COMMERCE COMMISSION NEW ZEALAND

October 2013

DRAFT Competitor Collaboration Guidelines

Contents

Purpose of these guidelines

The Commerce (Cartels and Other Matters) Amendment Bill (the Bill) amends a number of provisions of the Commerce Act 1986 (the Act). In particular, the Bill:

- introduces a new cartel prohibition, which replaces the current prohibition on price fixing
- provides three exemptions to the cartel prohibition for vertical supply contracts, joint buying arrangements, and collaborative activities
- enables parties involved in a collaborative activity that enter into an arrangement containing a cartel provision to seek clearance from the Commission for that arrangement
- makes engaging in cartel conduct a criminal offence, although criminal sanctions will not be available until two years after the Bill is passed.

The purpose of these guidelines is to explain:

- the cartel prohibition and the consequences of engaging in cartel conduct
- the three exemptions to the cartel prohibition for vertical supply contracts, joint buying arrangements, and collaborative activities
- the clearance regime for collaborative activities.

Because these guidelines are necessarily general, we apply them flexibly according to the facts of each case. The guidelines do not, and cannot, address every issue that might arise.

While we have provided examples in the guidelines to help illustrate key concepts, you should not assume that these examples apply directly to your own situation. In all cases the specific facts will determine how the Act applies. You should seek legal advice if you are in doubt.

These guidelines do not bind the Courts. It is ultimately up to the Courts to determine whether conduct breaches the cartel prohibition or if an exemption applies.

We may amend these guidelines from time to time, in accordance with developments in the relevant law and economics.

Note: For the purposes of consultation (and because we are consulting ahead of enactment in order to have the final guidelines in place as soon as possible after enactment) we have prepared these guidelines on the basis the Bill is incorporated into an Act in the form currently before the House.

Chapter 1. Introduction

1.1 The purpose of the Act is to promote competition in markets for the long-term benefit of consumers within New Zealand.[1] This purpose is based on the premise that effective competition plays an important role in driving the performance of New Zealand's economy.[2]

1.2 Competition generally delivers lower prices, increases firms' incentives to innovate and results in a better allocation of resources. Ensuring our markets are competitive enables us to build sustainable economic growth that creates jobs, increases income and allows New Zealand firms to compete effectively internationally.

1.3 Two of the ways the Act promotes competition are by prohibiting arrangements that substantially lessen competition and, more specifically, by prohibiting cartels. Anti-competitive arrangements – including cartels – are prohibited because they can result in higher prices, resources being misallocated, and firms facing a decreased incentive to innovate[3]. These outcomes are not in the long term interests of New Zealand consumers.

1.4 However, the Act also recognises that competition is not an end in itself.[4] In some situations, the long-term benefit of New Zealand consumers may be achieved through collaboration.

Prohibition on anti-competitive arrangements

1.5 At a general level the Act prohibits any person from entering into or giving effect to a contract, arrangement or understanding containing a provision that has the purpose, effect, or likely effect of substantially lessening competition in a New Zealand market.

1.6 The prohibition on anti-competitive arrangements applies to all arrangements and to all provisions. This means that even where a provision is not prohibited by the cartel prohibition (either because it is not a cartel provision, or because an exemption applies) it will be prohibited if it has the purpose, effect or likely effect of substantially lessening competition.[5]

1.7 We use the term 'arrangement' in these guidelines as shorthand for the phrase 'contract, arrangement or understanding'. We explain what amounts to an arrangement in Chapter 2.

1. Commerce Act 1986, s 1A.
2. See *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352.
3. *Commerce Commission* v Visy [2012] NZCA 383 at [32].
4. *Godfrey Hirst NZ Ltd v Commerce Commission* (2011) 9 NZBLC 103,396, at [46].
5. Commerce Act 1986, s 27.

The cartel prohibition

1.8 The cartel prohibition exists because cartels are considered so likely to substantially lessen competition that they should be prohibited without the need to enquire as to whether that cartel in fact has that purpose, effect or likely effect. Cartels are considered so likely to substantially lessen competition because, by definition, a cartel exists when firms agree to reduce or remove competition that exists or would otherwise exist between them.

1.9 Entering into or giving effect to an arrangement containing a cartel provision (or attempting to do so) is unlawful. This is true regardless of whether or not the cartel provision has a harmful effect on competition. The penalties for breaching the Act are described in Chapter 2.

1.10 A cartel provision is a provision in an arrangement between competitors that has the purpose, effect or likely effect of:

1.10.1 fixing prices – an arrangement not to compete on price, or on an element of price;

1.10.2 restricting output – an arrangement not to compete on output, by restricting capacity, sales, output, etc; or

1.10.3 allocating markets – an arrangement not to compete to sell to or buy from certain customers or suppliers, or in particular areas.

1.11 We describe what amounts to a cartel provision in detail in Chapter 2.

Exemptions from the cartel prohibition

1.12 While cartels are unlawful because they are very likely to have harmful effects, the Act recognises that some cartel provisions are much less likely to harm competition.

1.13 Indeed, cartel provisions can form part of arrangements that have pro-competitive or benign competitive effects. Such arrangements may increase innovation, reduce production costs, enhance product quality, and/or result in lower prices.

1.14 Therefore, the Act provides three different exemptions to the cartel prohibition for cartel provisions in certain types of arrangements. If an exemption applies, then the cartel provision is not unlawful provided the provision does not have the purpose, effect or likely effect of substantially lessening competition. The three exemptions cover:

1.14.1 vertical supply contracts – explained in Chapter 3;

1.14.2 joint buying and promotion agreements – explained in Chapter 4; and

1.14.3 collaborative activities – explained in Chapter 5.

Clearances for collaborative activities

1.15 A person that is, or will be, involved in a collaborative activity can apply for clearance to enter into an arrangement that contains one or more cartel provisions. We explain the clearance regime in Chapters 6 and 7.

1.16 If we clear an arrangement containing one or more cartel provisions, that arrangement cannot be challenged by any person as being in breach of the prohibitions on cartel provisions or anti-competitive arrangements.

Authorisation for cartel provisions

1.17 A person can apply for authorisation of any anti-competitive arrangement. This includes an arrangement containing a cartel provision which does not fall within the exemptions and where clearance is not available.

1.18 We will authorise an anti-competitive arrangement if we are satisfied that the arrangement is likely to result in such a benefit to the public that it outweighs the lessening in competition that would be likely to result.

1.19 As with a clearance, if we authorise an arrangement, that arrangement cannot be challenged by any person as being in breach of the prohibitions on cartel provisions or anti-competitive arrangements.

1.20 The authorisation regime is briefly explained in Chapter 8. We have also published detailed Authorisation Guidelines explaining our process for considering authorisations. These are available on our website.[6]

Guidance for franchises

1.21 Franchises are not given special or specific treatment under the Act. In the context of cartels, this means that a conventional analysis must be undertaken to determine whether the franchise contains a cartel provision and whether an exemption applies.

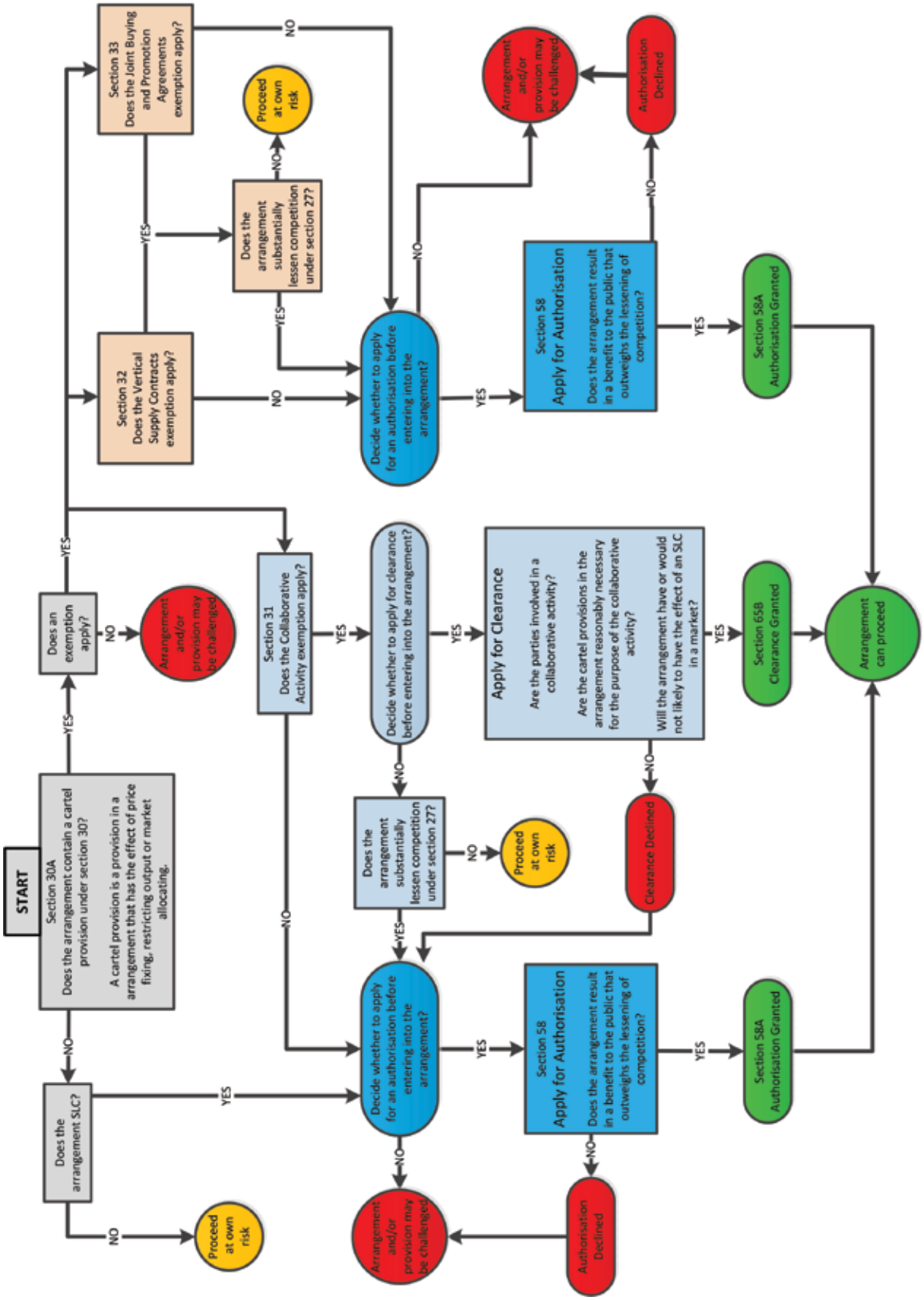
1.22 However, we have provided guidance on how the cartel prohibition and the exemptions to the new prohibition may apply to franchises in Chapter 9.

Summary of the scheme of the amended Act

1.23 The diagram opposite summarises how the prohibition on anti-competitive arrangements, the new cartel prohibition, the new exemptions to the cartel prohibition and the clearance regime interact.

6. http://www.comcom.govt.nz/business-competition/guidelines-2/authorisation-guidelines/.

Figure 1: Scheme of cartel prohibition, exemptions and clearance regime



Transitional provisions relating the cartel prohibition

1.24 The new cartel prohibition applies:

1.24.1 to arrangements that are entered into after the new section 30 comes into force – this is the date of Royal assent; and

1.24.2 where parties seek to give effect to a cartel provision after the new section 30 comes into force – the date of Royal assent – even where the arrangement containing that cartel provision was entered into before the date of Royal assent.

1.25 However, the Bill includes a nine month transition period commencing on the date of Royal assent. During this transition period:

1.25.1 no person can commence legal proceedings against any person giving effect to an arrangement containing a cartel provision that was entered into prior to the date of Royal assent; but

1.25.2 proceedings may be taken against behaviour that contravenes the previous section 30 price fixing prohibition.

1.26 The Bill also provides a transition period of two years for the application of the Act to the Shipping Act 1987.

Chapter 2. The cartel prohibition

Cartel provisions unlawful

2.1 Entering into or giving effect to a contract, arrangement or understanding that contains a cartel provision is prohibited.[7] We explain in this Chapter what amounts to an arrangement and what conduct falls within each of these provisions.

2.2 If a provision is a cartel provision and none of the three exemptions to the prohibition apply, that provision is unlawful.[8] This is the case regardless of that provision's actual effect on competition. This is because cartel provisions are considered so likely to substantially lessen competition that they are presumed to do so.

2.3 A cartel provision is a provision of an arrangement between competitors that has the purpose, effect or likely effect of:[9]

2.3.1 fixing price;

2.3.2 restricting output; or

2.3.3 allocating markets.

2.4 The three types of cartel provisions are not mutually exclusive and may overlap. For example, a provision may amount to both price fixing and market allocation.

2.5 As explained in the Introduction, there are three exemptions to the cartel prohibition. The three exemptions are explained in Chapters 3 to 5. If an exemption applies, then the cartel provision is not unlawful.

2.6 However, even if an exemption applies to a cartel provision (or even if the provision is not a cartel provision), the arrangement containing the provision may nonetheless be prohibited if it has the purpose, effect or likely effect of substantially lessening competition in a market.[10]

What is an arrangement?

2.7 As explained in the Introduction, we use arrangement in these guidelines as shorthand for contract, arrangement or understanding.

7. Commerce Act 1986, s 30.
8. Commerce Act 1986, s 30D.
9. Commerce Act 1986, s 30A.
10. Commerce Act 1986, s 27.

2.8 The essence of all of these terms – ie, an arrangement – is that two or more parties reach a consensus leading to an expectation that at least one person will act or refrain from acting in a particular manner.[11] The three different terms are used to denote varying degrees of the formality of the consensus.

2.9 A contract means a legally enforceable contract (which can be written and/or oral, implied and/or express). An arrangement or understanding is something short of this: the key question is simply whether the parties have reached a consensus.

2.10 An arrangement can be established through direct evidence that a party entered into an arrangement, or it may be inferred from a course of conduct or other evidence, including circumstantial evidence.[12] Even a 'nod and a wink' between parties may be evidence of an arrangement.[13]

Arrangements between competitors and potential competitors

2.11 The cartel prohibition only applies where the provision is part of an arrangement between competitors or potential competitors.

2.12 Parties are potential competitors if, but for the cartel provision, they would or may compete in the same market. In these guidelines, when we talk about competitors we are also referring to potential competitors.

EXAMPLE OF AN ARRANGEMENT BETWEEN POTENTIAL COMPETITORS

A computer manufacturer has an arrangement with a hard drive manufacturer for the supply of hard drives. This is not an arrangement between potential competitors as each company operates at different levels of the supply and distribution chain.

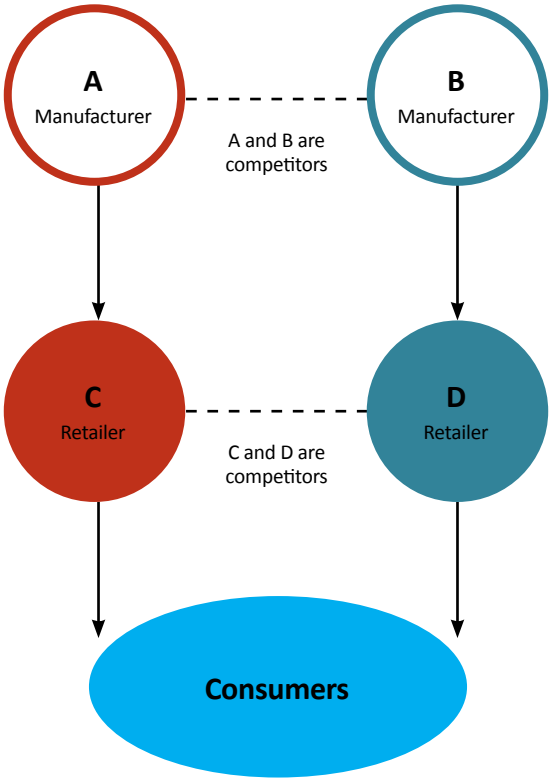
However, if the arrangement also contains a provision that prohibits the hard drive manufacturer from entry into the computer manufacturing market, this may suggest that the two parties are potentially competitors in relation to computer manufacturing. This may therefore be an arrangement between potential competitors and subject to the cartel prohibition.

Horizontal arrangements

2.13 Arrangements between competitors are often referred to as 'horizontal arrangements'. They are considered horizontal because they are between persons operating at the same level of the supply chain. That is, they supply or could supply the same customers, or buy from or could buy from the same suppliers.

11. *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608, at [15], [17].
12. *Commerce Commission v Qantas Airways Ltd (No 2)* (1992) 5 PRNZ 227 at p 7.
13. *Re Mileage Conference Group of the Tyre Manufacturers' Conference Ltd's Agreement* (1966) LR 6 RP 49; [1966] 2 All ER 849 at p 102, p 859.

Figure 2: Horizontal supply chain



EXAMPLE OF A HORIZONTAL ARRANGEMENT BETWEEN COMPETITORS

An arrangement between two tennis ball manufacturers is an arrangement between competitors.

Vertical arrangements

2.14 In contrast with a horizontal arrangement, a vertical arrangement involves persons operating at different levels of the supply chain. That is, they do not supply the same customers, and do not buy from the same suppliers. Vertical arrangements are generally not between competitors. An example of a vertical arrangement is an arrangement between a manufacturer and a wholesaler, or between a wholesaler and a retailer.

Figure 3: Vertical supply arrangement

EXAMPLE OF A VERTICAL ARRANGEMENT

An arrangement between a tennis ball manufacturer that does not supply tennis balls at the retail level (either directly or via an interconnected body corporate) and a retailer is not an arrangement between competitors.

2.15 Vertical arrangements are not subject to the cartel prohibition. However, they are subject to the general prohibition against anti-competitive agreements.

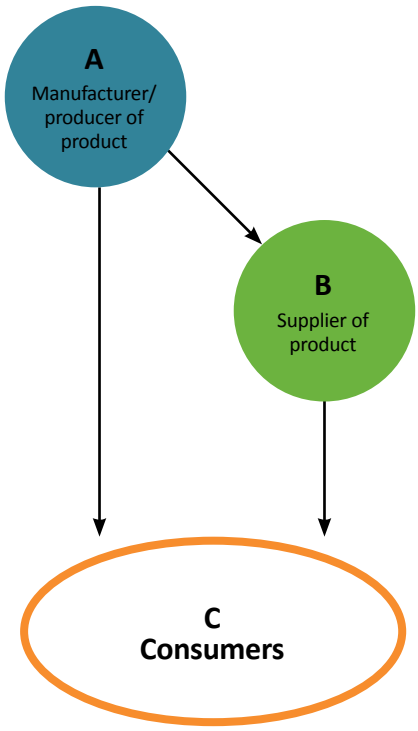
2.16 In addition, the Act prohibits vertical arrangements that involve resale price maintenance (RPM).[14] RPM occurs when a supplier of goods enforces, or tries to enforce, a minimum price at which the resupplier must on-sell those goods. A supplier of goods will breach the RPM prohibition if the supplier specifies a price and takes certain actions to enforce that specified price. You can find more information in our RPM factsheet available on our website.[15]

14. Commerce Act 1986, s 37.
15. http://www.comcom.govt.nz/resale-price-maintenance-2/.

Arrangements containing both horizontal and vertical aspects

2.17 Many arrangements will have both horizontal and vertical aspects. A common example is where supplier (A) supplies goods to distributor (B) who resupplies those goods to customers (eg, in a retail store). A also supplies directly to customers (eg, over the internet). In those circumstances, A and B are in a vertical arrangement in which A supplies goods to B and in a horizontal relationship in which both A and B also compete to sell to customers.

Figure 4: An arrangement with horizontal and vertical aspects

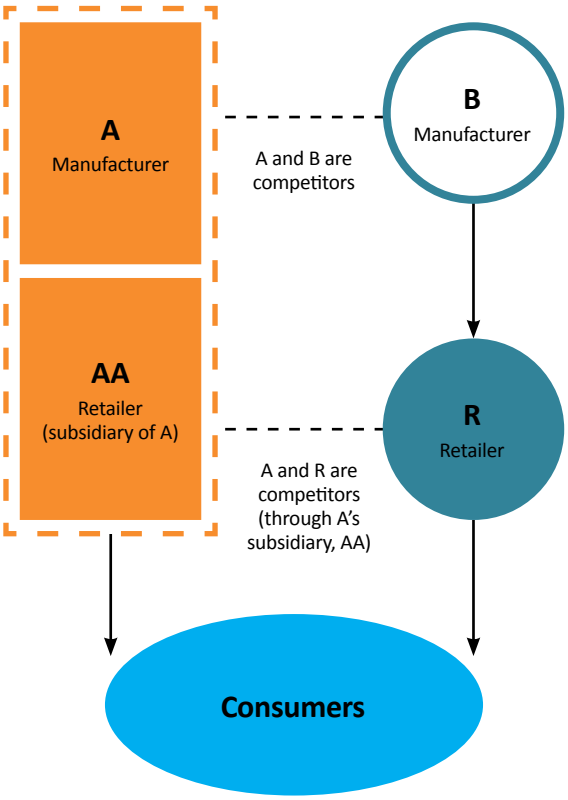


A competes with B as both A and B supply the product to C.

2.18 In assessing whether a firm competes with another firm, each of the firm's interconnected bodies corporate is taken to be a party to the arrangement.[16] Using the example above, suppose that A does not itself supply goods to consumers, but its subsidiary AA does. In that instance, AA competes with B and, since A and AA are interconnected bodies corporate,[17] A is considered a competitor of B. As can be seen in Figure 5, A and AA are both considered to be competitors of B and likewise both are also competitors of R.

16. Commerce Act 1986, s 30B.
17. Two bodies corporate are treated as interconnected if one of them is a body corporate and the other is a subsidiary; both bodies corporate are subsidiaries of the same body corporate; or both are interconnected with bodies corporate that are interconnected. Commerce Act 1986, s 2(7).

Figure 5: Manufacturer competing with a retailer via a subsidiary



EXAMPLE

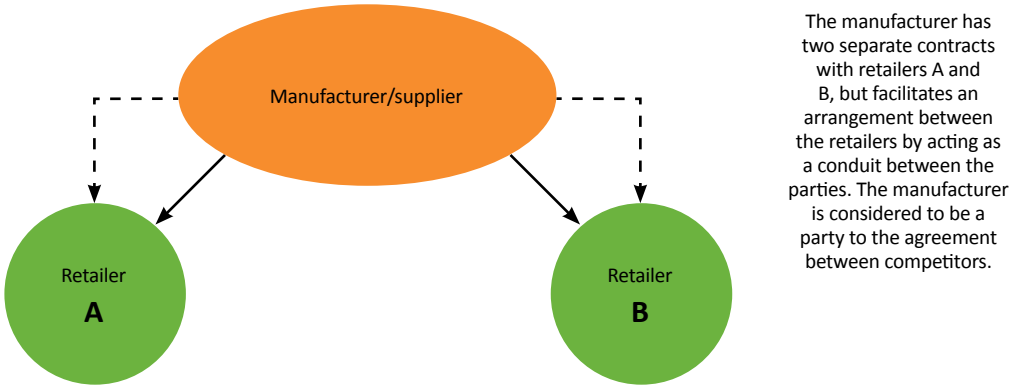
Arrangement between a manufacturer and a retailer that is an arrangement between competitors

An arrangement between a tennis ball manufacturer that also supplies tennis balls at the retail level (either directly or via an interconnected body corporate) and a retailer is an arrangement between competitors.

2.19 Where an arrangement involves competing and non-competing parties, the fact that some parties are not competitors does not mean the arrangement falls outside the prohibition.[18] [19] Such an arrangement is often referred to as a 'hub and spoke' arrangement. This is illustrated in Figure 6 below.

18. This is provided for through the definition of the cartel provisions in ss 30A(2), (3), and (4).
19. We can consider the aggregate effect of multiple arrangements when assessing a substantial lessening of competition. Commerce Act 1986, s 3(5).

Figure 6: 'Hub and spoke' arrangement



EXAMPLE OF A HUB AND SPOKE ARRANGEMENT

Hasbro, a toy designer, manufacturer and marketer, arranged with UK toy retailers Argos and Littlewoods that those retailers would not sell popular Hasbro toys below a set price, to ensure they did not undercut other stores. The UK Competition Appeal Tribunal upheld the Office of Fair Trading's decision that there was a hub and spoke price fixing agreement between the three parties that Argos and Littlewoods would sell Hasbro toys at a fixed price recommended by Hasbro.

Price fixing

2.20 Price fixing occurs when parties enter into or give effect to an arrangement fixing, controlling or maintaining:

2.20.1 the price[20] of goods and services that two or more of the parties to the arrangement supply or acquire in competition with each other; or

2.20.2 any discount, allowance, rebate, or credit of goods or services that two or more of the parties to the arrangement supply or acquire in competition with each other.

EXAMPLE: WOOD PRESERVATIVES CARTEL

Following an investigation into the markets for two wood preservatives, we brought proceedings in the High Court against Koppers Arch Wood Protection (NZ) Ltd, its Australian parent company, three Nufarm companies and two Osmose companies and some executives for breaches of the price fixing provisions of the Act.[21] The unlawful conduct included competitors agreeing to share pricing information, simultaneously raise prices, and not compete on price.[22]

20. For an example of a case involving fixing the component of a price, see *Commerce Commission v Air New Zealand* [2013] NZHC 1414.
21. See *Commerce Commission v Koppers Arch Wood Protection (NZ) Ltd* [2009] NZCCLR 1.
22. The unlawful conduct also included an arrangement not to compete for each other's customers, which may now be considered as market allocation.

2.21 An arrangement need not establish an actual price to be price fixing. Rather, price fixing occurs when competitors agree to directly or indirectly fix prices for goods or services.[23] Price includes a component of a price such as a surcharge or fee.

2.22 As a result, price fixing includes arrangements to fix prices at a predetermined level, to eliminate or reduce discounts, to increase prices, to set a minimum price, to agree a price to bid for a contract, to maintain prices above a certain level, or to apply a formula to calculate prices.

EXAMPLE: CARWASH CARTEL

Commerce Commission v Caltex NZ Ltd[24] involved an agreement between oil companies to jointly end a promotion which gave petrol buyers a free carwash with every fuel purchase over $20.

While the companies had independently priced their fuel, the Court held that the agreement to end the carwash promotion amounted to price fixing as the discount was an 'inseparable part' of the price of the petrol.

2.23 Price fixing can also occur when competitors acquire goods or services.

EXAMPLE: MEAT PROCESSING CARTEL

In *Commerce Commission v Taylor Preston Ltd*[25] the High Court found that North Island meat companies had entered into arrangements relating to the price at which they would acquire livestock from farmers. These were held to be price fixing arrangements in breach of the Act.

Restricting output

2.24 Output restrictions between competing suppliers of goods or services occur where two or more of those competing suppliers arrange to prevent, restrict, or limit:[26]

2.24.1 their supply, production, or likely supply or production of those goods; or

2.24.2 their supply, capacity, or likely supply or capacity to supply those services.

2.25 Output restrictions between competing buyers of goods or services occur where two or more competing buyers of goods or services arrange to prevent, restrict, or limit their acquisition or likely acquisition of those goods or services.

23. *Commerce Commission v Caltex NZ Ltd* [1998] 2 NZLR 78, at pp 84-85.
24. *Commerce Commission v Caltex NZ Ltd* [1998] 2 NZLR 78.
25. *Commerce Commission v Taylor Preston Ltd* [1998] NZLR 389.
26. Commerce Act 1986, s 30A(3). Such arrangements are illegal because having less of something for sale will generally lead to prices increasing. However, it is not necessary to show that prices are actually affected.

EXAMPLE: TASMANIAN SALMON GROWERS' CARTEL

In 2003 the Australian competition authority (the ACCC) commenced proceedings against salmon producer Tassal and the Tasmanian Salmon Growers Association, alleging they entered into an arrangement to limit the supply of salmon and to fix, control or maintain the price of salmon.[27]

The ACCC alleged that Tassal and the Association had agreed that the five major growers would 'grade out' 10% of salmon from the 2001 year class, and that they would later consider a possible grading out of a further 5%. The purpose of these agreements was to reduce fish numbers to ensure the financial viability of the salmon farming industry in Tasmania. At the time the arrangement was entered into, the Tasmanian salmon industry was in financial difficulty and supply was outstripping demand.

The Federal Court of Australia held that there was an arrangement or understanding between competitors to limit the supply of fish and that this would likely have the effect of controlling or maintaining price, in breach of the anti-competitive provisions of the Australian Trade Practices Act 1974.

Market allocation

2.26 Market allocating, or market sharing, between competing suppliers of goods or services occurs where two or more of those suppliers arrange to allocate between themselves the customers to whom, or the geographic areas in which, each will supply their respective goods or services.[28]

2.27 Market allocation not only concerns sales to final customers. The prohibition covers arrangements between suppliers to allocate sales to any persons, including distributors, resuppliers or final customers.

2.28 Market allocating, or market sharing, between competing buyers of goods or services occurs where two or more of those buyers arrange to allocate between themselves the particular suppliers from whom, or the particular geographic areas in which, each will acquire their goods or services.

27. *ACCC v The Tasmanian Salmonid Growers Association Ltd* (2003) ATPR 41-954.
28. Commerce Act 1986, s 30A(4).

EXAMPLES OF MARKET ALLOCATION

Customer allocation between competing suppliers

In *Commerce Commission v Eli Lilly & Co (NZ) Ltd*[29], two wholesale suppliers of animal remedies reached an agreement by which one supplier would only proactively sell the Elanco brand of animal remedy products to large purchasers (ie, those that spent $10,000 or more per annum on Elanco products), while the other would only proactively sell to those below that threshold. The agreement was held to constitute market allocation through dividing the market by customer allocation.

Geographic market allocation between competing suppliers

In *Commerce Commission v Christchurch Transport Ltd*[30] the chief executive officer of Christchurch Transport Limited approached its next biggest competitor in the market for subsidised passenger bus services in metropolitan Christchurch. He proposed an exchange of tender information with a view to each party submitting tenders that would ensure each company retained the routes it had historically serviced.[31]

In that way, the companies would have been allocating the geographic areas in which they supplied their competing services.

Geographic market allocation between competing buyers

Two New Zealand fishing companies agree that one will acquire its filleting and processing services from South Island providers, while the other will acquire the services from North Island providers.

Penalties for breaching the cartel prohibition

2.29 Those who engage in cartel behaviour may be subject to civil and criminal sanctions.

2.30 The criminal regime does not come into effect until two years after the Amendment Act comes into force.[32] We will issue specific guidance on when we will seek criminal sanctions before the criminal regime comes into force.

Civil penalties

2.31 In a civil proceeding, if a court considers that a person has entered into, or given effect to a cartel provision,[33] then the Court may order various remedies, such as:

2.31.1 for an individual, a penalty of up to $500,000, and/or an order that a person must not be a director, promoter, or involved in the management of a body corporate for a period of up to five years;

29. *Commerce Commission v Eli Lilly & Co (NZ) Ltd* (HC) Auckland CL 19/98, 30 April 1999.
30. *Commerce Commission v Christchurch Transport Ltd* CP72/98 21 August 1998.
31. Despite the discussions, the businesses did not reach an arrangement. The conduct, therefore, amounted to an attempt to breach the Act.
32. Commerce Act 1986, s 2(2).
33. The Act also prohibits any person from aiding, abetting, counselling, or procuring any other person to contravene the cartel prohibition, inducing, or attempting to induce, any other person to contravene the cartel prohibition, or otherwise being in any way, directly or indirectly, knowingly concerned in, or party to, a contravention by any other person of the cartel prohibition. Commerce Act 1986, s 80(1).

2.31.2 for a body corporate, a penalty of up to the greater of $10 million, or three times the commercial gain, or, if this cannot be easily established, 10% of turnover; and/or

2.31.3 for both individuals and a body corporate, an award of damages and/or exemplary damages.[34]

Criminal penalties

2.32 When the criminal regime comes into effect two years after Royal assent, the maximum criminal penalty for an individual will be up to seven years' imprisonment.

2.33 A person who is not an individual is liable on conviction to pay a penalty of up to the greater of $10 million, or three times the commercial gain, or, if this cannot be easily established, 10% of turnover.[35]

Enforcement Response Guidelines

2.34 Our Enforcement Response Guidelines describe in general terms what enforcement responses are available to us and what factors we take into account when deciding which response to use.[36]

Cartel Leniency Policy

2.35 We investigate arrangements that may breach the cartel prohibition. We become aware of potential breaches of the Act in a number of ways, including via complaints, our own enquiries, and engagement with business. In relation to cartels, one of the key ways we become aware of cartel conduct is through our Cartel Leniency Policy.

2.36 Our Cartel Leniency Policy aims to encourage people to report cartels in which they have become involved.

2.37 It achieves this by granting immunity to the first member of a cartel to approach us, provided they meet the immunity requirements under the Cartel Leniency Policy. Immunity means we will not take legal action against that person.

2.38 Where a person does not qualify for immunity, we encourage them to cooperate with our investigations. Our policy on cooperation allows us to recommend to the court a lower level of penalty for cartel members who are not the first member of a cartel to approach us, provided that they cooperate fully during our investigation. Cartel members that cooperate as early as possible in an investigation are likely to get greater reductions in penalty.

2.39 You can find more information on our Cartel Leniency Policy on our website at http://www.comcom.govt.nz/leniency-policy-for-cartels/.

34. Damages are only available to third parties, while pecuniary penalties and banning orders are only available to the Commission.
35. Commerce Act 1986, s 82B(5).
36. Available at http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines.

Chapter 3. Exemption for vertical supply contracts

3.1 The vertical supply exemption to the cartel prohibition applies to certain cartel provisions in supply contracts where a supplier and a customer compete to sell the supplier's goods or services.[37] The reference to "customer" in the exemption does not mean the ultimate consumer. Rather it refers to the supplier's immediate customer.[38]

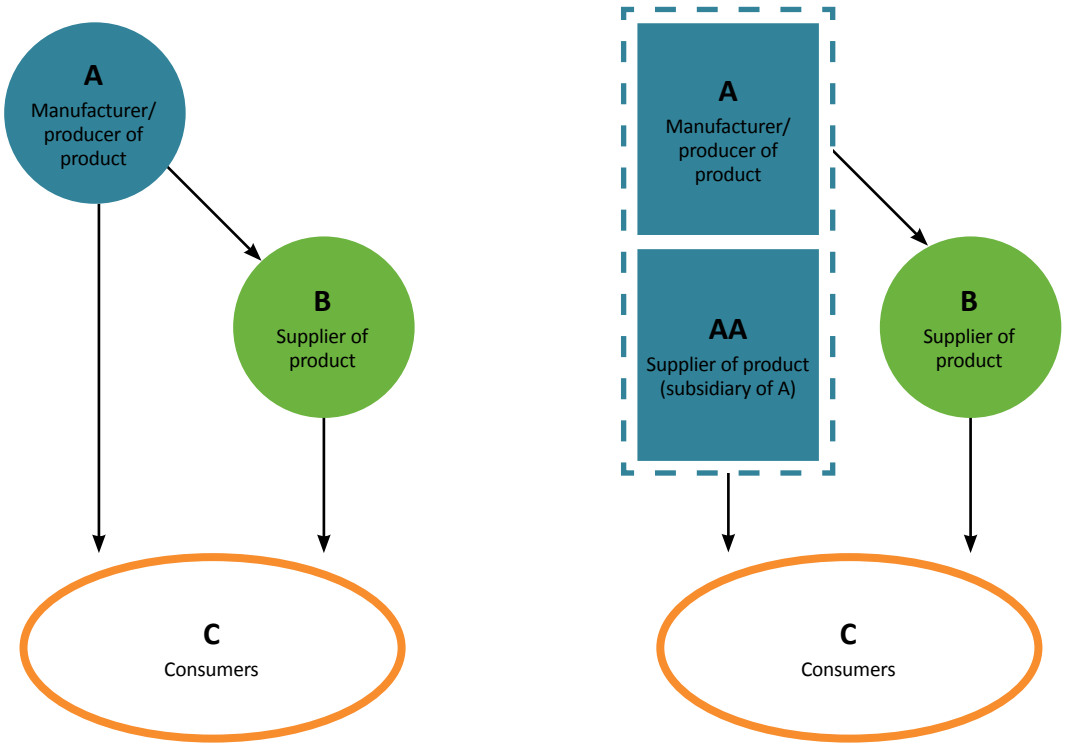
When will a supplier and a customer be in competition with each other?

3.2 As explained in Chapter 2, a cartel provision requires an arrangement between competitors. It follows that the vertical supply contract exemption is not relevant unless a supplier and a customer are competitors (or potential competitors). A common example where a supplier and a customer are competitors is where the supplier supplies goods both directly to end customers (eg, over the internet) and also supplies to distributors who then resupply those goods (eg, in a retail store).

3.3 Figure 7 below (which is reproduced from Chapter 2) illustrates, more generally, situations in which a supplier and a customer may be in competition. As can also be seen from Figure 7, if the supplier supplies to customers via a subsidiary, the supplier is still considered to be in competition with the re-supplier.[39]

37. However, parties must not engage in resale price maintenance, see paragraph [2.16].
38. As explained in Chapter 2, even if the vertical exemption applies to a cartel provision, the provision may nonetheless be prohibited if it has the purpose, effect or likely effect of substantially lessening competition in a market.
39. Commerce Act 1986, s 30B.

Figure 7: When a supplier and a customer will be competitors[40]



When does the exemption apply?

3.4 The vertical supply contract exemption applies where:[41]

3.4.1 a supplier or likely supplier of goods or services (A) and a customer or likely customer of that supplier (B) enter into a contract;[42] and

3.4.2 the cartel provision in the contract:

3.4.2.1 relates to the supply or likely supply of goods or services by A to B, or to the maximum price at which B may resupply the goods or services originally supplied by A to B; and

3.4.2.2 does not have the dominant purpose of lessening competition between A and B.

Relates to the supply of goods or the maximum resale price

3.5 To be exempt a cartel provision must relate to the supply of goods or services from A to B, including B's maximum resale price.

40. In this example, both A and AA are party to the arrangement (Commerce Act 1986, s 30B). As a result, either or both may be subject to enforcement action.
41. Commerce Act 1986, s 32.
42. The exemption only applies to contracts; it does not extend to arrangements or understandings.

3.6 A supply contract will inevitably set the price at which A will supply goods or services to B. Such a pricing provision will 'relate to' the supply of goods or services from A to B and so fall within the first part of the exemption.

3.7 In addition, A may impose restrictions on B's ability to sell the goods or services supplied by A. Such restrictions might include, for example, setting out where or to whom B can resupply goods or services supplied by A, or the quantity B can resupply.

3.8 We consider that these restrictions that A imposes on B are likely to 'relate to' the supply of goods from A to B (and so fall within the first part of the exemption) if they form part of the contractual obligations giving rise to the supply.

3.9 A restriction will not be covered by the exemption if the restriction does not form part of – ie, is collateral to – the contractual obligations for the supply of goods from A to B. For example, if the restriction relates to the sale of a different good or service to that being supplied.

3.10 In addition, the exemption specifically enables A to set a maximum resale price. This means that, even if A and B compete for the sale of the goods or services, A can include a condition in its supply contract with B that B cannot sell the goods or services above a maximum price, provided that the dominant purpose of that condition is not to lessen competition.

3.11 However, where a supplier imposes a minimum resale price, that minimum resale price is likely to breach the RPM prohibition. This will be the case even if the provision falls within the vertical supply exemption (or even if the provision is not a cartel provision because the supplier and the customer are not competitors).[43]

Dominant purpose of lessening competition

3.12 The exemption does not apply where the cartel provision has the dominant purpose of lessening competition between any two or more of the parties to the contract.[44] This limitation is designed to ensure that parties do not enter into sham arrangements to circumvent the cartel prohibition.

3.13 The dominant purpose of a provision is the main or principal reason for the provision.[45] As such, the prevailing objective of the provision must not be to lessen competition between the parties. If it is – that is, if the cartel provision is simply a device to engage in anti-competitive conduct – then the exemption will not apply.

3.14 We will take into account the conduct of the parties and all other relevant circumstances when assessing whether a provision of a vertical supply contract has a dominant purpose of lessening competition between the parties. This will include the broader context of the supply relationship of which the relevant cartel provision forms part, and the cartel provision's role in that relationship.

43. Commerce Act 1986, s 37.

44. The exposure draft of the Bill published for consultation by the then Ministry Of Economic Development (MED) did not include a vertical supply exemption. The exemption's inclusion was ratified by Cabinet following submissions on the exposure draft on the basis that "Such arrangements are common place and are generally considered to enhance consumer welfare. Unless they have an anticompetitive purpose they should be exempt from the per se prohibition" Hon Simon Power *Proposed Amendments to the Commerce Act in relation to Cartels* at [85].

45. As discussed in more detail in Chapter 5, a 'dominant' purpose can be contrasted with the definition of purpose in section 2(5) of the Commerce Act, which defines purpose as meaning a "substantial purpose". Our approach to defining dominant purpose is consistent with the ordinary meaning of dominant which includes 'prevailing' and 'most influential'.

3.15 There is no bright line as to when an aim or objective becomes the dominant purpose. It is up to the parties to the arrangement to show that the cartel provision does not have the dominant purpose of lessening competition.

EXAMPLES

A shoe manufacturer operates a website through which it sells shoes to consumers. The manufacturer also sells shoes to a high street retailer, which then resells those shoes to consumers. The manufacturer and the retailer are likely to be competitors. Therefore, the cartel prohibition may apply to provisions in arrangements between them which relate to shoes.

Maximum resale price

In its supply contract with the retailer, the manufacturer includes a provision that prevents the retailer from selling any of the manufacturer's shoes at a price greater than the retailer's purchase price (ie, its wholesale price) plus 25%.

The maximum resale price provision may amount to price fixing and therefore be prohibited by the cartel prohibition.

However, the vertical supply exemption may apply as the cartel provision sets the maximum price at which the retailer can sell the manufacturer's shoes, provided the dominant purpose of the provision is not to lessen competition between the manufacturer and the retailer. Where there is a genuine maximum price that parties are free to sell below, it is unlikely to have the dominant purpose of lessening competition.

Restriction on the retailer selling online

In its supply contract with the retailer, the manufacturer includes a provision that prevents the retailer from selling any of the manufacturer's shoes online.

This provision may amount to market allocation and would on its face be prohibited by the cartel prohibition.

However, the vertical supply exemption may apply. The cartel provision is likely to relate to the supply of goods from the manufacturer to the retailer; it would therefore fall within the exemption provided the dominant purpose of the provision is not to lessen competition between the manufacturer and the retailer.

Restriction on the manufacturer's discretion over its retail selling price

In its supply contract with the retailer, the manufacturer includes a provision that prevents the retailer from selling any of the manufacturer's shoes to a customer at a price less than the price at which the manufacturer sells its shoes to the retailer.

Regardless of whether there is a cartel provision and an exemption applies, the arrangement will be prohibited by the RPM prohibition.

Chapter 4. Exemption for joint buying and promotion agreements

4.1 The joint buying and promotion exemption applies when competing buyers arrange to purchase goods or services collectively on terms that an individual buyer would be unlikely to be able to negotiate on their own. For example, a group of small grocers might get together to collectively purchase a large order of tinned fruit at a volume discount, or real estate businesses might jointly purchase advertising in a newspaper.

4.2 While such arrangements between competing buyers could be regarded as price fixing, the exemption deems a provision not to be price fixing if the provision:[46]

- 4.2.1 relates to the price of goods or services the competing buyers directly or indirectly collectively acquire;
- 4.2.2 provides for the competing buyers to collectively negotiate the price for goods or services which they then purchase individually; or
- 4.2.3 provides for an intermediary to take title to goods and resell or resupply them to one or more of the competing buyers.

4.3 If buyers have collectively acquired goods or services, any arrangement between those buyers to jointly advertise the price at which they will resupply those goods or services is also exempt from the cartel prohibition. However, the parties to the advertising arrangement must still be free to sell the goods at their own price if they choose.

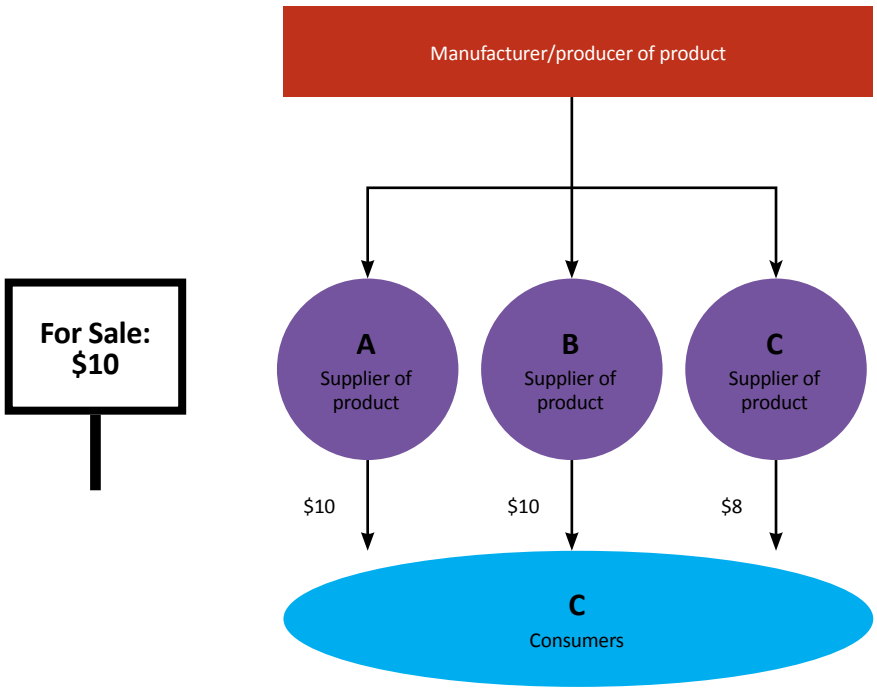
4.4 This is illustrated by Figure 8. One of the small grocers in the example above might decide to advertise and sell the collectively acquired tinned fruit at a price lower than the agreed advertised price for a weekend special.

4.5 Even if the joint buying exemption does not apply, the collaborative activity exemption may still apply. This exemption is discussed in Chapter 5.

4.6 In addition, even if this exemption applies to a cartel provision, the provision may nonetheless be prohibited by the general prohibition against anti-competitive agreements if the provision has the purpose, effect or likely effect of substantially lessening competition in a market.

46. Commerce Act 1986, s 33.

Figure 8: Joint buying and promotion agreement



EXAMPLES

Joint buying

Several small computer repair companies arrange to jointly purchase components in order to achieve cost savings through purchasing the components in bulk. The companies are then free to price the components as they see fit.

The computer repair companies are likely to be competitors for the acquisition of the computer components. Therefore, the arrangement to jointly purchase is likely to be price fixing and therefore be prohibited by the cartel prohibition.

However the exemption would apply as the cartel provision relates to the price of goods to be collectively acquired by the repairers.

The exemption also covers the computer repair companies if they jointly advertise the collectively acquired components. However, each company must be free to sell the components at a different price than that jointly advertised.

On the other hand, the exemption would not cover a scenario where the companies jointly advertise the price at which they would use the jointly acquired components to repair computers. This is because the repair price includes other costs, such as labour and overheads, which have not been jointly acquired.

EXAMPLES

Acquisition at a collectively agreed price

Three car yards jointly negotiate a contract with a radio station for a regular advertising space for a two year period. The car yards then rotate the advertising space between them, with each purchasing the advertising space directly from the radio station during their allotted time. This allows the car yards to benefit from the more favourable terms of a long-term contract that they would not have been to be able to commit to individually.

The car yards are likely to be competitors for the acquisition of advertising space. Therefore the arrangement to purchase at an agreed price is likely to be price fixing and therefore be prohibited by the cartel prohibition.

However, the exemption is likely to apply as the cartel provision provides for collective negotiation of the price for goods or services followed by individual purchasing at the collectively negotiated price. Although this arrangement may not breach the cartel prohibition, the agreement between competing car yards to rotate advertising space may nevertheless substantially lessen competition in breach of section 27.

Chapter 5. Exemption for collaborative activities

5.1 The collaborative activity exemption applies to a cartel provision in an arrangement if:[47]

5.1.1 the parties to the arrangement are involved in a collaborative activity; and

5.1.2 the cartel provision is reasonably necessary for the purpose of the collaborative activity.[48]

5.2 A party to a collaborative activity who proposes to enter into an arrangement containing a cartel provision has the option of applying to us for clearance of the arrangement. We explain how the clearance regime works in Chapter 6.

Collaborative activity defined

5.3 A collaborative activity is an enterprise, venture, or other activity, in trade, that:

5.3.1 is carried on in cooperation by two or more persons; and

5.3.2 is not carried on for the dominant purpose of lessening competition between two or more of the parties.[49]

Enterprise, venture, or other activity, in trade

5.4 Trade is defined in the Act as any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land.[50]

Co-operation between two or more persons

5.5 The collaborative activity must be carried on by two or more persons in cooperation with each other. We regard this as requiring the parties to the collaborative activity to be working together towards the same common objective.[51] The 'carried on' language also reflects the fact that the activity must be active.

47. Commerce Act 1986, s 31.
48. As explained in Chapter 2, even if this exemption applies to a cartel provision, the provision may nonetheless be prohibited if it has the purpose, effect or likely effect of substantially lessening competition in a market.
49. Commerce Act 1986, s 31(2).
50. Commerce Act 1986, s 2.
51. The Oxford English Dictionary defines "cooperate" as meaning "work jointly towards the same end".

Not for the dominant purpose of lessening competition between the parties

5.6 To qualify for the exemption, the collaborative activity must not be carried out for the dominant purpose of lessening competition between the parties to the arrangement.[52] This limitation "reflects the need to guard against the use of sham joint ventures or other sham collaborations to evade operation of the per se criminal and civil prohibitions against cartel conduct".[53]

5.7 While an arrangement may have more than one purpose, a dominant purpose is the main or principal reason for the collaboration. This is in contrast to the definition of purpose in section 2(5) of the Act, which defines purpose as meaning a "substantial purpose". Our approach to defining dominant purpose is consistent with the ordinary meaning of dominant which includes 'prevailing' and 'most influential'.

5.8 The prevailing objective that the parties are jointly working towards must not be to lessen competition between them. If it is – that is, if the cartel provision is simply a device to engage in anti-competitive conduct – then the exemption will not apply.

5.9 There is no bright line as to when an aim or objective becomes the dominant purpose. It is a matter of judgement for the Court (when applying the collaborative activity exemption) or the Commission (in the context of a clearance) based on the facts of the case.

5.10 The assessment of whether the dominant purpose of a collaborative activity is to lessen competition is objective. In making this assessment, we consider the substance of the activity, rather than the form it takes. Simply labelling an arrangement as a collaborative activity is not sufficient to bring the collaboration under the protection of the exemption. We can infer the dominant purpose of a collaborative activity from the conduct of any relevant person or from any other relevant circumstance.[54]

5.11 We recognise that parties collaborate for a number of reasons other than to lessen competition.

5.11.1 For example, a collaboration may allow parties to combine their different capabilities or resources so as to improve their ability to compete. One party may have special technical expertise that usefully complements another party's manufacturing process, allowing the latter party to lower its production cost or improve the quality of its product.

5.11.2 Similarly, collaboration may help the parties attain economies of scale or scope beyond the reach of any one of them, again improving the parties' ability to compete. For example, two parties may be able to combine the production of their complementary goods to lower the cost of bringing their products to market.

5.11.3 There may also be reasons why parties collaborate that are not directly related to improving their ability and incentive to compete, yet do not indicate a dominant purpose not to compete. For example, parties may collaborate to achieve some environmental, health and safety, or other social welfare purpose, which is unrelated to their individual or collective competitiveness.

52. The exemption for vertical supply contracts (discussed in Chapter 3) also requires consideration of whether the cartel provision has the dominant purpose of lessening competition. These general principles also apply to the exemption for vertical supply contracts.
53. Hampton L, Scott P *Guide to Competition Law,* Lexis Nexis 2013, at 196.
54. Commerce Act 1986, s 31(3).

5.12 If a collaborative activity has multiple purposes, we will identify the dominant purpose of the collaborative activity to assess whether the dominant purpose of the collaborative activity is to lessen competition. We will apply the same approach if two or more parties to the collaborative activity indicate different purposes.

EXAMPLES

Where parties may not have a dominant purpose of lessening competition between them

- Two computer manufacturers have different design and technology expertise. They decide that by combining different capabilities or resources they will be able to offer cheaper goods or services.
- Two firms combine their research or marketing activities to reduce the time needed to develop and sell a new product.

5.13 Where parties cannot demonstrate why they are collaborating, then there is a high risk that we or a court will infer that their dominant purpose is to lessen competition between the parties.

Cartel provision must be reasonably necessary for the purpose of the collaborative activity

5.14 To gain the benefit of the exemption, the cartel provision must be reasonably necessary for the purpose of the collaborative activity. In this context, we take 'purpose' to mean all substantial purposes of the collaborative activity. Whether a cartel provision is reasonably necessary is assessed at the time when the agreement is entered into.[55]

5.15 By using the term 'reasonably necessary', Parliament has signalled that a cartel provision need not be essential for the collaborative activity. This means that a party does not need to show that, but for the cartel provision, the collaborative activity would not occur. [56]

5.16 We say this for two principal reasons.

5.16.1 First, while 'necessary' reflects a high standard – its dictionary definitions include 'indispensable, requisite' – Parliament has chosen to qualify it by 'reasonably', ie, within reason.

5.16.2 Second, the phrase 'reasonably necessary' is also used in other jurisdictions, most particularly in the United States Federal Trade Commission and the United States Department of Justice's *Antitrust Guidelines for Collaborations Among Competitors* (US Guidelines) and section 45 of Canada's Competition Act. It is clear from the explanatory materials to the Bill, that Parliament had in mind the US Guidelines and the way those Guidelines interpreted the 'reasonably necessary' requirement when including the phrase in the collaborative activity exemption. Those Guidelines do not require a cartel provision to be essential in order to have the benefit of being excused from the US's per se price fixing rules.[57]

5.17 We therefore consider that a cartel provision is reasonably necessary if the parties would be

55. Commerce Act 1986, s 31.

56. Of course, if the collaboration could not be achieved absent the cartel provision, then this would be sufficient to demonstrate that the cartel provision is reasonably necessary for the collaborative activity.

57. However, the explanatory materials also note that "in contrast with the approach in the US Guidelines, the exemption for collaborative activity does not require efficiency enhancing integration". Ministry of Economic Development *Cartel Criminalisation – Exposure Draft Commerce (Cartels and Other Matters) Amendment Bill: Explanatory material* June 2011 at [51].

materially hindered in achieving the collaborative activity's purpose if they used a significantly less restrictive alternative to the cartel provision. We recognise that the significantly less restrictive alternative must be one which is practically workable.

5.18 Examples where a cartel provision may be reasonably necessary compared to a significantly less restrictive alternative include where the cartel provision materially reduces the parties' risk in achieving the collaborative activity's purpose(s), or reduces the cost of achieving that purpose, or shortens the timeframe for parties to do so.

5.19 On the other hand, a cartel provision may not be reasonably necessary when it applies for a significantly longer period of time, or has a significantly greater geographic scope than is in fact required for the parties to achieve the purpose(s) of the collaborative activity.

5.20 Parties should be able to explain why other alternatives to the cartel provision are inadequate or unavailable, or why such alternatives would not allow the parties to pursue their collaborative activity. It is not enough for a party to merely assert that they would not enter into the collaboration in the absence of the cartel provision, or that they would face materially greater obstacles without the cartel provision.

5.21 If there is more than one cartel provision in an arrangement, each cartel provision must be reasonably necessary for the purpose of the collaborative activity.

Chapter 6. Clearances for cartel provisions relating to collaborative activities

6.1 A party proposing to enter into an arrangement containing a cartel provision that is part of a collaborative activity can apply for clearance for that arrangement. This is a voluntary regime; there is no statutory requirement to seek clearance.

6.2 Where we clear an arrangement, parties to the arrangement will not contravene the cartel prohibition or the prohibition on arrangements that substantially lessen competition by entering into or giving effect to the arrangement. In essence, a clearance provides certainty that we do not consider the cartel provision or any other aspect of the arrangement unlawful.

6.3 If the parties to the arrangement subsequently want to enter into a new or additional arrangement containing a cartel provision, they must seek a further clearance for that new arrangement. Similarly, if a new party joins an arrangement which has been given clearance, the arrangement is considered to be a new arrangement and therefore does not have the benefit of clearance.

6.4 We can only consider clearance applications if the arrangement containing a cartel provision has not yet been entered into or given effect to.[58] We do not have jurisdiction to clear arrangements that do not contain a cartel provision.

6.5 However, that does not mean that the collaborative activity cannot already exist. It may be possible that an existing collaboration may require a new arrangement with a cartel provision. An example of this may be where two parties are engaged in a joint selling collaboration and the advent of a new product requires a new arrangement containing a cartel provision. The clearance regime would be available for the new arrangement.

When we will grant clearance

6.6 We will give clearance if:

- 6.6.1 the applicant and any other party to the arrangement are or will be involved in a collaborative activity; and
- 6.6.2 every cartel provision[59] in the arrangement is reasonably necessary for the purpose of the collaborative activity; and
- 6.6.3 entering into the arrangement, or giving effect to any provision of the arrangement, will not have, or would not be likely to have, the effect of substantially lessening competition in a market.[60]

58. Commerce Act 1986, s 65A(1).
59. We do not need to determine whether a particular provision is in fact a cartel provision, providing there are reasonable grounds for believing it might be. Commerce Act 1986, s 65A(3).
60. Commerce Act 1986, s 65A.

6.7 The applicant must satisfy us that each of these criteria is met.[61] If we are not satisfied that all of the criteria are met, we must decline clearance.

6.8 The first two requirements of the clearance test are identical to the collaborative activity exemption criteria. Therefore, the same analysis applies as outlined in Chapter 5. The third requirement is designed to determine whether the arrangement (or any provision within the arrangement) will substantially lessen competition in a market.[62]

Satisfying the Commission that the parties are engaged in a collaborative activity

6.9 For the reasons explained in Chapter 5, the essential question we ask to determine whether the parties are engaged in a collaborative activity is "why are you doing this?"

6.10 Applicants should identify and explain: what the collaborative activity is, and what its purpose is. Applicants should provide evidence to corroborate their explanation, including the pro-competitive or benign outcomes that the collaboration is likely to achieve. Documents created during the evaluation and negotiation of the collaboration (rather than those created at some later date) may be useful in demonstrating the objectives of the arrangement.

6.11 We will decline jurisdiction if the parties are not engaged in a collaborative activity, or if the arrangement does not contain a cartel provision.

Satisfying the Commission that the cartel provision is reasonably necessary for the purpose of the collaborative activity

6.12 Similarly, the essential question we ask to assess whether a cartel provision is reasonably necessary is "why do you need the cartel provision to obtain the benefits of your collaboration?"

6.13 As explained in Chapter 5, we do not regard the reasonably necessary test as a 'but for' test. Rather, we make a pragmatic and commercial assessment as to whether the parties would be materially hindered in achieving the collaboration's purpose using a significantly less restrictive alternative. If the answer is "yes", then it is likely we would regard the cartel provision as being reasonably necessary.

6.14 In making this enquiry, we consider a range of factors including how long the cartel provision will apply for and what the cartel provision covers (for example, whether it applies to products or locations outside of the collaboration) and how feasible it is to exit or terminate the arrangement.

6.15 Applicants should explain why other alternatives to the cartel provision are inadequate or unavailable, or why such alternatives would not allow the parties to pursue their collaborative activity. Evidence of alternative options the parties considered at the time the arrangement was negotiated may be relevant.

6.16 This explanation may include evidence from markets in New Zealand or overseas where similar collaborations have used comparable cartel provisions to achieve their objectives. If the evidence available suggests that in other markets significantly less restrictive means have been used to achieve a similar end, we expect evidence from the applicant to explain why their circumstances are different.

61. The standard of proof is the balance of probabilities.
62. This requires the same analysis of an arrangement as under section 27 of the Act.

Satisfying the Commission that the arrangement is not likely to substantially lessen competition

6.17 We assess whether entering into the arrangement or giving effect to any provision in the arrangement has, or would be likely to have, the effect of substantially lessening competition in a market.[63] To carry out this assessment, we look at all the provisions in the arrangement, not just the cartel provisions.[64]

Substantial lessening of competition

6.18 Competition means workable or effective competition.[65] One hallmark of a competitive market is the extent to which participants within it possess 'market power', ie, the ability to, for example, raise price profitably and sustainably above competitive levels.

6.19 The substantial lessening of competition (which includes a hindering and/or prevention of competition[66]) test is a relative standard.[67] It asks whether the parties' market power would increase relative to what it would be without the arrangement.[68] A number of factors are relevant when assessing whether competition is or is likely to be substantially lessened, including:

6.19.1 the nature of the restrictions contained in the arrangement;

6.19.2 the nature of the products involved;

6.19.3 the number and size distribution of independent suppliers, and the degree of market concentration;

6.19.4 the conditions of entry, that is the ease with which new firms may enter and secure a viable market, and the resulting likelihood of timely constraining entry; and

6.19.5 other restraints, such as countervailing buyer power.

6.20 A lessening of competition – or an increase in market power – may manifest in a number of ways, including higher prices or reduced quality, with the arrangement as compared to without the arrangement.

6.21 However, only a lessening of competition that is substantial will prevent us from clearing an arrangement containing a cartel provision. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[69] Some courts have used the word material to describe a lessening of competition that is substantial.[70]

63. Commerce Act 1986, s 65A(2)(c).
64. We also apply a substantial lessening of competition test when assessing mergers. Our Mergers and Acquisitions Guidelines set out how we assess a substantial lessening of competition in the merger context. These are available at http://www.comcom.govt.nz/business-competition/guidelines-2/mergers-and-acquisitions-guidelines/.
65. Commerce Act 1986, s 3(1).
66. Commerce Act 1986, s 3(2).
67. *ANZCO Foods Waitara Ltd & Ors v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 at [240].
68. See the discussion in *ANZCO Foods Waitara Ltd & Ors v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 at [245]-[246]. The test captures the creation, preservation and enhancement of market power.
69. *ANZCO Foods Waitara Ltd & Ors v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 at [239]. See also *Re Closure of Whakatu and Advanced Works* (1987) 2 TCLR 215.
70. *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [129].

6.22 Consequently, no bright line separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[71] However, a lessening of competition that affects a significant section of the market may be enough to amount to a substantial lessening of competition.[72]

Effect or likely effect

6.23 As we can only clear arrangements that are yet to be implemented, we focus on an arrangement's likely effects.

6.24 A substantial lessening of competition will be 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires a substantial lessening of competition to be more than a possibility, but does not mean it needs to be more likely than not to occur (ie, it does not need to have a greater than 50% probability of occurring).[73]

71. *ANZCO Foods Waitara Ltd & Ors v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 at [240].
72. *Dandy Power Pty Ltd v Mercury Marine Pty Ltd* [1982] FCA 178, at 43, 887.
73. *Woolworths & Ors v Commerce Commission* (2008) 8 NZ BLC 102, 128 (HC) at [111].

Chapter 7. The Commission's collaborative activity clearance process

7.1 In this Chapter we describe the process we follow when considering whether to give clearance. We also describe our approach to confidential information.

7.2 We have designed our process to ensure we can complete clearance investigations as quickly and transparently as possible, while adhering to the principles of natural justice.

7.3 Our process has the following stages: pre-clearance, the clearance application, our investigation and determination, and post-determination.

Pre-clearance – pre-notification discussions

7.4 We encourage potential applicants to inform us (by contacting the Competition Manager)[74] about potential clearance applications as early as possible.

7.5 We treat the fact and content (including any documents provided) of all pre-notification discussions as confidential until an application is registered. We do not seek third party views at the pre-notification stage.

7.6 While pre-notification discussions are not compulsory, they are designed to reduce the time we need to investigate once we have received a clearance application. Pre-notification discussions can benefit both the applicant and the Commission by:

- 7.6.1 educating our investigation team about industries that are complex and/or unfamiliar;
- 7.6.2 setting the scene for the arrangement, including its rationale, at an early stage;
- 7.6.3 clarifying the information and evidence we are likely to need, and identifying useful evidence that may assist our analysis;
- 7.6.4 allowing the applicant and us to have a preliminary discussion about likely competition issues (although our comments are only indicative and not binding); and
- 7.6.5 providing us with an opportunity to indicate further information that should be included in the application.

7.7 These pre-notification discussions allow us to plan more effectively for a clearance process, and to allocate appropriate resources. This means we can provide the applicant with a better indication of the likely timeframe for our investigation.

74. The Competition Manager can be contacted at competition@comcom.govt.nz.

7.8 To get the most out of these discussions, we encourage at least one of the applicant's senior employees to attend. We also expect an applicant to provide us with a substantially developed draft clearance application at least two working days before meeting with us, to allow us to review the application prior to meeting.[75]

Applying for clearance

Requirements for a clearance application

7.9 Clearance applications must be made in the prescribed form.

7.10 The application form sets out the information we need to start our investigation and allows applicants to present their arguments (and any supporting evidence the applicant wishes to provide). Only one of the parties to the proposed arrangement needs to apply for clearance of a cartel provision.

7.11 We require both a confidential version and a public version of the application. In the confidential version any information for which confidentiality is sought must be highlighted and contained in square brackets. In the public version the confidential information should be removed from within the square brackets, with the brackets remaining, ie, [ ].

7.12 The application must be accompanied by the appropriate filing fee. Payment can be made by cheque or electronic payment into our bank account. Please use the applicant's company name as the reference when depositing funds electronically. Our bank account details are:

Commerce Commission
BNZ North End
02-0536-0329867-00

7.13 After receiving a clearance application and payment, we check that the application is in the correct form and completed to a sufficient standard to enable us to proceed with our investigation. We then register the application.

7.14 If the application does not meet our requirements, we inform the applicant at the earliest opportunity and give them the opportunity to remedy this.

7.15 If the applicant does not address our concerns, or does not pay the fee, we may decline to register the application.[76]

Publication of a public version of a clearance application

7.16 Once we have registered a clearance application and agreed with the applicant which information is confidential (our approach to confidentiality is discussed later in this section) we publish a public version (a version that omits the confidential information) on the clearance register on our website and issue a media release. We do this to inform the public of the application and to enable third parties to make submissions to us.

75. A longer timeframe may be appropriate for more complex arrangements that contain a cartel provision.
76. Commerce Act 1986, s 65C.

How we investigate and determine a clearance application

Who determines a clearance application

7.17 Each clearance application is decided by a Division of Members of the Commission appointed by the Chair for that purpose.

7.18 The Division is supported by a multi-disciplinary team of Commission staff, comprising one or more investigators, and economic and legal staff. The Commission may procure external advice on a clearance application.

7.19 Staff brief the Division during the investigation. The Division provides staff with guidance and direction.

Indicative clearance timeline

7.20 The Act sets out a 30 working day statutory timeframe in which we must either give or decline to give clearance. If this time elapses without an extension being agreed, we are deemed to have declined to give clearance.[77] [78]

7.21 We have developed an indicative investigation timeline to allow us to consider clearance applications within 30 working days. As we gain experience with the new clearance regime, this indicative timeline may change.

Day 1	Clearance application registered.
Day 5	We provide an investigation timeline.
Day 10	We may publish a statement of preliminary issues on our website.
Day 30	We give clearance, or decline to give or send a letter of issues and seek an extension.

7.22 The exact time we take to reach a decision will vary. More complex clearance applications may take longer than 30 working days and it may be necessary to continue the process as shown below.

Day 40	We meet with the applicant to discuss the applicant's response to the letter of issues.
Day 45	We send a letter of unresolved issues (discussed at paragraph 7.51 below).
Day 50	We meet with applicant about the letter of unresolved issues.
Day 60+	We release our final decision.

7.23 We try and give the most accurate timeline we can at an early stage. However, we may have to seek further extensions later in the process, particularly where we need to:

7.23.1 test new information provided by the applicant or other interested parties; and/or

7.23.2 provide an applicant with the opportunity to fully respond to any unresolved issues.

Communication with the applicant

7.24 A member of the investigation team contacts the applicant early in the investigation to let them know who the main point of contact will be.

7.25 Throughout our investigation we keep in regular contact with the applicant about progress. How often depends on the circumstances of the case.

77. Commerce Act 1986, s 65A(4).

78. We make extension requests verbally in the first instance, although we will follow that request with a written request by email or letter.

Seeking views from interested parties

7.26 When we assess clearance applications, we take into account a party or parties' submissions, submissions of interested parties, and any other relevant evidence gathered during the course of our investigation.

7.27 We contact those we think are likely to have information that is relevant and useful to our investigation.

7.28 However, anyone who has information that they believe is important for our investigation, or wants to provide us with a written submission in response to the statement of preliminary issues can contact us at registrar@comcom.govt.nz.

How we gather information

7.29 We gather information from applicants and other parties in a variety of ways, depending on the circumstances. This can include through face-to-face interviews, telephone interviews, letters or emails.

7.30 We usually seek information on a voluntary basis, although in some cases we use our information gathering powers to require parties to provide information. We discuss our powers to do so in more detail below.

7.31 It is an offence for any person to attempt to deceive or knowingly mislead us through communications with us, interviews, emails or telephone conversations.

The interview process

7.32 Where we wish to interview someone, we make contact to request a time for a face-to-face or telephone interview. Before the interview, we provide a public version of an application for clearance, explain our processes and provide an agenda or a list of topics to be discussed (including any specific information we require).

7.33 We prefer to conduct these interviews on a voluntary basis. However, under our powers to require information we can require persons to appear before us to give evidence under oath.

7.34 We prefer to record interviews and can provide a copy to the interviewee on request. Recording interviews ensures that both parties have access to an accurate record of what was discussed, and allows us to converse freely without the need to take extensive notes.

7.35 Interviews often include discussion of information that is confidential. We explain our approach to confidentiality at paragraphs 7.61 to 7.68 below. However, interviewees are encouraged to identify all commercially sensitive and/or confidential information during the interview.

7.36 We often request that interviewees provide evidence or information to substantiate their arguments. This is more likely to happen where such arguments are key considerations in our assessment of a clearance application.

Information requests

7.37 We also often ask applicants or other parties to provide information relevant to our investigation.

7.38 We recognise that in many cases such information is confidential. As with interviews, we encourage parties to identify all commercially sensitive and/or confidential information when providing information to us.

7.39 When we make an information request, we usually specify a deadline for the information to be provided. This allows us to progress our investigation as quickly as possible. We encourage parties to contact us as soon as possible if they think they cannot meet the deadline.

Our statutory information-gathering powers

7.40 We can require a person to supply information or documents or give evidence by issuing a statutory notice (a section 98 notice). We can issue a section 98 notice where we consider it necessary or desirable for the purposes of carrying out the Commission's functions and exercising its powers under the Act.

7.41 There are a number of reasons why we may decide to use a section 98 notice, including that:

7.41.1 it ensures information is gathered in a timely manner;

7.41.2 parties may prefer it because, for example, they might be under a duty such as a confidentiality obligation not to reveal that information unless compelled to do so; or

7.41.3 parties with relevant information are unwilling to disclose the information voluntarily.

7.42 A section 98 notice explains what is required under the notice (for example, information, documents and/or giving evidence in person), and provides a timeline for providing that information or documents.

7.43 A section 98 notice creates a legal obligation for the recipient to provide us with the information requested. It is an offence to refuse or fail to comply with a section 98 notice without reasonable excuse.

7.44 If the recipient anticipates difficulty in complying with a section 98 notice, they should let us know as early as possible and explain the reasons why. For example, if the information we have asked for does not exist or the documents are no longer in the recipient's possession or control, the recipient must explain why the requested documents or information cannot be provided.

7.45 Similarly, if the recipient wishes to seek an extension to the deadline, they should make a request stating the reasons and allowing sufficient time for us to process the request before the original deadline.

Documents we prepare during the assessment of a clearance application

7.46 As indicated above, there are a range of documents we may prepare at different stages during our investigation. These include a statement of preliminary issues, a letter of issues, and a letter of unresolved issues.

Statement of preliminary issues

7.47 For most clearance applications we publish a statement of preliminary issues.[79] This outlines our preliminary view of the issues (based on the information we have at that time) with the aim of:

7.47.1 increasing the transparency of our process;

7.47.2 providing interested parties with an opportunity to consider the issues we have identified; and

7.47.3 uncovering further information which might assist our investigation.

7.48 We publish a statement of preliminary issues on our website approximately 10 working days after registering the application. We also issue a media release inviting responses to be made to us.

Letter of issues and letter of unresolved issues

7.49 We send a letter of issues to an applicant where, following our initial investigations, we have concerns about potential competition issues that may arise from a proposed arrangement that contains, or may contain, a cartel provision.

7.50 A letter of issues is not a final decision. Rather, a letter of issues aims to clearly outline our concerns and invite the applicant to provide further information that might address these concerns. We often meet with applicants to discuss a letter of issues, although we prefer that applicants also provide a written submission (and supporting evidence) as part of their response.

7.51 If, following an applicant's response to the letter of issues, we consider some issues remain unresolved, we are likely to send a letter of unresolved issues to the applicant. A letter of unresolved issues provides the applicant with a further opportunity to provide additional information or submissions to allay our concerns.

Effect of a clearance

7.52 As explained in Chapter 6, where we clear an arrangement, parties to the arrangement will not contravene the cartel prohibition or the prohibition on arrangements that substantially lessen competition by entering into or giving effect to the arrangement.

Post-determination: publication of decisions and written reasons

7.53 Once we have completed our investigation, the Division makes a decision on whether to give or decline to give clearance. The Chair of the Division then signs a notice of clearance/decline of clearance.

7.54 We inform the applicant of our decision by telephone and then issue a media release and update the clearance register on our website. Where the applicant is listed on the New Zealand stock exchange, we issue the media release outside of trading hours. We may also inform other interested parties of our decision.

79. Where the issues are very straightforward and publishing a statement of preliminary issues is likely to delay our decision, we may choose not to do so.

7.55 We also publish written reasons to explain our decision and to provide guidance for the business community.

7.56 While we draft written reasons during our investigation, we can only finalise these following our decision. This may mean that we do not publish written reasons on the day we issue our decision.

7.57 We do, however, recognise that businesses want to understand the reasons for our decisions as soon as possible, particularly when we decline clearance. Because of this we aim to publish reasons as soon after our decision as we are able. Where we have declined clearance, we aim to publish the reasons within 10 working days.

Appeals against a clearance decision

7.58 The Commission's clearance decision can be appealed to the High Court by the applicant, or any other person who is a party to the arrangement to which the application for clearance relates.[80] [81]

Revocation of clearances

7.59 We may revoke clearance if we are satisfied that:[82]

7.59.1 the clearance was given on information that was false or misleading in a material particular; or

7.59.2 there has been a material change of circumstances.

7.60 If we are considering revoking clearance, we will request submissions from the person to whom clearance was given and any other person we consider is likely to have an interest in the matter.

Confidentiality

Confidentiality as to the fact of a clearance application

7.61 Applicants sometimes ask that we do not publicly disclose the fact that they have made a clearance application (fact confidentiality).

7.62 We consider requests for fact confidentiality on a case-by-case basis, but we are only likely to grant fact confidentiality for a limited period and only in exceptional circumstances. This is because fact confidentiality is likely to severely hamper our investigation, as investigators cannot gather information from parties and test information provided in a clearance application.

Confidential information provided by parties during a clearance process

7.63 All information we receive is subject to the principle of availability under the Official Information Act 1982 (the Official Information Act).

80. Commerce Act 1986, s 92(ca).

81. The High Court Rules provide that a party must file any appeal within 20 working days of the date on which the decision is made. As the decision date will often be different to the date on which we publish our reasons, we generally indicate to parties that we will not oppose a party filing an appeal out of time provided they file any appeal within 20 working days of the date on which we publish our written reasons.

82. Commerce Act 1986, s 65D.

7.64 However, the Official Information Act does not require us to disclose information if it would prejudice our investigations, or where the public interest in making the information available is outweighed by the fact that, in our view:

7.64.1 disclosure would unreasonably prejudice the commercial position of the supplier or subject of the information; or

7.64.2 we received the information under an obligation of confidence, and if we were to make that information available it would:

7.64.2.1 prejudice the supply of similar information to us (by any person) where it is in the public interest that such information continues to be supplied to us; or

7.64.2.2 be likely otherwise to damage the public interest.[83]

7.65 We acknowledge that much of the information we seek during our investigations will be commercially sensitive. We also recognise that this information is generally highly relevant to our investigation. As such, we recognise that preserving the confidentiality of commercially sensitive information and providing protection against disclosure is necessary. This ensures that parties continue to supply such information to us, and that we can deal with clearance applications as quickly and efficiently as possible.

7.66 That said, because we aim to carry out our investigations quickly, transparently and adhering to the principles of natural justice, we take a cautious approach in accepting assertions of confidentiality. We test all claims to ensure that the information provided is truly commercially sensitive.

7.67 We also encourage parties to provide us with a public version of any submission made, which can then be viewed by the applicant/interested parties.[84] We discuss this with parties on a case by case basis.

7.68 In some cases, we may need to test confidential information provided by one party with the applicant or other interested parties. If possible, we hypothetically test the confidential information.

83. While we have the discretion to issue a confidentiality order under s 100 of the Act to prohibit the publication or communication of certain information, we very seldom do so. This is because the information would already be protected by the obligations of confidence and the exceptions to disclosure obligations in the Official Information Act. Further, a s 100 order expires 20 working days from the date of a determination, and so it will not protect information on an ongoing basis.

84. We may also publish public versions of submissions on collaborative activity clearance applications on our website.

Chapter 8. Seeking authorisation

8.1 If an arrangement containing a cartel provision does not qualify for an exemption, we may nonetheless give authorisation.

8.2 We can only grant authorisation for arrangements that we consider are likely to substantially lessen competition. If we are not satisfied that an arrangement will substantially lessen competition, we must decline to authorise the arrangement.

8.3 We must grant authorisation where we are satisfied that the arrangement will be likely to result in a benefit to the public that would outweigh the lessening in competition. We call this the 'public benefit test'.

8.4 When we authorise an arrangement containing a cartel provision, it cannot be challenged by us or by a third party as being a breach of sections 27 or 30, and section 30D of the Act will not apply.

8.5 We authorise arrangements for a period for which we can be satisfied there are net public benefits. Typically, applicants seek authorisation for the length of the relevant arrangement.

8.6 For more information on when we will authorise arrangements and the standard process that we follow when determining authorisation applications, you can refer to our authorisation guidelines.[85]

85. Available at http://www.comcom.govt.nz/business-competition/guidelines-2/authorisation-guidelines/.

Chapter 9. Franchises

9.1 Franchises are not given special or specific treatment under the Act. In the context of cartels, this means that a conventional analysis must be undertaken to determine whether the franchise contains a cartel provision and whether an exemption applies.[86]

9.2 Nevertheless, this Chapter provides guidance as to when and how the new cartel prohibitions – and the exemptions from them – are likely to relate to franchise agreements.

Cartel prohibition will not apply to many franchise arrangements

9.3 Many franchise arrangements will fall outside the cartel prohibition. This is because many arrangements between a franchisor and a franchisee are not arrangements between competitors – that is, the franchisor does not compete with its franchisees. What amounts to an arrangement between competitors is described in Chapter 2.

9.4 Where the cartel prohibition does not apply, franchise arrangements will be lawful provided that neither the franchise nor the provisions of any franchise arrangements have the purpose, effect, or likely effect of substantially lessening competition (ie, they are unlikely to be anti-competitive). Franchise arrangements are also subject to the prohibition on RPM.[87]

9.5 In this respect, what case law there is suggests that genuine franchises seldom raise competition concerns. For example, in the case which touches most closely on franchises, the High Court stated:

> In a real sense, a franchise agreement is a joint venture between the franchisor and franchisee, and sometimes between the franchisees as well. In those circumstances, I wonder whether a normal incident of the organization of such a business venture is easily subject to review under the Commerce Act. A franchisor in the position of Washworld will not license what are in fact copy-cat businesses unless able to protect itself later from the possibility of a franchisee using the franchise agreement as a springboard for competitive activity. So, such franchise agreements with their associated restraints may in fact promote the competitive process.[88]

86. Indeed, the Act – including the existing prohibition on price fixing – has had little involvement in the regulation of franchises.

87. Commerce Act 1986, ss 37, 38. For more information on RPM, refer to our guidelines which can be found online at http://www.comcom.govt.nz/business-competition/fact-sheets-3/resale-price-maintenance-2/.

88. *Washworld Corporation (Leases) Ltd v Reid* (1998) 8 TCLR 372 (HC), at 387-388 per Young J.

When a franchise arrangement may be subject to the cartel prohibition

9.6 A franchise arrangement may be an arrangement between competitors where:

9.6.1 a franchisor owns businesses that compete against some or all of its franchisees; or

9.6.2 there is an arrangement between competing (or potentially competing) franchisees.[89]

9.7 The cartel prohibition prohibits provisions of arrangements between competitors that fix prices, restrict output or allocate markets or customers. These terms are described in detail in Chapter 2.

9.8 This means that, without limiting the types of franchise terms that may be cartel provisions, terms that would require close consideration include those relating to:

9.8.1 geographic or customer market allocation;

9.8.2 pricing of products or services, especially terms where the franchisor sets or recommends prices to be charged by franchisees; and

9.8.3 restrictions on the type or quantity of product.

9.9 As noted, this is not an exhaustive list. Other types of franchise terms may also be cartel provisions.

Exemptions likely to apply to cartel provisions in genuine franchises

9.10 If a franchise arrangement does contain a cartel provision, one of the exemptions may well apply.

Franchises likely to be collaborative activities

9.11 The collaborative activity exemption is described in detail in Chapter 5.

9.12 A genuine franchise is likely to be a collaborative activity. In contrast, a franchise which is in reality a cloak for an arrangement to lessen competition between the participants in the franchise will not be a collaborative activity.

9.13 The cartel prohibition will not apply to a cartel provision that forms part of a genuine franchise arrangement provided that the cartel provision is reasonably necessary for the purposes of the franchise.

9.14 We explain how we assess whether a cartel provision is reasonably necessary for the purposes of a collaborative activity in Chapter 5. The same test applies to cartel provisions in franchise arrangements. In short, parties to the franchise would need to satisfy themselves that the franchise would be materially hindered if it used a significantly less restrictive (but practically workable) alternative to the cartel provision. Parties to a franchise should be able to explain why other alternatives to the cartel provision are inadequate or unavailable.

89. See, for example, *News Limited v Australian Rugby Football League Limited & Ors* (1996) 135 ALR 33.

Vertical supply contracts applied to franchises

9.15 The vertical supply exemption is described in detail in Chapter 3.

9.16 Where a franchisor supplies goods or services to a franchisee in circumstances where the franchisee and the franchisor sell (or potentially would sell) those same goods or services in competition with each other, the vertical supply exemption would apply to a cartel provision provided the cartel provision does not have the dominant purpose of lessening competition between the franchisor and the franchisee.

Joint buying or promotion applied to franchises

9.17 The joint buying or promotion exemption is described in detail in Chapter 4.

9.18 This exemption would apply where franchise members agree to the price at which they will acquire goods or services together, purchase individually or collectively agreed prices, or where an intermediary – such as the franchisor – takes title to goods prior to those goods being acquired by franchisees.

9.19 The exemption also allows franchise members to jointly advertise the resale price for goods or services which they have collectively acquired, or collectively negotiated to acquire. However, the joint advertising part of the exemption does not enable the franchise members to jointly agree their final selling price. Such a price fixing provision would need to be assessed under the collaborative activity exemption.

Clearances and authorisations

9.20 Clearances and authorisations are described in Chapters 6 to 8.

9.21 As with all other types of arrangements containing cartel provisions, if a franchise arrangement contains a cartel provision a party to a franchise may choose to apply for a collaborative activity clearance. Alternatively, a party to a franchise could apply for authorisation where the conduct does not fall within the exemptions.

EXAMPLES

Company A – the franchisor – operates a franchised pick-up and delivery dry cleaning business in Wellington.

No arrangement between competitors

A does not operate its own dry cleaning pick-up and delivery service. Rather A licenses its business model and brand to three franchisees, X, Y and Z, which also operate in the Wellington region.

In this scenario, there is no arrangement between competitors. The cartel prohibition therefore does not apply. Nor would the franchise arrangement be likely to substantially lessen competition.

Arrangement between competitors

Suppose that A operates its own store in Willis Street in Wellington's CBD as well as licensing its business model and brand to X, Y and Z. Each of A's franchise arrangements with X, Y, and Z is likely to be an arrangement between competitors, because A competes (or could compete) with each of X, Y and Z.

In its franchise arrangements with each of X, Y and Z, A specifies the territories within which X, Y and Z may offer pick-up and delivery dry-cleaning services.

- X can only offer services from its shop on The Terrace and offer pick up services to customers on The Terrace.
- Y can only offer services from its shop on Lambton Quay and offer pick up services to customers on Lambton Quay.
- Z can only offer services from its shop on Featherston Street and offer pick up services to customers on Featherston Street.

Each arrangement contains a market allocation provision, which is defined as a cartel provision under section 30 of the Act.

Neither the vertical supply contract nor the joint buying exemptions apply to this market allocation provision.

The franchise is likely to be a collaborative activity; therefore the collaborative activity exemption would apply if the market allocation provision is reasonably necessary for the purposes of the franchise.

A and each of X, Y and Z should assess whether the strict geographic limitations are reasonably necessary for the franchise. For example, would relaxing the limitations on where the franchisees can collect dry-cleaning from, materially hinder the franchise?

If the parties are satisfied that the provision is reasonably necessary, then they may choose to proceed with the arrangement. If we took the view that the exemption did not apply, it would be open to us to take enforcement action. Alternatively, the parties could apply for clearance.

Regardless of whether the franchise arrangement falls within an exemption, the general prohibition on arrangements that substantially lessen competition still applies.

This is a guideline only and reflects the Commission's view. The publication is not intended to be definitive and should not be used instead of legal advice. It is businesses' responsibility to remain up to date with legislation.

→ To check for updates to this guideline visit:
www.comcom.govt.nz/competitor-collaboration-guidelines

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