5 **note** that the Commission is planning to review its authorisation systems, including consideration of a 'streamlined' process for considering applications for authorisation of restrictive trade practices;
- 6 **agree** not to introduce;
- a a trade practice clearance system;
 - b a collective bargaining notification regime;
- 7 **note** that the Commission's framework for assessing costs and benefits as part of the authorisation process is sound and in line with international best practice;
- 8 **note** that the proposed amendments outlined above are neither urgent nor significant;
- 9 **agree** to delay legislating until a suitable legislative vehicle is available; and
- 10 **agree** that the Cabinet papers on which the Commerce Commission (International Cooperation and Fees) Bill is based should be published on the Ministry of Economic Development's website.

Hon Lianne Dalziel
Minister of Commerce

Date signed: _____

Regulatory Impact Statement

EXECUTIVE SUMMARY

- 1 A review of the clearance and authorisation provisions in the Commerce Act considered whether there were ways to improve the effectiveness and efficiency of the clearance and authorisation regime under the Act. Overall, it concludes that the provisions are of a high standard and work well for our small economy and given resource constraints on the Commerce Commission ('the Commission'). Thus the review recommends that no change is necessary to all but four of the issues canvassed.
- 2 Legislative change is recommended relating to the Commission's processes and third party appeal rights against Commission determinations as follows:
 - a *Merger clearance time frames*: the statutory time frame for the Commission to make merger clearance determinations should be increased from 10 to 40 working days;
 - b *Halting conduct while authorisation application to be determined*: the requirement that parties halt conduct while the Commission is considering an application for authorisation of that conduct should be repealed, thus requiring the Commission to seek court orders if it considers the conduct is harmful to competition.
 - c *Commission conferences*: subject to (d) below, the right of an applicant and third parties to call a Commission conference in the course of considering an application should be repealed, such that conferences are called at the initiative of the Commission. The Commission should be able to call a conference at any time during its proceedings and not just after the release of a draft determination.
 - d *Third parties' right to appeal Commission determinations*: standing of third parties to appeal against Commission determinations (currently linked to participation at a conference) should be amended as follows:
 - i for authorisation determinations, third parties will have standing if they can satisfy the court that they have a significant interest in the determination and they participated in the Commission's proceedings on that determination; and
 - ii for clearance determinations, third parties should not have standing to appeal. These parties will instead rely upon judicial review.

ADEQUACY STATEMENT

- 3 The Ministry of Economic Development (MED) confirms that 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 MED considers the RIS and the RIA analysis undertaken to be adequate. A draft RIS was circulated with the Cabinet paper for departmental consultation purposes.

STATUS QUO AND PROBLEM

Merger clearance time frames

- 4 Section 66(3) of the Act states that clearance determinations shall be made within 10 working days or such longer period as the Commission and the applicant may agree. If the Commission does not make a determination within the set or agreed time frame the clearance is deemed declined.
- 5 Prior to 1990 it was mandatory for businesses above a certain size threshold to seek clearance in order to merge. Under this system the majority of merger proposals had no impact on competition and thus 10 working days was adequate for the Commission to screen applications to clear those merger proposals requiring no further analysis.
- 6 The types of clearance applications the Commission now receives under the voluntary pre-notification regime are almost always complex and extensions are agreed as a matter of course. Only one of 56 clearance applications received between 2004/05 and 2006/07 was determined within 10 working days.
- 7 The Output Agreement between the Commission and purchase Ministers sets a performance standard for the Commission to determine clearance applications within 40 working days. In the same three year period to 2006/07, the Commission determined 66 percent of clearances within this time frame.
- 8 Merger applicants require certainty around timing and transparency in the Commission's clearance process given the time-sensitive nature of most merger agreements. Submitters are concerned that the current regime involves excessive delays with no indication upfront when a business can expect a decision and 'time-drift' caused by the ability to extend the time frame as many times as the Commission deems necessary.⁹

Halting conduct while authorisation application to be determined

- 9 Section 59A of the Act empowers the Commission to authorise arrangements that are already in force. However, in such cases, section 59A(2) requires that all parties to the agreement discontinue giving effect to the arrangement while the Commission is investigating the application. 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.

⁹ An extension requires the Commission and the parties to agree, but if agreement is withheld, the party risks their application being deemed declined.

- 10 Since this provision was enacted, the Commission has received one application for an arrangement that came into effect while the Commission was still considering the matter.¹⁰ In this case, the Commission considered that it could not require the parties to stop nor could it decline jurisdiction to consider the application for this reason. The Commission's draft determination in this case outlines its preliminary view that the arrangement is unlikely to lessen competition.
- 11 Consequently, there is reason to believe that the requirement to stop is unenforceable. However, if the provisions had been enforceable, there is reason to believe that disgruntled parties to arrangements could seek to use the provision for strategic purposes.
- 12 Parties can seek to continue the conduct by applying to the Commission, but the Commission submits that the requirement to demonstrate 'exceptional hardship' may be too difficult a threshold to meet.

Commission conferences

- 13 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 (in relation to a trade practice authorisation).
- 14 The main purpose of a conference from the Commission's perspective is to provide for a means of obtaining information and testing views. From the parties perspective a conference serves to allow the applicant to be heard directly by the decision-maker and, attendance at a conference confers appeal rights on third parties.
- 15 The issue is whether the applicant and/or a third party should be able to require the Commission to hold a conference. The primary concern with the provision is that it could act to delay the Commission's decision if a conference is called where the Commission feels it would serve no purpose. In addition, third parties can use the ability to call a conference to game and delay the system. To date there has been one instance of a party (the applicant) invoking the right to call a conference when the Commission considered that it was not required.

Third parties' right to appeal Commission determinations

- 16 Section 92(a) and (c) of the Commerce Act outlines standing to appeal against Commission determinations for clearance or authorisation. The applicant has standing and, in the case of mergers, so does the person whose assets or shares are proposed to be acquired. Third parties have standing if they participated in a Commission conference.
- 17 Persons entitled to participate in a conference are:

¹⁰ Todd Petroleum Mining Company Limited and Todd Taranaki Limited, application for authorisation of certain provisions in the Maui Pipeline Operating Code, dated 26 August 2005.

- a any person whose presence at the conference the Commission considers would be desirable (s64(1)(b)); and
 - b in the case of a restrictive trade practice authorisations, any person who received a draft determination (s64(1)(b)), being:
 - a person who the Commission considers has a sufficient interest in the application (and who the Commission has given notice of the application or who contracted the Commission giving notice of their interest in the application (s62(2)(b) and (c))), or
 - a person who the Commission considers may assist the Commission in its consideration of the application (s62(2)(d)).
- 18 It is not automatic that the Commission will hold a conference for clearances and authorisations. In the case of mergers, a decision to hold a conference is at the Commission's discretion, although it may need to obtain agreement from the applicant to extend the statutory time frame for consideration of the application to accommodate the conference. In the case of restrictive trade practice authorisations, the Commission may hold a conference at its own discretion or at the request of the applicant or any other person to whom the Commission has sent a draft determination.
- 19 The issue is whether the linking of third party appeal rights to participation in a conference is efficient and equitable.

OBJECTIVES

- 20 The terms of reference outline that it is generally accepted that the clearance and authorisation provisions in the Commerce Act are of a high standard. Thus the intention of the review is to draw on experience to date to test whether changes to the provisions would improve the effectiveness and efficiency of the overall regime.
- 21 Specifically, changes to the status quo would need to improve the timeliness and/ or the quality of outcomes without increasing disproportionately the cost of administering or participating in Commission's processes, and without effecting natural justice.

OPTIONS CONSIDERED

Merger clearance time frames

- 22 Apart from retaining the status quo of 10 working days, officials also considered the option of a 30 working day statutory time frame for determining a clearance application. The time frame should be realistic but challenging, and balance the parties' requirements for timely decision-making with the Commission's statutory obligations to follow due process and produce quality outcomes.
- 23 Too rigid of a time frame is not appropriate because mergers are not of equal size and complexity. Some decisions will be determined quickly (for example, within 25 working days), while others may take longer. A 30 working day time

frame, based on past performance, would only see approximately 50% of clearance applications determined within the statutory time frame.

- 24 In addition the Commission needs to retain the ability to extend the time frame with the agreement of the parties on a case-by-case basis.¹¹ Placing restrictions on the extension process could have adverse consequences for the quality of decision-making and may impede cases where an extension would benefit the applicants, such as limiting the Commission's ability to consider divestment undertakings offered in response to letters of concern.

Preferred Option

- 25 On balance we favour a statutory time frame of 40 working days. This is still a challenging time frame within which the Commission and all parties involved will have to work to. It is consistent with the performance measure currently set in the Output Agreement, and it is comparable with other international regimes.
- 26 In addition the Commission are currently consulting on a draft set of merger clearance guidelines. The purpose of the guidelines is to improve transparency and thus promote certainty in the process.
- 27 This option imposes no additional compliance cost on business and will focus the Commission's efforts in improving the efficiency of this process.

Halting conduct while authorisation application to be determined

- 28 Four alternative options to the status quo and the preferred option (repealing the requirement to halt conduct) were considered as follows:
- a leave unchanged the requirement to halt the conduct, and instead to give the Commission greater discretion to allow the conduct to continue (i.e. by lowering the exceptional hardship threshold in section 59A(3));
 - b provide for the requirement to stop to be enforceable (e.g. by deeming the application to lapse or authorisation to be declined), through the same mechanisms as for enforcing Part 2, by including reference to this section in some or all of section 80(1)(a) (pecuniary penalties), section 81(a) (injunctions) and section 82 (damages);
 - c change the standard in section 59A(3) to the standard that applies for interim injunction, by using words such as "if in the opinion of the [decision-maker] it is desirable to do so";
 - d change the process in section 59A(3) from a Commission decision to a new right for a person who wishes to engage in the conduct to apply to the Court for an interim Order to be allowed to engage in the conduct specified in the Order, pending a decision on the authorisation application.

¹¹ Given that the clearance process is voluntary, the consequence of a deemed decline if the time frame expires without a decision should also be retained. This provision maintains the incentives on the merger parties to cooperate with the Commission and provide sufficient information to enable it to be make a determination.

- 29 The first alternative option, lowering the 'exceptional hardship' threshold to for example, 'hardship', would require the Commission to divert resources to assessing whether or not the parties should halt. This would be a separate process involving an assessment of the financial circumstance of the parties, and not the competition implications which is the focus of the authorisation application.
- 30 For all of the alternative options, there remains a presumption that an arrangement will be harmful to the public. However there should not be a presumption that an arrangement will be harmful, as the parties will have significant disincentives to apply to the Commission in such cases given their continuing liability.

Preferred Option

- 31 MED recommend that sections 59A(2) (that all parties to the agreement discontinue giving effect to the arrangement while the Commission is investigating the application) and section 59A(3) (empowering the Commission to waive this requirement if stopping the conduct would be likely to result in exceptional hardship to any of the parties) be repealed.
- 32 Parties would likely use this provision where market conditions have changed after the arrangement came into force, but the parties consider the public benefits of the arrangement continue to outweigh the detriments. Consequently, the parties should only be required to stop when there is an indication that the conduct could be harmful in that case, taking into account the relative costs of doing so.
- 33 It is preferable that the law incentives parties to come forward for authorisation before entering into an arrangement. This is achieved by making sure that the parties remain liable under the Act unless and until the arrangement has been authorised.
- 34 The generic mechanism of the Commission applying to the court to seek a temporary injunction to stop the conduct should be sufficient. It need not do this immediately, but just as soon as it has sufficient information to be concerned. This would not require the Commission to divert significant resources, as the impact on competition will be considered as part of the authorisation process so the information requirements of the two processes would be relatively complementary.

Commission conferences

- 35 Apart from the status quo and the preferred option, the review considered two additional options as follows:

- a limit the right to call a conference to the Commission and the applicant;
 - b allow the applicant and any party to whom a draft determination has been sent to ask the Commission to call a conference, but leave it to the Commission to decide; and
- 36 All of these options were considered on the assumption that third party appeal rights will be no longer be linked with the conference process.
- 37 The case for allowing the applicant the right to retain the power to call a conference is stronger than the case for allowing a third party to require a conference. Unlike a third party, an applicant is unlikely to want to delay the process. Submitters argued that if the decision was left to the sole discretion of the Commission, there is a danger that no conferences will be held. The ability of an applicant to participate in a conference is considered important because there is the perception from submitters that a conference is the only means that applicants can be heard directly by Commission members.
- 38 However empowering the applicant to be able to call a conference, when it is not necessary, may not be an effective use of the Commission's time and resources.
- 39 Repealing the right of applicants and third parties to call a conference would not diminish the rights of parties to have their views taken into account because section 61(3) of the Act states that the Commission must take into account any submissions made to it by the applicant or any other person.
- 40 Moreover, even without the specific legislative mandate to require the Commission to call a conference, an applicant (or even a third party that participated in a Commission process) could request of the Commission that a conference be held. It would then be up to the Commission to decide whether a conference would add value.

Preferred Option

- 41 MED is of the view that the discretion to call a conference should be the Commission's alone and that the Commission should be able to call a conference at whatever point it considers would be most beneficial (such as upon the release of 'issue papers'). This change would involve repealing section 62(3), (4) and (5), and would bring this part of the Act into line with the Commission's regulatory functions, with the potential to see quicker, more efficient information gathering and decision-making as a result.
- 42 MED also considers that if a 'streamlined authorisation' process is implemented as has been discussed in the Cabinet paper, the consideration of trade practice authorisations may become frequent. It would be important in this instance to limit the ability of third parties intervening in order to delay the process. It may also be important in order to facilitate speedier decision-making, to empower the Commission to call a conference at any stage in its investigations.

- 43 Whether to call a conference requires consideration by all parties of the trade-off between the timely and cost-effective decision, and the perception that natural justice has been achieved. However in terms of merger analysis, there is no provision for a conference to be called by the applicant or parties, it is surmised because merger decisions need to be concluded quickly.

Third parties' right to appeal Commission determinations

- 44 Apart from the status quo and the preferred option, the review considered two further options for third party appeal rights, as follows:
- a remove standing to third parties for appeals against clearance determinations only;
 - b third parties should be able to seek leave of the High Court to appeal authorisations through a general test – if party participated in the Commission's processes (such as providing a written submission), *and* the High Court thought fit; and
- 45 Currently, if a conference is called, a broad class of persons may gain appeal rights, including persons who may have no direct or financial interest in the transaction (e.g. professional advisers and experts). If no conference is held, parties can only appeal by judicial review or by joining an appeal. MED considers that it is desirable to give greater certainty to third parties as to their appeal rights, independent of a decision to hold a conference.
- 46 The current provisions, especially for clearances, do not perform well against the natural justice and accountability objectives because when a conference is not held third parties are denied standing. This is tempered by the availability of other appeal mechanisms such as judicial review and the ability to join an appeal. However the former appeal mechanism is limited to appeal on points of law and the latter is unlikely to be of use to third parties in cases where an authorisation or clearance has been approved. The harm caused by limited access to standing is difficult to ascertain.
- 47 The current provisions also perform poorly against the certainty and cost objectives, although this detriment is limited in the case of clearances given that a conference is rarely called. A very broad appeal right could cause unnecessary delay and cost to the Commission, the courts and the parties to the proposal. There is a risk of parties, and in particular competitors, using appeals to delay or frustrate transactions.
- 48 These costs and risks are particularly felt for time sensitive transactions such as mergers. Any increase in the ability of third parties to appeal a Commission determination may undermine the integrity of the voluntary clearance regime, the purpose of which is to reduce the risk of litigation and thus provide certainty. However if the scope of appeal rights widens so that more appeals occur, applicants may choose to opt out of the process altogether. This may be a risk even if more appeals do not actually eventuate, as uncertainty can be driven by the design of a regime as much as the practice.

49 Moreover for merger clearances it can be argued that the Commission takes adequate account of third party issues through submissions received and discussions held. Merger clearances are granted where the Commission finds no or very limited competition and consumer detriment. In addition, the Commission does not call conferences in the context of clearance applications at present anyway and so in practice, there would be no real change to standing for third parties wishing to appeal a determination.

Preferred Option

- 50 MED recommends that third parties should be able to seek leave of the High Court to appeal authorisations through a specific test – if party participated in the Commission’s processes (such as providing a written submission), *and* it can demonstrate it has a material interest.¹²
- 51 The objective of appeal provisions is to provide an adequate check on the quality of the Commission’s decisions and to provide adequate access to justice for those materially affected by decisions. In addition, the provisions should be designed to improve business certainty and to reduce the overall cost of seeking clearance or authorisation. Consequently, there is a trade off between natural justice and business certainty.
- 52 Given these arguments, MED recommends that third parties do not have a broader standing to appeal than is currently available to them, that is, judicial review and joining an appeal.
- 53 However, there is a stronger case for third parties to have standing to appeal in the case of authorisations. Transactions subject to authorisations have an adverse impact on competition and on consumers. By their nature authorisations in general come with higher risks and higher costs (and greater benefits on the other side).
- 54 One of the alternate options discussed above, and MED’s recommended option, both retain the requirement for the parties to participate in the Commission’s processes, thereby limiting the potential for forum shopping. However the preferred option provides for a higher threshold in that the party has to demonstrate a material interest, rather than leaving it to the court’s final discretion to allow the appeal. In addition the preferred option is likely to perform better in terms of transparency and predictability. The material interest test could provide a useful filter in weeding out vexatious and strategic appeals.
- 55 The preferred option also provides more guidance to the Courts. In practice there may be little difference between allowing the Court the discretion to decide and standing based on material interest. However having the guidance is likely to reduce some time for Court in determining standing.
- 56 Overall, the provision of access to justice and in the case of authorisations, and with a well designed test to filter out mischievous appeals, MED recommends

¹² An example is the ‘sufficient interest’ criterion in section 47(3) of the UK Competition Act 1998.

that appeal rights conferred on third parties should be by way of demonstration of material interest.

IMPLEMENTATION AND REVIEW

- 57 There are only four legislative changes recommended as a result of this review, all of which are minor and non-urgent. Officials recommend that these changes be included in the next suitable legislative vehicle rather than developing a specific bill to consider these issues now.
- 58 A public announcement on the overall outcomes of the review of the clearance and authorisation provisions of the Act will be made by the Minister of Commerce following Cabinet decisions.

CONSULTATION

- 59 The Treasury, the Commerce Commission and the Ministry of Justice have been consulted on the outcomes of the review and support the recommendations in the Cabinet paper.
- 60 The Ministry of Justice sought comments from the judiciary who were unable to comment within the time frame given. It is unlikely that there will be any concerns raised by the judiciary, however to the extent that there is we will work with the judiciary to reach a resolution.