Commerce Amendment Bill

Government Bill

As reported from the Commerce Committee

Commentary

Recommendation

The Commerce Committee has examined the Commerce Amendment Bill and recommends that the bill be passed with the amendments shown.

Introduction

This commentary describes the bill and related Supplementary Order Paper No 37 (the SOP), and discusses our consideration and recommended amendments. The bill seeks to amend the Commerce Act 1986 (the Act). It aims to assist general deterrence by clarifying when certain offences are illegal, increasing the likelihood that offences will be detected, making offending profitless both for bodies corporate and their agents, and halting anti-competitive conduct at an early stage by signalling more use of interim injunctions.

Supplementary Order Paper No 203 was sent to the Commerce Committee of the last Parliament by the then Minister for Enterprise and Commerce, Hon Max Bradford. However, SOP No 203 and related submissions were not carried over to the new Parliament. Despite that, some of the measures were included in the new SOP.

The Minister of Commerce, Hon Paul Swain, requested that we consider SOP No 37. This SOP seeks to strengthen the Act, so that it will apply to a wider range of undesirable conduct and provide stronger penalties and remedies. It also retains the provisions from

SOP No 203 from the previous Parliament that would have empowered the Commerce Commission (the Commission) to issue cease and desist orders.

Summary

We recommend a number of changes to the bill, including:

- a new purpose statement promoting competition for the long-term benefit of New Zealand consumers
- omission of clause 3, which would have expanded the range of conduct deemed to substantially lessen competition
- putting greater emphasis on penalising individual offenders
- providing that if the plaintiff proved each of the three elements of section 29, the defendant would have an opportunity to prove the arrangement was, nevertheless, not anti-competitive
- narrowing the scope of the prohibition on indemnities in the bill to relate to price fixing offences only
- providing for alternative pecuniary penalties based on a multiple of the illegal gain or a percentage of turnover
- (by majority) increasing the possible maximum amount of pecuniary penalties that may be imposed on bodies corporate from $5 million to $10 million.

We are unable to reach agreement on the followings matters:

- replacing the prohibition against the use of a dominant position in a market with much of the language in the equivalent Australian provision, including a new lower threshold of "substantial degree of power in a market" (section 36)
- clarifying the effect of section 36 by replacing "use" with "take advantage of" and to make clear that anti-competitive intent can be inferred from behaviour
- replacing the "dominance" threshold for mergers and acquisitions with the equivalent Australian threshold, which is "substantially lessening competition" (section 47)
- empowering the Commission to issue cease and desist orders (proposed new sections 74A to 74D)
- exempting the Commission from the requirement to give undertakings as to damages where the Commission applies for an interim injunction (proposed new section 88A).

Background

Commerce Act

The long title of the Act states that it is "an Act to promote competition in markets within New Zealand". Part I establishes the Commission as the Crown entity responsible for enforcing the Act, and adjudicating certain matters. Anti-competitive behaviour is prohibited under Part II and anti-competitive mergers and acquisitions are prohibited under Part III. Price control matters are covered by Part IV. Part V relates to Commission authorisations and clearances and Part VI covers enforcement, remedies and appeals and includes the right of private action. Miscellaneous matters are covered in Part VII.

The Act protects the competitive process, not competitors. It recognises that:

- the bulk of business activity is not anti-competitive
- efficient business activity is achieved through an intricate blend of competition and co-operation
- monopolies must be allowed to compete on their merits. Firms can obtain monopoly power by providing consumers with the price or quality options that they desire. Hence, simply having a monopoly is not prohibited by the Act.

Enforcement perspective

The dominant reason for penalties under competition law is the forward looking aim of promoting general deterrence. To promote deterrence, illegal conduct must be profitless, which means that the expected penalty should be linked to the expected illegal gain. The courts should severely penalise today's offender to discourage others from committing similar acts. Therefore it is the character of the offence rather than the character of the offender that should determine whether the Commission should take a case and the size of the penalty that the court imposes.

However, other factors also need to be considered. There is often a fine line between pro-competitive and anti-competitive conduct, particularly in section 36 cases taken by private litigants. Caution is important in these circumstances as severe punishment of conduct close to the margins of illegality and legality could discourage normal risk taking behaviour and promote "soft" competition by firms with monopoly power.

In the last five years the Commission has taken 12 cases under the Act, while the Australian Competition and Consumer Commission has taken approximately 90 restrictive trade practice cases. A list of prosecutions taken by the Commission since 1991 is attached as appendix C.

The Commission received nearly 1800 complaints relating to the Act and the Electricity Industry Reform Act 1998 in 1999/2000. However, it only filed two court actions under the Act as well as continuing with existing litigation. Out of a total of 25 clearance applications received during the period, all but seven were approved.

General comments

Many submissions generally support the bill and SOP. The Major Electricity Users' Group (MEUG) believes changes to the Act are long overdue. Clear Communications suggests the bill does not go far enough and enhancements to private action rights are also required. Many submissions support certain aspects of the reform package, but not others.

Many submissions oppose the bill and SOP, and some strongly oppose certain clauses. Telecom submits that the philosophies underlying the proposed amendments are misconceived. Some submissions argue that the bill will not protect consumers from anti-competitive behaviour and may encourage opportunistic behaviour. Fletcher Challenge Energy and others suggest the bill will increase risk and uncertainty for business. Meridian Energy submits that the stronger penalties and remedies will deter competitive conduct and should not be enacted. Some submissions argue that the changes to certain thresholds will significantly increase compliance costs for business.

The New Zealand Law Society (the Law Society) expresses concern about a piecemeal approach being taken to reform that addresses perceived deficiencies but does not deal with underlying issues. It suggests that New Zealand's "light handed" regulatory framework, while admirable in concept, does not work well in dealing with the issues facing those who wish to compete in markets where a firm has market power. We note that the Law Society did not support all of the proposed amendments in SOP No 37.

We consider that reforms are desirable to improve competition law within New Zealand. Government members consider that it is desirable to harmonise our arrangements with our major trading partners.

The light-handed regulatory approach introduced in New Zealand in the late 1980s was predicated on the existence of effective competition within markets and, where robust competition does not occur, on the threat of price control and information disclosure to deter firms with market power from abusing their position of dominance. Government members consider that this approach has not prevented some dominant firms from overpricing their goods and services and generally behaving in an anti-competitive manner to the detriment of consumers. In particular, reliance on potential competition ("contestability") as a substitute for actual competition is considered to have been an overly optimistic assumption.

The move towards transTasman harmonisation of competition law is important and should be pursued where it supports the purpose of this bill and recognises the special circumstances of the two economies including, where appropriate, size. Enactment of these reforms may see an increase in certain compliance costs and there will be initial uncertainty for the business community. We believe any uncertainty can be managed through adequate education and consultation. Overall, although there are some aspects of the bill on which government and opposition members disagree, we consider the benefits to be derived from improvements to the Act outweigh the costs and there will be a net benefit to the economy.

New purpose statement

The SOP seeks to replace the long title of the Act with a new purpose statement. Currently the Act's long title implies that competition is an end in itself. This narrow view is not reflected in the body of the Act, which through such mechanisms as the "public benefit test", takes a wider view of the impact of conduct on the wellbeing of New Zealanders as a whole.

Intention of purpose statement

The new purpose statement is intended to make transparent the existing policy of the Act by making clear that competition is not an end in itself but a means to increasing consumer welfare in the long-term. The ultimate goal is to facilitate effective competition to promote economic growth, while accommodating the unusual situation where competition does not improve the welfare of New Zealanders as a whole.

Submissions

Submissions from MEUG and Microsoft are among those that support the inclusion of such a provision. Vodafone gave broad support to the clause's intent, but suggested that the wording places too much emphasis on competition per se rather than efficient outcomes. Some argue that the statement does not sufficiently emphasise the interests of consumers. For example, Clear Communications argue that the interests of consumers should be paramount.

Others submit that the purpose statement has too much of a consumer emphasis. The Law Society said that the statement could have a profoundly negative effect on the interpretation of the Act by requiring that, in assessing benefits, the interests of consumers must always come first. Telecom submits that the inclusion of a consumer-focused statement is unnecessary and potentially confusing, and should be omitted until its potential effects have been properly considered and assessed. The Business Roundtable submits that the reference to consumer risks undue weighting being given to distributional rather than welfare effects.

Competition versus efficiency

We considered the relative weight given to "competition" versus "efficiency" implied by the purpose statement in the SOP, which incorporates the two elements, being "the promotion of competition" and "the efficient operation of markets". In this statement there is a presumption that the goal of benefits to consumers will be achieved through the promotion of competition. However, this presumption may be rebutted if the long-term benefit to consumers is likely to be achieved through efficiency gains that outweigh any anti-competitive detriment.

The concept of efficiency in economics generally has three aspects. One way of viewing this is that there are two static aspects (productive and allocative) and one inter-temporal aspect (dynamic). Each of these factors are considered in an efficiency analysis according to the degree of confidence associated with its quantitative measurement and durability. While recognising the importance of dynamic efficiency gains and losses, their weighting may be qualified due to their uncertainty and the need to value them in net present value terms.

A competition analysis is generally consistent with an efficiency analysis in a competitive market. However, a competition analysis

emphasises the competitive process and, as a consequence, consumer welfare. This analysis does not prohibit monopolies per se. An efficiency analysis considers the net present value of impacts of any arrangement on productive, allocative and dynamic efficiency. This would be consistent with long-term consumer welfare.

Committee views

We consider that the addition of the purpose statement will not fundamentally change the interpretation of the Act. It is clear that the statement will confirm the existing approach that competition is a means to an end, not an end in itself. The difference is that it does this more explicitly than the existing long title, and clarifies that it is the impact on the long-term welfare of consumers within New Zealand that should be the overarching goal when assessing market behaviour.

Also, the Act retains the clear demarcation between the role of the courts and the Commission. The courts determine whether conduct is anti-competitive and, therefore, illegal. The Commission considers applications for authorisation. That function is not within the functions of the courts, except on appeal.

We, however, consider that the proposed purpose statement should be simplified to emphasise and reinforce the primary purpose of the Act in promoting competition for the long-term benefit of consumers within New Zealand. This can be accomplished by excluding reference to the efficient operation of markets. We also considered whether the words "long-term" may lead the courts and the Commission to over emphasise dynamic efficiency at the expense of more immediate benefits. We accept the words "long-term" on the basis that welfare is defined as the welfare of consumers within New Zealand. The authorisation process should continue to be seen largely as an efficiency exception. We recommend the addition of an amended version of the statement in the SOP.

Definitions

Clause 2 seeks to insert a definition of "turnover". This is necessitated by proposed new section 80(2)(b)(ii) in clause 6 of the bill. We recommend that a definition of "accounting period" be added for the same reason. The SOP also provides a new definition of "Minister" to bring the legislation into line with standard drafting practice.

Scope of price fixing offence unchanged

Section 30 of the Act deems price fixing to substantially lessen competition for the purposes of section 27. Clause 3 of the bill seeks to extend the types of agreements that are deemed to substantially lessen competition under section 30 to include bid rigging, market allocation and output limitation agreements. The SOP proposes the removal of clause 3 from the bill.

Submissions suggest that the change proposed by the bill would also capture many agreements that are usually pro-competitive, such as franchise agreements. Bell Gully and others argue that the clause is unnecessary as bid rigging and market allocation agreements are usually centred around price fixing. Some submissions argue that generalised rules lack the flexibility to promote efficiency and competitiveness. MEUG submits that the clause should be retained.

We consider that retention of the clause may inadvertently capture some agreements that are usually pro-competitive, particularly vertical agreements such as franchising. We consider that clause 3 should be omitted in accordance with the SOP. This will have the effect of maintaining the current scope of section 30. This will make little practical difference to hard core cartels. Output limitation and market allocation agreements would either continue to be:

- considered under section 27; or
- prohibited under section 30 where price fixing is also an element of the cartel.

Changes to Commerce Commission membership

The SOP seeks to insert a new clause 3 to provide for the appointment of two Commissioners to administer the cease and desist orders process. The requirement that Commissioners be barristers or solicitors of at least five years' standing is intended to remove much of the concern about granting judicial powers to the Commission. We are unable to reach agreement on this matter.

Section 29

Most prohibitions in the Act contain a "competition test". Such "rule of reason" prohibitions require an assessment of the effect of the conduct on a market. The general prohibition that addresses collusive arrangements is found in section 27. Hence, proceedings

under section 27 involve the calling of evidence to test the effect that the conduct in question has on a market.

In a limited number of cases, competition law makers have determined that some behaviour is so obviously anti-competitive that it is not necessary to go through the expensive and time consuming task of assessing the effect of the behaviour on a market. These are called "per se" offences. Section 29 is a per se offence. Group boycotts and price fixing are per se offences in most OECD countries.

Section 29 prohibits agreements where the following three conditions are met:

- the arrangement is between competitors (the "horizontal" aspect)
- the arrangement has an exclusionary aspect (i.e. agreeing not to buy from, or sell to, the target)
- the target is in competition with one or more parties to the arrangement.

We considered two issues in relation to section 29: a technical amendment included in the SOP; and a wider concern that section 29 prohibits some pro-competitive vertical arrangements.

Technical amendment

The SOP seeks to make a technical amendment to the prohibition on collective horizontal boycotts. Section 29 would be amended to extend the prohibition to situations where the targeted company competes with an interconnected body corporate of one of the parties to the collective boycott.

Wider section 29 issue

The wider issue is that section 29 may capture pro-competitive arrangements involving a vertically integrated firm that also operates exclusive dealing agreements with other downstream firms. For example, a manufacturer might agree to sell its products through one or more, but not all potential retailers of the products. If the manufacturer also sells direct to the public through, say, the internet then it appears that the three conditions listed previously will have been met. Such an arrangement is most unlikely to be anti-competitive because the distributor's market power will usually be limited by inter-brand competition.

Several submissions suggest section 29 should be repealed. Russell McVeagh states that such conduct comes to its attention on "almost a weekly basis". The Law Society suggests that a possible solution would be to introduce a competition test.

Four possible solutions

We considered and rejected the Law Society's proposal to include a competition test in section 29. Adding a competition test to section 29 would turn it into a rule of reason test, in which case it would be better to repeal section 29 and rely on section 27.

Another option would be to add a competition defence to section 29. If the plaintiff proved each of the three elements of the section, the defendant would have an opportunity to prove the arrangement was, nevertheless, not anti-competitive. This carries some connotation of a reversal of the onus of proof. This option has similar problems of adding a rule of reason dimension to a per se test, but not to the same degree.

We also considered whether the first limb of section 29 (that requires the arrangement to be between two or more competitors) could be amended to require that at least two of those competitors not be vertically integrated entities. The main problem with this solution is that it carves considerably more conduct out of section 29 than is desirable.

Fourthly, we considered whether section 29 should be repealed. This would mean that group boycotts would be considered under section 27.

Addition of a defence

We consider that a competition defence should be added to section 29. If the plaintiff proved each of the three elements of the section, the defendant would have an opportunity to prove the arrangement was, nevertheless, not anti-competitive. This carries some connotation of a reversal of the onus of proof. We also support the adoption of the amendment in the SOP, and recommend the operation of section 29(2) be extended to the new section 29(1)(c).

Misuse of a dominant position

Sections 36 and 36A prohibit dominant firms from using their market power for exclusionary or anti-competitive purposes. There have

been interpretive problems with these sections. The changes address three issues:

- through judicial interpretation of the "dominance" threshold, the scope of section 36 has become too narrow
- the Privy Council adopted a hypothetical test for "use", but applied it too narrowly
- section 36 does not provide guidance on the extent to which purpose can be inferred from actions and surrounding circumstances.

The amendments in the SOP seek to overcome these problems by harmonising the sections with sections 46 and 46A of the Australian Trade Practices Act 1974.

Change to threshold

The wording of the section is derived from Article 86 of the Treaty of Rome. While the treaty does not define "dominant position", the meaning and scope of the concept has been clarified by the case law of the European Court of Justice. In this regard, dominance has been interpreted in the economic sense, which was the interpretation originally intended by the Parliament of New Zealand. However, in an important case in the early 1990s, the Court of Appeal relied on the dictionary, or ordinary, meaning of the word. [1] It has been argued the effect was to set the test at too high a level. Consequently, this could mean that firms may now be able to harm the economy through conduct that does not breach the Act, but would have breached the Act if the economic interpretation had been used.

Subsequently, the courts have sought to ameliorate that decision by more closely reflecting economic analyses of welfare and efficiency in their approach. Nevertheless, the dictionary approach to "dominance" has not yet been explicitly overturned. There is therefore some continuing uncertainty over the weighting between the economic and plain English meanings of "dominance". The SOP seeks to fully return section 36 to its economic roots by adopting "substantial degree of power in a market", which is the wording used in the equivalent sections of the Australian Act. In doing so, it seeks to lower the threshold to more clearly specify that anti-competitive behaviour is illegal under the Act.

[1] *Telecom Corp of NZ Ltd v Commerce Commission* [1992] 3 NZLR 429

Submissions

Several submissions support amending the definition, including those from the Manufacturers Federation and Federated Farmers. Some argue the proposed definition may lack conclusiveness and is open to interpretation.

Numerous submissions oppose the change. Telecom considers that change will result in many more market participants being shackled with the burden of complying with the section, which may harm the competitiveness of New Zealand industry. Chapman Tripp oppose the change as it will, in its opinion, significantly increase compliance costs. Other submitters said lowering the threshold will have an adverse impact on many large firms. Vodafone suggests that the "high market power" test should be adopted instead.

Committee views

Government members support the new definition in the SOP. The advantage of the new threshold is that it focuses directly on the concept of market power. This will provide a more accurate characterisation of the misuse of market power that section 36 is designed to address, and will provide a better focus for judicial interpretation.

The Australian threshold will also have the advantage of removing any concern about differences in the current thresholds, in relation to the use of market power within transTasman markets. The New Zealand courts will be able to look to 14 years of Australian jurisprudence. Government members are reassured by evidence from the Commission and others that the special characteristics of the New Zealand market would be considered in applying the Australian test to New Zealand.

Government members note that while certain compliance costs may increase, these would be outweighed by the benefits of stronger competition, by returning the prohibition to one that is founded in sound economics.

The committee considers that "high market power" would create too much uncertainty, as the words would be unique to New Zealand. We note that many submitters opposed to the proposed changes represent large, existing incumbent players in New Zealand markets.

We are unable to reach agreement on the proposed change to the threshold.

Substitution of "use" with "take advantage of"

In relation to section 36 matters, competitive behaviour and anti-competitive behaviour often look alike. Hence, in order to allow firms that satisfy the section's market power threshold to compete on their merits, it is essential for section 36 to include an objective filter to differentiate between permissible competitive activity and impermissible anti-competitive activity. The "use" test performs this function.

In the absence of this test, section 36 jurisprudence would be driven solely off subjective purpose, passing from one fact-specific decision to the next. This conclusion is relatively uncontentious. What has been criticised by some commentators has been the way in which the Privy Council applied a particular approach to the objective test for the "use" limb. In *Telecom Corp of NZ Ltd* v *Clear Communications Ltd*, the Privy Council held that a firm in the same circumstances as Telecom, but in a competitive market, being asked to supply a component of its services to a competitor, would have charged prices that recouped opportunity cost, therefore Telecom did not use its dominant position. [2]

The SOP proposes to replace the word "use" with "take advantage of", which is the language used in the equivalent Australian sections. This change will direct the New Zealand courts to adopt the more flexible approach used by the High Court of Australia in *Queensland Wire Industries Pty Ltd* v *Broken Hill Pty Ltd.* [3]

Submissions

The Law Society, Simpson Grierson and some other submitters assert this change will not undo the precedent set by the Privy Council in *Telecom Corp of NZ Ltd* v *Clear Communications Ltd.* The Law Society argues that the "essential problem" with section 36 is not being dealt with by the current reform proposals and that the proposed wording of the section will not reverse the Privy Council decision, which said that the Efficient Component Pricing Rule (Baumol-Willig rule) does not constitute "use".

Simpson Grierson suggests that the committee should adopt the United States' Sherman Act approach of assuming a breach unless an objective motivation can explain the full extent of the behaviour. Conversely, other submitters believe that the change will give the

[2] 1 NZLR 385; (1994) 6 TCLR 138: 5 NZBLC 103, 552.
[3] (1989) 167 CLR 177.

courts scope to overcome the restrictive way in which the Privy Council interpreted "use". Telecom submits that replacing "use" with "take advantage of" is unnecessary and potentially confusing.

Committee views

Government members recognise the issues the Law Society, Simpson Grierson and others raise, in particular, that the Privy Council definition of "use" is very restrictive. Government members wish to make very clear that the intention of Parliament in adopting the words "take advantage of" would be to reverse this interpretation by the Privy Council, and to provide the New Zealand courts with the opportunity to apply the test with an appropriate level of flexibility without giving them carte blanche to adopt a subjective purpose driven approach.

We are unable to reach agreement on the proposed new wording "take advantage of".

Proof of purpose

The SOP seeks to insert new clause 36B into the bill to provide that purpose may be inferred from relevant conduct and circumstances. The clause is based upon the Australian Act. We heard a submitter who felt that the New Zealand courts take this approach already and unnecessary change may have unforeseen consequences.

There has been some debate before the courts as to whether the test of purpose under section 36 is a "subjective" or an "objective" test. Part of the reason for the debate is a concern that proof of subjective purpose may cause a high evidential burden on plaintiffs.

We consider that the courts are generally taking the approach outlined in proposed new section 36B. They are allowing objective circumstantial evidence to be used to infer the purpose of the defendant. However, we consider it necessary to prescribe this approach in legislation for two reasons. Firstly, it will make transparent what has been good practice. Secondly, it reinforces the move by the Court of Appeal to play down the significance of the debate on whether purpose is a subjective or objective test.

Conclusion

Being unable to reach agreement on the proposed change to the threshold meant there was a tied vote on the clause in the slip, which included the proof of purpose proposal, and, therefore, the proposed

provisions in the SOP have not been added, despite there being support for some of them.

Merger control

Most business mergers and acquisitions are pro-competitive or competitively neutral. Section 47 prohibits the small number of mergers and acquisitions that are anti-competitive. It can be described as a preventative measure. While Part II can also be preventative, it is usually invoked after existing anti-competitive behaviour has been detected and, therefore, some measure of damage has been done. Section 47 seeks to prevent the damage before it is done.

Section 47 prohibits mergers and acquisitions that create or strengthen a dominant position in a market. Because the term "dominance" is used in sections 36 and 47, the interpretive problem described previously also applies to mergers and acquisitions. We received evidence that the issue of "dominance" has not been adequately dealt with. There is a concern that the existing legal framework permits potentially anti-competitive behaviour or mergers and acquisitions to occur that would be prevented in comparable jurisdictions.

The problem is that a small number of anti-competitive mergers can proceed without any consideration being given to their effects on competition. The reasons for this are:

- the level of attention paid to market share information. Market shares can provide an unreliable guide to the possible extent of harmful effects where the parties to the merger are particularly strong competitors in a market segment where products are highly differentiated by strong branding or because of their innate characteristics.
- the definition of dominance in section 3(8) does not allow co-ordinated anti-competitive effects to be considered. Only one firm can be dominant in a market.

The SOP proposes to replace the "dominance" test with a general competition test prohibiting mergers and acquisitions that would have the effect of "substantially lessening competition". The same change was made in Australia in 1992. This language is also used in Canada and the United States.

Other jurisdictions using the dominance test (i.e. the European Union and some of its constituent states), allow mergers that lead to "joint dominance" to be blocked. Hence, their concept of joint

dominance has much more in common with the "substantially lessening competition" test than New Zealand's concept of single firm dominance.

The amendment is likely to encourage more applications to the Commission for pre-merger clearance. Also, some mergers that might otherwise have been able to have been cleared may have to be considered under the authorisation test in future.

We examined the issue of whether a different approach was justified in New Zealand because of the small size of our economy. We recognise that small economies may have to tolerate more concentrated markets in order to obtain economies of scale. This may become more important as New Zealand companies seek to compete in a globalised market place. On the other hand, in small economies there are greater risks that market power will endure for longer periods of time. This points to the importance of having a robust public benefit exception, as is provided by the authorisation process.

Safe harbours and other guidance

There was discussion on the importance of safe harbour market share information, which competition authorities include in their merger guidelines. These aim to provide certainty to the business community that they will be able to proceed with certain acquisitions without being at risk of challenge by the competition authority. Because they are "green light" rather than "red light" tests they tend to be rather conservative.

Among the three countries with "substantially lessening competition" merger tests there is an inverse relationship between the safe harbour figures and the size of the economy. The United States has by far the least permissive safe harbours, with Canada in the middle and Australia having the most permissive. This strongly suggests that by adopting the "substantially lessening competition" test, New Zealand will be importing an analytical framework, not the way that that framework is applied in any specific country.

A related issue is whether it is useful for the Act to list matters that must be taken into consideration in deciding whether a merger substantially lessens competition. Section 50(3) of the Australian Act includes such a list. At this stage we do not support a similar provision for the Act. While it might be argued that such a list reduces uncertainty, the contrary argument is that it is not the matters themselves that are uncertain, it is the complexities associated

with applying them that create the complications. It might also become necessary to amend the list as economic thinking develops. However, we recommend that the Government give further consideration to this matter.

Submissions

A number of submissions support the proposed amendment to section 47 such as MEUG, Federated Farmers and the Port Company Reform Group, but many oppose the change. Tranz Rail argues the dominance threshold should be retained and the proposed threshold will deter competitive and efficient mergers and acquisitions. It also argues that there will be substantial uncertainty following introduction of the new test. Telecom also raises concerns about potentially substantial regulatory costs and uncertainty.

Several submissions, including one from the Manufacturers Federation, question whether the threshold used in Australia is appropriate for New Zealand, given the disparity of market size. We heard submissions that claim the new threshold could prevent industry rationalisation and restrict the domestic growth opportunities of New Zealand firms. Some submitters suggest that different criteria should be applied to industries that are predominately export orientated. The Law Society submits that the costs of changing the merger test outweigh the benefits as, in most cases, the cartel behaviour in question can be dealt with under Part II relating to anti-competitive behaviour.

Cost of change

The application fees currently payable by firms for clearances ($2,250) and for authorisations of restrictive practices ($11,250) and business acquisitions ($22,500) have not been changed since January 1991. We understand that the Commission would require either higher application fees, or an increase in funding to process the additional applications. The Commission has advised that this increase is likely to be between $607,000 to $763,000 in the first year, $467,000 to $623,000 in the second year, and $432,000 and $583,000 thereafter (GST inclusive). A final decision on funding for the Commission is expected to be made by the Government in 2001.

Providing certainty

In the absence of relevant New Zealand case law we understand that the Commission would initially rely on:

- case law from other jurisdictions. In Australia, the "substantially lessening competition" threshold test has been in operation for 8 years
- regulatory principles used in other jurisdictions. There is a good deal of consistency between the merger guidelines across jurisdictions
- any explicit guidance as to the intentions of the Government or Parliament in introducing or passing the legislation
- accepted economic thought.

Committee views

Government members consider that the anticipated release of draft merger guidelines by the Commission, combined with overseas experience and jurisprudence, will minimise the risks of uncertainty. The draft guidelines will be open for public comment prior to the change in legislation to provide the business community with some certainty of the Commission's approach to the new threshold.

Government members support the new threshold test. It will allow the courts and Commission to consider the full range of potentially anti-competitive mergers and acquisitions. We note that the authorisation process is available for acquisitions where efficiency gains, including export gains, outweigh anti-competitive detriments and contribute to a net public benefit. We also note that the application of the threshold by the Commission will take into account the specific competitive conditions of the New Zealand market. We consider that factors, such as minimum efficient scale, export orientation and import exposure, can be legitimately evaluated by the Commission within the proposed framework. In our view, the evolution of those interests within a global market is not inconsistent with this framework. Rather, globalisation should not become an excuse for a less rigorous examination of New Zealand's national interests.

National and ACT members do not believe that lowering the threshold for mergers and acquisitions will improve competition and consider that the proposed threshold is unsuitable for an economy the size of New Zealand's. The new threshold will increase compliance costs for business and weaken the ability of New Zealand companies

to grow domestically in order to compete globally. The threshold will stunt the growth of New Zealand companies, while at the same time encouraging litigation against foreign and domestic businesses wishing to acquire or merge New Zealand interests. In today's world firms need to be global players in a global market. This new threshold could put New Zealand at a disadvantage in a transTasman context. In an economy as receptive to innovation and change, as New Zealand's is, it is possible for new businesses to emerge and take on the dominant players. The new threshold will do nothing to alter this and may even act to suppress innovation and enterprise.

We are unable to reach agreement on the merger threshold in the SOP.

Authorisations for existing conduct

At present it is unclear whether the Commission can grant an authorisation if a restrictive trade practice has been given effect to. Some commentators consider that the Commission cannot grant an authorisation if conduct has been given effect to in the past. Others consider that the Commission can, so long as the conduct is halted while the application is being considered. Clause 5 seeks to confirm the latter, more permissive approach.

It has also been suggested that there should be no restriction on the ability of parties to seek authorisation retrospectively. However, this approach could risk fundamentally changing the nature of the Act. It could substantially weaken the incentives on firms to consider whether conduct is illegal before giving effect to it. Rather, it would encourage firms to take greater risks and, in the event of detection, seek an authorisation. We were convinced by this argument.

Nevertheless, we are concerned about the situation in which an agreement that was not anti-competitive at the time it was entered into later became anti-competitive through changing circumstances. In order to accommodate this, we consider that the Commission should be allowed to permit conduct to continue during the course of its consideration of an authorisation application if it considered that stopping the conduct would cause exceptional hardship. We recommend accordingly.

Cease and desist orders

The SOP proposes new sections 74A to 74D. These new sections would allow the Commission to issue cease and desist orders. The

orders represent a significant change to the role of the Commission, giving it a quasi-judicial function. The problem that the proposed cease and desist orders seek to address is the high cost and delay associated with litigation under the Act. These costs and delays reduce the deterrent effect of the threat of court action.

Currently, the Commission has the ability to terminate conduct allegedly in breach of the Act by warnings, affecting an administrative settlement, or by obtaining an interim injunction. However, injunctions are only available through the High Court. Cease and desist orders would be an administrative injunction to terminate conduct that is, prima facie, in breach of the Act. Failure to comply with an order would be punishable by the High Court, but orders would apply pending review and unless the High Court orders to the contrary. Sanctions may be imposed by the High Court for breach of an order.

Submissions

Some submissions support the cease and desist orders proposal. Clear Communications suggest that procedural safeguards should be considered. They also suggest that the "prima facie" test be lowered to "reasonable belief", which is the test that applies in the European Union and the United Kingdom.

A majority of submissions oppose the introduction of cease and desist orders. Tranz Rail argues that the Commission should not be able to exercise judicial powers prior to a full hearing. Both the Law Society and Manufacturers Federation believe that the fact the Commission will investigate, recommend action, apply for an order, and determine whether to make an order raises a question of serious propriety. Several submissions suggest the powers may be contrary to the New Zealand Bill of Rights Act 1990. The Business Roundtable considers that empowering the Commission in this way is not an appropriate solution to perceived delay by the courts.

International examples

Cease and desist type powers are used in other jurisdictions such as the United States, the European Union and the United Kingdom. Most of these jurisdictions have competition authorities with more extensive powers. Australia does not have a general cease and desist power, but does have a specific power in respect of participants in the telecommunications industry.

New Zealand Bill of Rights Act 1990

Submitters raised concerns about the orders infringing on section 25 and 27 of the New Zealand Bill of Rights Act (the Bill of Rights Act). Hence, we sought an opinion from the Attorney-General, who has a primary role advising Parliament on Bill of Rights Act issues. Her advice was that the cease and desist provisions do not raise any such issues. Section 25(a) of the Bill of Rights Act provides for the right to a fair trial in an impartial court when a person is charged with an offence. The SOP does not create offences with which a person can be charged. Section 27(1) provides for the observance of the principles of natural justice by any tribunal or other public authority. We were advised by the Attorney-General that the proposed new sections clearly observe these principles. We note that the proposed amendments are not inconsistent with the Bill of Rights Act, based on advice we received from the Attorney-General.

Advantages

Cease and desist orders have advantages over administrative settlements. To be effective such settlements need to be backed up with the threat of court action. This will not be the case with cease and desist orders. The orders will provide the Commission with a power to direct offenders to comply with the Act without resorting to the cost, formality and time delays associated with the court system.

Other government agencies in New Zealand already have some similar powers. For example, the Takeovers Panel, expected to be operational in 2001, is empowered to issue restraining orders in limited circumstances, and the Securities Commission has the power to suspend or cancel the registration of a prospectus.

Committee views

We note that the cease and desist order-making power was originally proposed by the Minister for Enterprise and Commerce of the previous administration in SOP No 203. Government members consider that cease and desist orders would be an effective addition to the Commission's powers and we recommend accordingly. It is noted that the process of appointing Commissioners charged with issuing cease and desist orders would not be commenced until after the bill is enacted. It will take several months before those members can be appointed. Therefore, government members consider that implementation of the cease and desist provisions should be delayed

and come into force by Order in Council should the SOP proceed in the House.

National and ACT members consider that a cease and desist order-making power will have many disadvantages. The orders may automatically be appealed in significant cases. In moderate cases, orders may offer little advantage over current enforcement tools. Moreover, the orders may negatively impact on the credibility and reputation of the Commission. The Treasury considers that the orders are unlikely to substantially reduce costs or delays in cases involving the Act. The Commission does not support the orders. In its view, being able to apply for interim injunctions is a sufficient safeguard. In the majority of the cases, where an interim injunction could have been sought, the Commission has managed to effect agreement. This would be a marked change to the way in which the Commission operates at present and, in the Commission's view, is neither required nor desirable for the New Zealand situation.

We are unable to reach agreement on the cease and desist order-making power.

Pecuniary penalties

The effectiveness of any competition law is vitally influenced by the effectiveness of the enforcement mechanisms. There needs, at minimum, to be a well-resourced enforcement agency, and penalty and remedy provisions that provide the courts with the flexibility to severely penalise the most serious offending.

Section 80(2) of the Act sets the maximum pecuniary penalty that may be ordered for a breach of certain provisions of Part II of the Act. The bill and the SOP seek to increase these maximum penalties. Clause 6 proposes that the maximum amount of pecuniary penalty for a body corporate be increased to the greater of:

- $5 million
- three times the value of any commercial gain or expected commercial gain, or
- if commercial gain is not known, 10 percent of the turnover of the body corporate and its interconnected bodies corporate (if any).

The SOP seeks to increase the maximum pecuniary penalty from $5 million to $10 million, while retaining the other options. As noted

previously, the purpose of penalty and remedy provisions in competition law is to penalise today's offender with sufficient severity to discourage others from committing similar acts. The proposed changes are consistent with that approach. They will provide a much stronger signal than the current provisions that the deterrence objective will only be served if anti-competitive behaviour is profitless.

Submissions

While some submissions, including those from Clear Communications and Vodafone support the proposed changes, nine submissions state that the existing penalties regime provides ample scope for the courts to impose adequate penalties. Telecom submits that the line between desirable and undesirable conduct is often not clear. Increasing penalties will promote soft competition, chill innovation and creativity, and encourage litigation gaming. Fletcher Challenge Energy submits that the proposed penalties are too extreme and cannot be justified given the fine line between prohibited and allowable conduct. The Law Society strongly opposes the increases. It submits that there is little evidence to support the proposition that increased sentences promote specific or general deterrence.

We note that there is a significant body of research showing that offenders respond to changes in opportunity costs, the probability of apprehension and the severity of penalties, particularly in relation to offences that are committed for pecuniary gain. However, the courts to date have not set penalties at anything like the maximum, even for serious contravention. The proposed changes will encourage the courts to use more appropriate penalty awards. We believe that the courts will continue to set penalties proportionate to the offence, including considering whether the offender has contravened the Act previously, issues of intent, and whether the conduct was a deliberate or obvious breach or close to the border of illegality and legality.

Commercial gain

Clause 6 seeks to insert proposed new section 80(2B), which would provide that an order must take into account commercial gain. This would emphasise the deterrence message. Mobil submits that the term should be defined. Russell McVeagh argues that the term will include intangibles and should be substituted by "net profit". It believes that the phrase "commercial gain" was intended to catch benefits beyond accounting net profit and suggests that to engage in

the exercise of trying to prove "non-accounting profit" gains would be problematic and impede the courts.

We note that the approach is not a novel one and there are similar provisions in five other statutes, including the Resource Management Act 1991 and the Electricity Industry Reform Act 1998. In general, the assessment of appropriate penalty will, as a matter of practical necessity, be a "broad brush" affair. Even the relatively simple matter of identifying potential sales "lost" and "gained", and deriving measures of loss and profit, does not lend itself to pedantic specification. The inherent approximation in such an exercise will far outweigh any lack of specificity in the statutory formulation. To direct the courts toward an accounting definition of profit may actually hinder the process. We recommend no change.

Turnover

Several submissions, including those from the Consumers Institute and MEUG, support the change to 10 percent of turnover in certain cases. However, some submissions specifically oppose basing penalties on turnover. Federated Farmers consider that the turnover option will place an excessive burden on high turnover/low margin firms. We consider that the courts will use their discretion to set penalties that are proportionate to the offence taking into consideration the particular circumstances of the offence. Some submissions argue that the definition should exclude turnover generated outside New Zealand by overseas parents and their international subsidiaries. We agree and consider that the maximum penalty should be linked to New Zealand turnover only and recommend accordingly.

Proposal to increase maximum pecuniary penalty to $10 million

The SOP proposes that the maximum pecuniary penalty be increased from $5 million to $10 million, while retaining the other options. Information made available to the committee shows that pecuniary penalty orders awarded since 1991 have been, on the whole, significantly less than possible under the current maximum (see appendix C). For example, since 1991 only three firms have been ordered to pay more than $1 million in pecuniary penalties. In 1999 the highest order was for $500,000 and in 2000 it was for $525,000.

Clearly the figures show that the courts are not ordering pecuniary penalties of the magnitude envisaged by Parliament when it legislated the maximum amount in 1990. By raising the maximum, Government and ACT members wish to send a unequivocal signal to the courts that Parliament, and indeed the public, expect offenders engaged in anti-competitive behaviour to the disadvantage of consumers to be severely penalised as a deterrence to others. Government and ACT members consider that the size of the penalty should be sufficiently high to make the offence profitless. Indeed, a higher penalty is needed to achieve optimum deterrence. This is particularly the case for hard core cartel offences, as they have no redeeming features.

National members' view

National members consider that raising the maximum penalty to $10 million for a body corporate is unwise and unjustified. We note that the bill, introduced by a minister in the previous administration, proposed to keep the maximum at $5 million. Information presented to the committee does show that the courts have not been making orders near the maximum, and there is scope for larger orders to be made within existing parameters. However, we are not persuaded by the argument that increasing the maximum to $10 million will necessarily encourage the courts to increase the size of orders, given that orders historically have been well below existing maximum levels. We are also concerned that the effect of large penalties will eventually be borne by shareholders and consumers.

Hypothetical tests

Proposed section 80(2)(b)(ii) contains a number of hypothetical tests. We consider that these tests, aimed at attempted breaches, will be very difficult to apply. It would be better to limit the clause to actual breaches. Attempted breaches should be dealt with under proposed section 80(2)(b)(i) and we recommend accordingly. This amendment will also require some consequential amendment to proposed section 80(2B).

Risk of double jeopardy

Russell McVeagh state that in the event section 82A is retained, section 80(2B) should also include a requirement for the courts to consider any exemplary damages awarded in setting a pecuniary

penalty. We do not consider that there is a risk of double jeopardy, but recommend that a provision similar to proposed section 82A(2) be added to section 80 to alleviate concern.

Presumption that penalties be imposed on individuals

The bill creates a presumption that pecuniary penalties should be awarded against individuals unless the courts consider that there is good reason for not making such an order. The maximum amount of pecuniary penalty for an individual will remain at $500,000.

The purpose of the change is to acknowledge that general deterrence is promoted if the individuals within firms that perpetrate offences face a personal pecuniary risk. Even though companies tend to gain the most from breaching the Act, remuneration structures and wider career aspirations can create incentives for individuals to breach the Act in order to directly benefit themselves.

The Law Society submits that the proposed amendment, combined with proposed section 80A, will expose directors and employees to far too much risk. We understand the position of the submitter and consider that the changes to proposed section 80A in the SOP have dealt with this problem.

Government and National members consider that the presumption will be a key measure deterring anti-competitive offending and must have more prominence in the legislation. We consider that clause 6 should be reordered so that proposed subsections (2A) and (2B) are placed in front of subsection (2) and recommend accordingly. The ACT member reserved on this point.

Indemnification of agents

Clause 7 proposes that bodies corporate be prohibited from indemnifying their agents in respect of liability or costs relating to pecuniary penalties imposed for breaches of a wide range of restrictive practices. Numerous submissions oppose the clause. The Employers Federation considers the prohibition is too harsh and probably unworkable. The New Zealand Stock Exchange suggests that if there is to be personal liability it should be limited to circumstances where directors have been negligent. In response to submissions, the SOP seeks to limit the extent of the prohibition against indemnification to price fixing, where it is clear what conduct constitutes a breach. We endorse this approach and recommend that the bill be

amended using a modified version of the clause contained in the SOP.

Banning serious offenders

Clause 7 also proposes that the courts may ban serious offenders from being involved in the management of a body corporate for a period of up to five years. This is a key element in placing more of the risk for offending against individual perpetrators. We endorse this approach. The ACT member reserved on this point. We also recommend a technical amendment to this section. The word "contravention" should be replaced with "matter giving rise to the contravention". We also recommend similar amendments to sections 82(2) and 88(3A).

Exemplary damages

Clause 9 proposes adding new section 82A to clarify that the courts may make orders for exemplary damages in addition to pecuniary penalties for the same conduct. A number of submissions support the proposed availability of exemplary damages, including those from MEUG, Federated Farmers and the Consumers Institute. However, some submitters express concern about the proposed provision.

Double jeopardy

The Retail Merchants Association considers that exemplary damages should not be available where the person has been ordered to pay a pecuniary penalty for the same conduct. Both Russell McVeagh and Mobil echo this point, suggesting that the proposal may offend against the principle of double jeopardy.

We carefully considered the issues raised in submissions and consider that there is no risk of double jeopardy. We believe that it is quite clear in proposed section 82A that the award of exemplary damages will be at the discretion of the courts on a case by case basis. In exercising their discretion, it is highly unlikely that judges would impose exemplary damages where an offender has already been fully punished.

Even if there were double jeopardy issues, the risks would be very low because the incentives to take repeat cases against offences under the Act are very weak. In the 14 years the Act has been in

force there has never been a case where public and private enforcement for penalties and damages respectively have been sought in relation to the same alleged contravention. Indeed, the Commission has a policy of not seeking pecuniary penalties where orders have been imposed by the courts following a private action in relation to the same conduct.

Bill of Rights Act

Russell McVeagh also brought possible Bill of Rights Act implications to our attention. Section 26(2) of the Bill of Rights Act prevents one being tried or punished twice for an offence. We note that in *Daniels* v *Thompson* [4], the Court of Appeal held that section 26(2) of the Bill of Rights Act does not operate as an absolute bar to an award of exemplary damages in a civil proceeding where a criminal prosecution has already been concluded. The Court of Appeal cited that High Court decision favourably in *Caldwell* v *Croft Timber Co Ltd.* [5] The Court of Appeal also found that section 26(2) and the underlying common law principles of *autrefois acquit* or *autrefois convict* are not applicable to civil proceedings. Cases brought by the Commission for pecuniary penalties are civil. Nevertheless, it is possible that the principles arising out of the jurisprudence under section 26 would be relevant to proceeding under the Act.

Consequential amendment required

The enactment of clause 9 will require a consequential amendment to section 75 to provide the High Court with the jurisdiction to hear and determine applications for exemplary damages and we recommend accordingly.

General provisions relating to granting of injunctions

Clause 10 provides that the courts must give weight to the interests of consumers when deciding whether to grant an interim injunction. We received and considered several submissions on this issue. Both Vodafone and the Consumers Institute support moves to increase the availability of interim injunctions. We note that the clause will require the courts to give "appropriate" weighting to the interests of consumers and needs no amendment in this regard. We consider that no party's interest should be given more than appropriate weighting.

[4] [1998] 3 NZLR 22, 34.
[5] [1997] ERNZ 136.

In the great bulk of cases, anti-competitive conduct adversely affects the interests of consumers. However, in some circumstances (where there are many weak sellers facing a monopsonist or oligopsonist) suppliers will be harmed. Federated Farmers submits that the interests of suppliers or acquirers should be recognised in these circumstances. We agree and recommend accordingly.

Undertakings as to damages not required by Commission

The SOP seeks to insert new section 88A. It exempts the Commission from the requirement to give an undertaking as to damages when seeking an interim injunction. We received several submissions that support inclusion of the provision. However, submissions from Tranz Rail, Telecom and Vodafone oppose the clause and suggest that it will reduce the accountability of the Commission, remove the incentive to be reasonable, and deprive third parties of important rights.

Committee views

The Commission is a public enforcement body. Government members consider that it has little or no incentive to behave opportunistically. Government members also note that the Australian Competition and Consumer Commission does not have to give such undertakings. Also, the Commission is subject to judicial review, which acts as a discipline on the exercise of its functions.

National and ACT members note that every other litigant seeking an interim injunction has to give an undertaking as to damages, and we are not convinced by the argument that the Commission should be treated differently. We note that the Government already indemnifies the Commission for undertakings.

We are unable to reach agreement on the matter.

Transitional provisions

It has been suggested that transitional provisions should be included in the bill, particularly with regard to the proposed amendments to sections 9, 29, 36, and 47 of the Act and proposed new sections 74A to 74D. There are three main arguments supporting the inclusion of transitional provisions. Firstly, it will take the business community time to learn and adjust to its obligations under the new prohibitions. Secondly, firms should be given time to assess what their risks are

under the new prohibitions and, if necessary, amend or vary their existing arrangements. Thirdly, it will give the Commission more time to prepare for the changes.

Group boycotts

The bill includes a technical amendment that extends the coverage of section 29. We also recommend a more permissive amendment to narrow the scope of the provision. We consider that there is no need for a transition in relation to either change. The effect of the technical amendment is that certain conduct that was already at risk under section 27 will now be treated as a per se offence under section 29. Therefore, the only change the business community has to adjust to is an increase in the clarity of the law on boycotts. The second change would make section 29 more permissive. Individual firms should be able to take advantage of this opportunity as soon as they are able.

Misuse of market power test

During our consideration we discussed three changes to section 36. The first deals with the change in the market power test. It is generally accepted that the change would represent a lowering of the threshold. Therefore, the business community and legal practitioners would need time to learn and understand what the new test means. There are also proposed changes to the "use" test and the law as it relates to "purpose". It is generally accepted that these are not fundamental changes.

The change to the threshold would affect two types of firms:

- those that are dominant in some markets and not in others
- those that regard themselves as not being dominant in any market at present, but with the potential to be subject to the "substantial degree of market power" test.

We consider that the arguments for a transitional period are strong for the second type of firm. However, as there is no practical way to define a transitional provision for this particular type of firm, should the SOP proceed in the House, we consider that a general transitional period should apply to section 36. Six months would be appropriate.

Technical amendment

It was drawn to our attention that there is a wording problem with section 44(1)(b). Although it is evident from the context that this provision should apply only to the provisions that prohibit collusive conduct, the plain language suggests that it also applies to sections 36 and 36A. Thus, it could be argued that an arrangement that is solely between interconnected bodies corporate could be argued to be exempt from sections 36 and 36A. It is very evident that such a conclusion would be plainly contrary to the intent of the Act. Hence, it would be surprising if a court were to accept such an argument. Nevertheless, that is what the plain words of section 44(1)(b) state. We consider that it is undesirable that this ambiguity should continue. We recommend accordingly.

Information disclosure by port companies

The Port Company Reform Working Group submits that an information disclosure regime for port companies should be introduced. It is concerned about possible monopoly pricing by certain port companies and considers that financial information currently made available by port companies is insufficient.

Although it is evident that the potential for monopoly pricing varies considerably from port to port and commodity to commodity, it is unclear whether there is a sufficiently large problem to warrant government intervention. We do not consider that the bill is the appropriate vehicle for dealing with this issue. However, government members recommend to the Government that the Ministry of Transport and the Ministry of Economic Development conduct a systematic review in 2001 of possible monopoly pricing by port companies and report to the committee.

Baumol-Willig rule

Several submitters raised the issue of the anti-competitive effects of the Baumol-Willig rule (also known as the Efficient Component Pricing Rule). In comparison to other pricing rules, the Baumol-Willig rule will produce a price at the top end of the range. [6] The rule has a number of significant disadvantages that have led to it being controversial as a pricing principle:

- by indemnifying an incumbent against lost revenue and profit it effectively prevents the competing-away of monopoly rents

[6] A Ramsey price could be higher.

- this has the effect of further entrenching an incumbent monopolist's position
- interconnection prices are set at an economically inefficient level that distorts investment signals and reduces consumer welfare
- the rule deters entry in the face of sunk costs and fails to adjust for economies of scope, dynamic efficiency and externalities, particularly where the information available to entrants and regulators is insufficient to establish competitive benchmark prices.

The Baumol-Willig rule is relevant to discussion of New Zealand competition law as it was deemed by the Privy Council to be inconsistent with section 36 of the Act. Thus a court could find itself bound to accept this Privy Council interpretation. In the absence of legislative reforms it could take substantial costly legal challenges and appeals to lay this precedent to rest.

We were also advised, however, that the Baumol-Willig rule could, in some special circumstances, have certain advantages. In particular, it could be used as a component of pricing rules that could permit the recovery of costs of social obligations without explicit quantification of those costs.

On balance, we note the economic and legal arguments against the Baumol-Willig rule, and that its principal application has been in the telecommunications sector. We note that submitters were not given an explicit opportunity to comment on the rule in the context of the bill and note that the Government is considering these issues.

Appendix A

Conduct of the examination

The Commerce Amendment Bill was introduced on 1 June 1999 and referred to the Commerce Committee for consideration. The committee called for public submissions and set a closing date of 2 July 1999. It received 40 submissions. The bill was carried over to the Commerce Committee of the 46th Parliament. An associated SOP was not carried over. On 2 August 2000 we received a letter from the Minister of Commerce requesting that we consider SOP No 37. We called for public submissions on the SOP and set a closing date of 15 September 2000. We received and considered 24 submissions, of which 19 were heard. Hearing evidence on the bill and SOP No 37 took nine hours and 25 minutes and consideration took 17 hours and 20 minutes. We received advice from the Ministry of Economic Development and the Office of the Attorney-General.

Committee membership

David Cunliffe (Chairperson)
Kevin Campbell (Deputy Chairperson)
Steve Chadwick
Hon Ruth Dyson
Gerrard Eckhoff
Warren Kyd
Dr the Hon Lockwood Smith
Pansy Wong

Appendix B

Overseas merger provisions

Jurisdiction	Competition threshold	Safe harbour	Public interest or efficiency defence
United States	"substantially to lessen competition, or to tend to create a monopoly"	HHI safe harbours	Yes, but the efficiencies must be sufficient to guarantee no price increase, whatever the effect on total welfare.
Canada	"likely to prevent or lessen competition substantially"	• The merged entity has less than a 35 percent market share; or • The combined market shares of the 4 largest market participants is less than 65 percent or the market share of the merged entity is less than 10 percent.	Yes. Recent statements made that efficiencies would not justify a merger to monopoly.
Australia	"substantial lessening of competition"	• The merged entity has less than a 40 percent market share; or • The combined market shares of the 4 largest market participants is less than 75 percent and the market share of the merged entity is less than 15 percent.	Yes. Efficiency focus.
Germany	"expected to create or strengthen a dominant position" Includes joint dominance.	Has de minimus threshold. Mergers that do not exceed deeming threshold, ie: • The merged entity has a market share of less than 33 percent; or • The combined market shares of:	Yes. Authorisation may only be granted if the scope of the restraint of competition does not jeopardise the market economy system.

Jurisdiction	Competition threshold	Safe harbour	Public interest or efficiency defence
		• the 3 largest market participants is less than 50 percent; or • the 5 largest market participants is less than 66 percent.	
United Kingdom	"not contrary to public interest"	Not known.	Primarily competition focus, but also consider: • promoting the balanced distribution of industry and employment; and • promoting competitive activity by UK companies in markets outside the UK.
European Community	"creates or strengthens a dominant position" Includes joint dominance.	Has de minimus threshold.	Competition focus.
New Zealand (currently)	"creates or strengthens a dominant position" Does not include joint dominance.	The merged entity has less than: • a 40 percent market share; or • a 60 percent market share where 1 other market participant has at least a 15 percent market share.	Yes. Efficiency focus.

Appendix C

Pecuniary penalty awards since 1991

Date	Defendant	Penalty/Order		Turnover of firm (where available)
1991	BP Oil New Zealand Ltd		$40,000	$1.295 million
	BP salesman		$8,000	
1992	Hewlett Packard (NZ) Ltd		$35,000	
1992	Sealy New Zealand		$30,000	$8.37 million
1993	Accent Footwear		$30,000	
1994	NZ Milk Corporation Ltd & Ors	(× 5)	$200,000 $30,000	$320 million (or 80% of fresh milk market sales)
1994	Wrightson NMA (Blenheim Real Estate) & Ors			
	McMurtry's Ltd		$10,000	
	Mr Avery, employee of McMurtry's		$10,000	
	Wrightson's Ltd		$5,000	
	Mr McLean, employee of Wrightson's		$5,000	
	3 other individual real estate agents	(x 3)	$10,000	
1995	Port Nelson		$500,000	$15.5 million
1995	Queen Street Backpackers	Permanent injunction	No penalty	
1995	NZ Motor Body Builders		$15,000	
1996	Country Fare Bakeries Ltd	(x 2)	$150,000	
	Quality Bakeries NZ Ltd			
1996	Rotorua Branch of Moteliers Association	Branch dissolved	No penalty	
1996	Toyota Dealers (Auckland)	(x 7)	$50,000	
1997	Toyota New Zealand		$250,000	$417 million
1997	DB Breweries		$110,000	$647 million
1998	Roadmarkers		$15,000	$2.5 to $3 million

Date	Defendant	Penalty/Order	Turnover of firm (where available)
1998	North Island Meat Companies:		
	AFFCO	$1.5 million	$880 to $920 million
	Richmond	$1.5 million	$500 to $520 million
	Lowe Walker	$1.5 million	$350 to $390 million
	Riverland	$375,000	
	Taylor Preston	$250,000	$95 million
	CR Grace	jointly liable	
	Waitotara	$225,000	$96 million
	Greenlea	$90,000	$75 million
	Wallford	$70,000	$35 to $40 million
	Benmore		$51 to $54 million
	Waikato Beef Te Kuiti	$25,000 + costs each	$28 to $35 million
1998	Christchurch Transport	$380,000	$12.5 million
	CEO, Mr Peter	$10,000	
1999	Eli Lilly & Co (NZ) Ltd animal remedies division Elanco	$500,000	$37 million
	Chemstock Animal Health Ltd	$200,000	
1999	Acer Computer NZ Ltd	$82,000	$24.5 million
2000	Caltex NZ Ltd	$450,000	$704 million
	Mobil Oil NZ Ltd	$350,000	$1,205 million
	Shell Oil NZ	$375,000	$1,332 million
2000	Carter Holt Harvey (INZCO)	$525,000	$2,267 million

Key to symbols used in reprinted bill

As reported from a select committee

Struck out (unanimous) Subject to this Act,	Text struck out unanimously
New (unanimous) Subject to this Act,	Text inserted unanimously
Struck out (majority) Subject to this Act,	Text struck out by a majority
New (majority) Subject to this Act,	Text inserted by a majority
{*Subject to this Act,*}	Words struck out unanimously
⟨*Subject to this Act,*⟩	Words struck out by a majority
Subject to this Act,	Words inserted unanimously
⟨Subject to this Act,⟩	Words inserted by a majority

Note: This bill has been reformatted in accordance with the resolution of the House of 22 December 1999.

Hon Paul Swain

Commerce Amendment Bill

Government Bill

Contents

The Parliament of New Zealand enacts as follows:

1 Title

(1) This Act is the Commerce Amendment Act **1999**.

(2) In this Act, the Commerce Act 1986[1] is called "the principal Act". 5

[1] 1986, No 5

1AA Commencement

This Act comes into force on the day after the date on which this Act receives the Royal assent.

New (unanimous)

1A Title repealed

The Title of the principal Act is repealed.

1B New section 1A inserted

The principal Act is amended by inserting, after section 1, the following section: 5

"1A **Purpose**

The purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand."

Struck out (unanimous)

2 Interpretation

Section 2(1) of the principal Act is amended by inserting, after the definition of the term **trade**, the following definition: 10

"**turnover** has the same meaning as in section 2(1) of the Financial Reporting Act 1993, except that every reference to an entity is a reference to a body corporate:".

New (unanimous)

2 Interpretation 15

Section 2(1) of the principal Act is amended by inserting, in their appropriate alphabetical order, the following definitions:

"**accounting period** has the same meaning as in section 2(1) of the Financial Reporting Act 1993, except that every reference to an entity is a reference to a body corporate 20

"**Minister** means the Minister of the Crown who, under the authority of any warrant or with the authority of the Prime Minister, is for the time being responsible for the administration of this Act

"**turnover** means the total gross revenues (exclusive of any tax required to be collected) received or receivable by a body corporate in an accounting period as a result of trading by that body corporate within New Zealand". 25

Struck out (unanimous)

3 Certain provisions of contracts, etc, with respect to prices, etc, deemed to substantially lessen competition

The principal Act is amended by repealing section 30, and substituting the following section:

"30(1) Without limiting the generality of section 27, a provision of a contract, arrangement, or understanding is deemed for the purposes of that section to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market if the provision has the purpose, or has or is likely to have the effect, of—

"(a) fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services; or

"(b) fixing, controlling, maintaining, or coordinating, or providing for the fixing, controlling, maintaining, or coordinating, of bids or tenders for goods or services; or

"(c) dividing, distributing, allocating, or apportioning, or providing for the dividing, distributing, allocating, or apportioning, of a market for goods or services on any basis, including customers, suppliers, territory, or time of sale; or

"(d) limiting, or providing for the limiting, of the quantity of goods produced, processed, distributed, or sold, or restricting, or providing for the restricting, of the number, volume, or frequency of services offered.

"(2) In **subsection (1)**, **goods or services** means goods or services that are—

"(a) supplied or acquired by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other; or

"(b) resupplied by persons to whom the goods are supplied by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other.

Struck out (unanimous)

"(3) The reference in **subsection (2)(a)** to the supply or acquisition of goods or services by persons in competition with each other includes a reference to the supply or acquisition of goods or services by persons who, but for a provision of any contract, arrangement, or understanding would be, or would be likely to be, in competition with each other in relation to the supply or acquisition of the goods or services."

New (unanimous)

3A Contracts, arrangements, or understandings containing exclusionary provisions prohibited

(1) Section 29(1) of the principal Act is amended by omitting the word "For", and substituting the words "Subject to **subsection (1A)**, for".

(2) Section 29 of the principal Act is amended by inserting, after subsection (1), the following subsection:

"(1A) A provision of a contract, an arrangement, or an understanding that would, but for this subsection, be an exclusionary provision under subsection (1) is not an exclusionary provision if it is proved that the provision does not have the purpose, or does not have or is not likely to have the effect, of substantially lessening competition in a market."

(3) Section 29(2) of the principal Act is amended by omitting the words "of this section", and substituting the expression "and (c)".

4 Repeal of section 35

Section 35 of the principal Act is repealed.

New (unanimous)

4B Other exceptions

(1) Section 44(1) of the principal Act is amended by repealing paragraph (b).

New (unanimous)

(2) Section 44 of the principal Act is amended by inserting, after subsection (1), the following subsection:

"(1A) Nothing in this Part (except **sections 36 and 36A**) applies to—

"(a) the entering into of a contract or arrangement, or arriving at an understanding, or the giving or requiring the giving of a covenant, if the only parties, or (in the case of a covenant or proposed covenant) the only persons who are or would be respectively bound by, or entitled to the benefit of, the covenant or proposed covenant, are or would be interconnected bodies corporate:

"(b) any act done to give effect to a provision of a contract, arrangement, or understanding, or to a covenant referred to in **paragraph (a)**."

5 New sections 59 to 59B substituted

The principal Act is amended by repealing section 59, and substituting the following sections:

"59 **Contracts or covenants subject to authorisation not prohibited under certain conditions**

"(1) Despite anything in this Act, but subject to **section 59B**,—

"(a) a contract to which section 27 or section 29 applies may be entered into if the requirements of **subsection (2)** are complied with:

"(b) a covenant to which section 28 applies may be required to be given, or may be given, if the requirements of **subsection (2)** are complied with.

"(2) For the purposes of **subsection (1)**, the requirements that must be met are,—

"(a) in the case of a contract to which section 27 or section 29 applies, that the contract is subject to a condition that the provision, or exclusionary provision, as the case may be, does not come into force unless and until authorisation is granted to give effect to the provision, or exclusionary provision and that application must be made for that authorisation within 15 working days after the contract is entered into:

"(b) in the case of a covenant to which section 28 applies, that the covenant is subject to the condition that it does

not have effect unless and until (*application*) authorisation is granted to give effect to it and that application must be made for that authorisation within 15 working days after the covenant is made.

"59A **When Commission may grant authorisation** 5

"(1) The Commission may grant an authorisation to a person—

"(a) to enter into a contract or arrangement, or to arrive at an understanding, even though the contract or arrangement has been entered into, or the understanding has been arrived at, before the Commission makes a determination in respect of the application for that authorisation; or 10

"(b) to give effect to a provision of a contract or arrangement entered into, or an understanding arrived at, even though the applicant has already given, or is already giving, effect to the provision before the Commission makes a determination in respect of the application for that authorisation; or 15

"(c) to require the giving of, or to give, a covenant even though the covenant has been given before the Commission makes a determination in respect of the application for that authorisation; or 20

"(d) to do an act or engage in conduct referred to in section 37 or section 38 even though the applicant has already done the act or is already engaging in the conduct before the Commission makes a determination in respect of the application for that authorisation. 25

"(2) (*However*) Subject to **subsection (3)**, all of the parties to the contract, arrangement, or understanding must, unless and until authorisation is granted, discontinue— 30

"(a) giving effect to the provision of the contract, arrangement, or understanding:

"(b) engaging in conduct referred to in section 37 or section 38.

New (unanimous)

"(3) The parties to the contract, arrangement, or understanding may do any of the things set out in **subsection (2)** as long as any of the parties establishes to the satisfaction of the Commission 35

New (unanimous)

that discontinuing any of those things would, or would be likely to, result in exceptional hardship to any of the parties.

"59B **Contraventions not prevented by granting of authorisation under section 59 or section 59A**

Nothing in **section 59 or section 59A** prevents conduct that occurred before an authorisation was granted in respect of it and that would otherwise have constituted a contravention of this Act from continuing to constitute a contravention."

New (unanimous)

5B Jurisdiction of High Court

Section 75(1) of the principal Act is amended by adding the following paragraphs:

"(f) applications for orders under **section 80B or section 80C**:

"(g) proceedings for offences against **section 80E**:

"(h) applications for orders under **section 82A**."

6 Pecuniary penalties

(1) Section 80(1) of the principal Act is amended by omitting all the words after the word "appropriate".

(2) Section 80 of the principal Act is amended by repealing subsection (2), and substituting the following subsections:

Struck out (majority)

"(2) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed,—

"(a) in the case of an individual, $500,000; or

"(b) in the case of a body corporate, the greater of—

"(i) $5,000,000; or

"(ii) three times the value of any commercial gain resulting, or expected to result, from the contravention if the Court is satisfied that the contravention occurred in the course of producing, or

Struck out (majority)

attempting to produce, a commercial gain, or, if the commercial gain or expected commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

"(2A) The Court must order an individual who has engaged in any conduct referred to in subsection (1) to pay a pecuniary penalty, unless the Court considers that there is good reason for not making such an order.

"(2B) In determining an appropriate penalty under this section, the Court must have regard to all relevant matters and, in particular, the nature and extent of any commercial gain, or any expected commercial gain, at the time of the contravention."

New (majority)

"(2) The Court must order an individual who has engaged in any conduct referred to in subsection (1) to pay a pecuniary penalty, unless the Court considers that there is good reason for not making such an order.

"(2A) In determining an appropriate penalty under this section, the Court must have regard to all relevant matters, in particular,—

"(a) any exemplary damages awarded under **section 82A**; and

"(b) in the case of a body corporate, the nature and extent of any commercial gain.

"(2B) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed,—

"(a) in the case of an individual, $500,000; or

"(b) in the case of a body corporate, the greater of—

"(i) $10,000,000; or

"(ii) either—

"(A) if it can be readily ascertained and if the Court is satisfied that the contravention occurred in the course of producing a commercial gain, 3 times the value of any commercial gain resulting from the contravention; or

New (majority)

"(B) if the commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any)."

(3) Section 80 of the principal Act is amended by repealing subsection (5), and substituting the following subsection:

"(5) Proceedings under this section may be commenced within 3 years after the date the contravention was discovered or ought reasonably to have been discovered. However, no proceedings under this section may be commenced 10 years or more after the date of the contravention."

7 New sections 80A to 80E inserted

The principal Act is amended by inserting, after section 80, the following sections:

"80A **Body corporate not to indemnify certain persons in respect of pecuniary penalties**

"(1) A body corporate must not indemnify a director, servant, or agent of the body corporate or an interconnected body corporate in respect of—

Struck out (unanimous)

"(a) liability for payment of a pecuniary penalty under section 80; or

New (unanimous)

"(a) liability for payment of a pecuniary penalty under section 80 that arises out of a provision of a contract, arrangement, or understanding that is deemed, under section 30, to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market; or

"(b) costs incurred by that director, servant, or agent in defending or settling any proceeding relating to that liability.

"(2) An indemnity given in contravention of **subsection (1)** is void.

Struck out (unanimous)

"(3) However, a body corporate may, if expressly authorised by its constitution or other document defining its constitution, indemnify a director, servant, or agent of the body corporate or an interconnected body corporate for any costs incurred by him or her in any proceedings under section 80—

"(a) that relate to liability for any act or omission in his or her capacity as a director, servant, or agent; and

"(b) in which judgment is given in his or her favour, or which are discontinued.

"(4) In this section,—

"**agent** includes a former agent

"**director** includes a former director

"**indemnify** includes relieve or excuse from liability, whether before or after the liability arises; and **indemnity** has a corresponding meaning

"**servant** includes a former servant.

"80B **Pecuniary penalties for contravention of section 80A**

"(1) If the Court is satisfied on the application of the Commission that a body corporate has acted in contravention of **section 80A**, the Court may order the body corporate to pay to the Crown such pecuniary penalty as the Court determines to be appropriate.

"(2) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed 2 times the value of any indemnity given in contravention of **section 80A**.

"(3) The standard of proof in proceedings under this section is the standard of proof applying in civil proceedings.

"(4) In any proceedings under this section, the Commission, upon the order of the Court, may obtain discovery and administer interrogatories.

"(5) Proceedings under this section may be commenced within 3 years after the matter giving rise to the contravention was discovered or ought reasonably to have been discovered. However, no proceedings under this section may be commenced 10 years or more after the date of the matter giving rise to the contravention. 5

"80C **Court may order certain persons to be excluded from management of body corporate**

The Court may make an order that a person must not, without the leave of the Court, be a director or promoter of, or in any way, either directly or indirectly, be concerned or take part in the management of, a body corporate for a period not exceeding 5 years as may be specified in the order, if the Court is satisfied on the application of the Commission that— 10

"(a) the person has entered into a contract or arrangement, or arrived at an understanding, containing a provision that is deemed by **section 30(1)** to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market: 15

"(b) the person has given effect to a provision of a contract, arrangement, or understanding that is deemed by **section 30(1)** to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market: 20

"(c) the person has entered into a contract, or arrangement, or arrived at an understanding, that contains an exclusionary provision: 25

"(d) the person has given effect to an exclusionary provision of a contract, arrangement, or understanding.

"80D **Application for order under section 80C** 30

"(1) The Commission must give not less than 10 days' notice of its intention to apply for an order under **section 80C** to the person against whom the order is sought.

"(2) On the hearing of the Commission's application or an application for leave by a person against whom an order under **section 80C** has been made,— 35

"(a) the Commission must appear and call the attention of the Court to any matter that seems to it to be relevant, and may give evidence or call witnesses; and

"(b) the person against whom the order is sought or has been made may appear and give evidence or call witnesses.

"(3) The Registrar of the Court must, as soon as practicable after the making of an order under **section 80C**, give notice of the order to— 5

"(a) the person against whom the order has been made; and

"(b) the Registrar of Companies, and the Registrar of Companies must give notice in the *Gazette* of the name of the person against whom the order is made.

"80E **Offence to act in contravention of order made under section 80C** 10

"(1) Every person commits an offence who acts in contravention of an order made under **section 80C**.

"(2) A person who commits an offence against **subsection (1)** is liable on conviction to imprisonment for a term not exceeding 5 years or to a fine not exceeding $200,000. 15

"(3) The offence is triable on indictment."

8 Actions for damages for contravention of Part II

Section 82 of the principal Act is amended by repealing subsection (2), and substituting the following subsection: 20

"(2) An action under subsection (1) may be commenced within 3 years after the date the matter giving rise to the contravention was discovered or ought reasonably to have been discovered. However, no action under subsection (1) may be commenced 10 years or more after the date of the matter giving rise to the contravention." 25

9 New section 82A inserted

The principal Act is amended by inserting, after section 82, the following section:

"82A **Exemplary damages for contravention of Part II** 30

"(1) The Court may order a person who has engaged in any conduct referred to in section 82(1) to pay exemplary damages even though the Court has made, or may make, an order directing the person to pay a pecuniary penalty under section 80 for the same conduct. 35

"(2) In determining whether to award exemplary damages and, if they are to be awarded, the amount of them, the Court must have regard to—

"(a) whether a pecuniary penalty has been imposed on the defendant for a contravention involving the conduct concerned in the claim for exemplary damages; and

"(b) if so, the amount of the pecuniary penalty."

10 General provisions relating to granting of injunctions

Section 88 of the principal Act is amended by (*renumbering subsection (3A) as (3B), and inserting before that subsection*) repealing subsection (3A), and substituting the following subsection:

"(3A) In determining whether to grant an interim injunction under this section, the Court must give such weight as the Court considers appropriate to the interests of consumers or, as the case may be, acquirers."

11 Offences

Section 103 of the principal Act is amended by adding the following subsection:

"(5) Proceedings for an offence against subsection (4) may be commenced within 6 months after the matter giving rise to the contravention was discovered or ought reasonably to have been discovered."

12 Provisions as to proceedings already barred and pending proceedings

Nothing in this Act—

(a) enables any proceedings to be brought which were barred before the commencement of this Act; or

(b) affects any proceedings commenced before the commencement of this Act.

Legislative history

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