

BEFORE THE COMMERCE COMMISSION

DECISION NO 247

IN THE MATTER of the Commerce
Act 1986 ("the Act")

A N D

IN THE MATTER of an application
for authorisation of an
agreement involving SOUTH
PACIFIC TYRES (NZ) LIMITED,
FRANK GEORGE ALLEN, and JOHN
COOPER AUTOMOTIVE (1988) LIMITED

DECISION OF THE COMMISSION

<u>The Commission:</u>	W E B Tucker (Chairman of the Division) R E Hall M A Vennell Kerrin M Vautier
<u>Representation:</u>	<u>For South Pacific Tyres (NZ) Limited</u> Mr M A Phelan Mr D C B Stevenson (Counsel)
<u>Date of Decision:</u>	3 May 1990

A. THE APPLICATION

1. South Pacific Tyres (NZ) Limited ("SPT") seeks authorisation for itself and Frank George Allen ("Allen") to enter into a Deed as to Restraint of Trade ("the Deed") and give effect to provisions whereby:

- (a) Allen covenants not to be employed, engaged in or concerned or financially interested in any firm, company or business concerned with tyre sales, servicing or retreading, other than John Cooper Automotive (1988) Limited ("JCA"), in the area north of Taupo's southern boundary, nor to be concerned or interested in any business using the names "Frank" or "Allen" or otherwise highlighting his interest in the business in the period to 31 December 1990 (clauses 4.02(1) and 4.02(2)); and
- (b) In the period to 31 December 1990 JCA may only operate one outlet, it shall not be engaged in tyre retreading or tyre importing, and shall purchase stocks of tyres,

tubes and tyre related products only from SPT, its subsidiaries, or suppliers approved by SPT, subject to availability at a fair market price, on normal commercial terms, in reasonable quantities and within a reasonable time of placement of orders (clause 4.02(3)); and

- (c) In the period from 1 January 1991 to 31 December 1992 JCA's sales of tyre and tyre related products shall include not less than a specified percentage of product sourced from SPT, its subsidiaries or other approved sources - subject to conditions as to price, terms, quantities and delivery (clause 4.02(4)).

B. PROCEDURES

2. The application was received on 25 October 1988 and registered, in terms of s.60(2)(a), on 27 October 1988. SPT sought confidentiality as to the proportion of JCA's sales subject to clause 4.02(4). An order to that effect was granted under s.100 on 3 November 1988. Pursuant to s.60(2)(d) the Commission gave public notice of the application in the New Zealand Herald on 20 November 1988. No person registered an interest in terms of s.60(3).

3. A draft determination was issued on 29 November 1989. The Commission tentatively concluded that s.27 did not apply but Clauses 4.02(3) and (4) were exclusionary provisions in terms of s.29. SPT, in terms of s.62(3), requested a conference. The conference was held on 30 January 1990.

4. The application had been lodged under cover of a letter from Iazard Weston which stated, inter alia, that "the parties ... have entered into the arrangement in a spirit of full co-operation". The application was formally made by SPT. The Commission initially believed that Iazard Weston was acting for both parties to the Deed.

5. However, following the conference the Commission realised that Mr Allen and his solicitors were unaware of the Draft Determination. A copy was sent to them. They advised the Commission that "they [did] not wish to make submissions to the Commission" and "will abide by the final determination of the Commission".

C. PARTIES TO THE PRACTICE

6. SPT was established in 1985 through the merger of the tyre businesses of Dunlop New Zealand Limited ("Dunlop") and Goodyear New Zealand Limited ("Goodyear"). Voting shares are owned as to equal shares by Dunlop and Goodyear with the former currently holding non-voting shares redeemable only for cash. SPT and its subsidiaries are involved in the manufacturing, importing, wholesaling and retailing of tyres, inner tubes, rubber and plastic products, sports goods and industrial chemicals. It has a 30% interest in Paramont Recaps Limited - a retreader, distributor and retailer of tyres.

7. Mr Allen has extensive experience in the tyre industry. He owned/operated Frank Allen's Tyre Services Limited ("Frank Allens") as a prominent independent tyre retailer with nine outlets in Auckland. He was subsequently employed for a short period as an executive of SPT. JCA, owned as to equal shares by Mr Allen and his wife, was established in September 1988. It acquired the business of John Cooper Automotive Ltd, a Glenfield garage/repair shop, and now operates a tyre retail outlet there.

D. BACKGROUND

8. The Deed arises as a consequence of Mr Allen selling his business and subsequently re-entering the trade through JCA. In May 1984 Abacus Holdings Limited ("Abacus") acquired all the shares in "Frank Allens". The agreement for sale and purchase contained a restraint of trade clause protecting Abacus' investment in goodwill ("initial restraint"). Specifically, Allen covenanted not to have any equity interest in, or be engaged in the operation or management of, any tyre retailing or retreading business north of the southern boundary of Taupo. He remained as an employee of the business until December 1985. The restraint was then effective for five years, i.e. until 31 December 1990.

9. Abacus sold "Frank Allens" to SPT in 1986. The agreement for sale and purchase ("Abacus/SPT agreement") provided that Abacus would take all necessary steps to enforce the "initial restraint" to protect SPT's investment in goodwill. Specifically, the Agreement provided that:

"9.03 The Vendor shall, where possible, co-operate with and assist the Purchaser in respect of the enforcement of a restraint of trade provision given by Frank Allen to the Vendor or the then Abacus Consolidated Limited on the purchase of the Company by the then Abacus Consolidated Limited and if possible shall assign such rights to the Purchaser."

Mr Allen was employed by SPT in January 1988. SPT waived the restraint of trade in respect of that employment. Mr Allen resigned later in 1988 and sought SPT's permission to re-entering the market through JCA. SPT agreed upon the terms set out in the Deed for which authorisation is now sought.

E. THE MARKETS

10. The relevant markets are those for the wholesale distribution and retailing of new tyres and tyre related products, retreading, and the retailing of 'retreads' in the area north of Taupo.

11. Tyres are manufactured locally by SPT and the Firestone Tyre and Rubber Co of NZ Ltd ("Firestone") producing the Dunlop/Goodyear and Firestone brands respectively. Dunlop, Goodyear and Firestone are also involved in the wholesale

distribution, importing, retreading and retailing of tyres. Other importers/distributors and their brands include:

Bridgestone Tyres (NZ) Ltd	Bridgestone
Radial Imports (NZ) Ltd	Yokohama
Independent Tyre Importers	Michelin
New Zealand Motor Distributors (Wellington) Limited	Pirelli, Goodrich
Value Tyre Co Ltd	Aurora, Riken, Hankook
Global Tyres NZ Ltd	Ohatsu, Tigar, Motorway
Super Tyres Industries Ltd	Kuhmo, General

12. SPT has 16 outlets in Auckland with 11 trading under the 'Beaurepaires' name and 5 "Frank Allens" outlets. Firestone has 9 Auckland outlets. There are about 90-100 "independent" outlets in Auckland specialising in tyres and related products. There are also over 300 service stations in the area with an interest in retailing tyres and related products. JCA operates in Glenfield. There are two other specialist tyre outlets in the immediate area. One is a Firestone outlet, the other is an "independent".

13. SPT estimates that its share of the Auckland retail tyre market is about 25-30%. Its market share has decreased since 1986 with the liberalisation of import licence controls. Imported tyres have increased their market share from about 20% to about 33% over the past two years. Tyres other than for use as original equipment (OE) for motor vehicle assembly became totally exempt from import licensing control on 1 April 1989. OE tyres must be sourced locally and in any case are not relevant to the present matter.

14. Tariffs on tyres (other than OE) for cars and light commercial vehicles under 508mm internal rim diameter are currently 26% (Normal) reducing to 22.5% on 1 July 1990 and 20% on 1 July 1991. There are no tariffs on other 'replacement tyres' or for tyres sourced from less developed countries.

F. JURISDICTION

15. The Deed was entered into on 30 September 1988. In terms of s.35(2) of the Act it was conditional upon authorisation being granted under the Act. Authorisation has been sought in terms of s.58(1)(a), in respect of clauses 4.02(1) and (2), and s.58(1)(f), in respect of clauses 4.02(3) and (4). Those sections of the Act relate to authorisation for arrangements etc to which ss27 and 29 respectively apply.

16. The Commission's approach, as determined in its Decision 205 Whakatu/Advanced Meat Works, is that it should first determine whether the practice is one which is prohibited by s.27 or s.29 of the Act.

Section 44(1)(d)

17. It is submitted on behalf of the applicant that:

"It appears to us that had the purchase of Frank Allen Tyre Service been made by our client direct, rather than with Abacus Consolidated having an intervening interest, no application to the Commerce Commission would have been required. The arrangement is clearly within the spirit of section 44(1)(d) of the Commerce Act 1986, but because of the chain of interest in the business, is now a matter which requires authorisation."

18. Section 44(1)(d) provides that:

"(1) Nothing in this Part of this Act applies -

(d) To the entering into of a contract for, or the giving or requiring the giving of a covenant in connection with, the sale of a business or shares in the capital of a body corporate carrying on a business in so far as it contains a provision that is solely for the protection of the purchaser in respect of the goodwill of the business."

19. Although the "initial restraint" was entered into in 1984 the provisions of ss27-29 of the Act apply to the giving effect to "arrangements" entered into prior to the commencement of the Act. The Commission agrees that the "initial restraint" was exempt by virtue of s.44(1)(d). Abacus was entitled to give effect to it until 31 December 1990 and could do so without contravening the Act. To protect its investment in the goodwill of "Frank Allens" SPT required Abacus to assist in enforcing the restraint. In the Commission's view that provision of the "SPT/Abacus agreement" was also exempt from Part II by virtue of s.44(1)(d).

20. However the Deed is not a contract for "the sale of a business or shares ...". The exemption provided by s.44(1)(d) is not applicable to the Deed - even though Clauses 4.02(1) and (2) merely continue a restraint which was so exempt. Further although the pre-existing restraint is exempt from the Commerce Act 1986 it is not clear that it is enforceable. This point was raised at the conference. Counsel for SPT acknowledged that the rights under the original restraint had not been specifically assigned and it was possible SPT could not enforce it. He noted Abacus had covenanted to enforce the restraint but was uncertain as to the current status of Abacus.

Section 27

21. Section 27 provides, inter alia, that:

"(1) No person shall enter into a contract containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

- (2) No person shall give effect to a provision of a contract ... that has the purpose, or has or is likely to have the effect of substantially lessening competition in a market."

22. Section 3(5) provides that:

"For the purposes of section 27 of this Act a provision of a contract ... shall be deemed to have or be likely to have the effect of substantially lessening competition in a market if that provision and -

- (a) The other provisions of that contract ... or
- (b) The provisions of any other contract to which that person or any interconnected body corporate is a party -

taken together have or are likely to have [that] effect ..."

23. In terms of s.3(5) clauses 4.02(1)-(4) are each assessed, for the purposes of s.27, in light of the totality of the Deed and the pre-existing restraints. SPT submits it has no other "tying arrangements" with tyre retailers. No other contracts etc involving SPT have been disclosed to the Commission.

24. Quite clearly clauses 4.02(1) and (2), read together with the existing restraint, do not "substantially lessen competition" in any market. They involve a lesser restraint than one which SPT claims the benefit of any event. Mr Allen has re-entered the market earlier than the previous restraints allowed - albeit limited solely to his involvement with JCA. The trade off for this is in clauses 4.02(3) and (4). JCA is restricted solely to SPT products for the period to 31 December 1990 (i.e. the remainder of the period covered by the previous restraints on Mr Allen) and is partially tied to SPT products for a further two years. The analysis which follows applies irrespective of the status of the pre-existing restraint.

25. Substantial is defined in s.2 as "real or of substance". Noting this definition, and comments by Deane J in Tillmans Butcheries (ATPR 10-138) the Commission, in Decision 205 Whakatu/Advanced, has adopted the view that substantial means not insignificant, ephemeral, nominal or minimal. The Commission in Decision 205 also listed five questions that are relevant, albeit not necessarily exhaustive or conclusive, to assessing the effect of a trade practice viz:

- (a) To what extent is competition foreclosed and what alternatives do others in the market have?
- (b) Does the practice have the effect of threatening independent initiative of operators in the market?

- (c) Does the agreement have the effect of causing operators in the market to compete less vigorously?
- (d) Does the agreement enable the parties thereto to exercise power over others e.g. over persons contracting with the parties or their competitors?
- (e) Does the agreement affect the ability or desire of potential entrants to enter the market(s) in question?

26. In the present case a single outlet is totally foreclosed to competitors of SPT for about two years and partially foreclosed for a further two years. That foreclosure is minimal in the context of the "metropolitan Auckland market". At a more localised level there are two other specialist tyre outlets in Glenfield and a number of service stations.

27. The Deed clearly limits independent initiatives by Mr Allen and JCA but has no such effect on any other person. Nor does it cause those in the market generally to compete less vigorously. The market power which SPT derives from this "one-off arrangement" is minimal. The arrangement has no effect on the ability of others to enter the market.

28. The Commission concludes that the effect of clauses 4.02(1)-(4), individually and together, are minimal and not sufficient to meet the threshold imposed by s.27.

Section 29

29. Section 29 of the Act provides that:

"(1) For the purposes of this Act, a provision of a contract, arrangement, or understanding is an exclusionary provision if -

- (a) It is a provision of a contract or arrangement entered into, or understanding arrived at, between persons of whom any 2 or more are in competition with each other; and
- (b) It has the purpose of preventing, restricting, or limiting the supply of goods or services to, or the acquisition of goods or services from, any particular person or class of persons, either generally or in particular circumstances or on particular conditions, by all or any of the parties to the contract, arrangement, or understanding, or if a party is a body corporate, by a body corporate that is interconnected with that party.

(2) For the purposes of subsection (1)(a) of this section, a person is in competition with another person if that person or any interconnected body corporate is, or is likely to be, or but for the relevant provisions would be, in competition with the other person, or with an interconnected body corporate, in relation to the

supply or acquisition of all or any of the goods or services to which that relevant provision relates."

30. The contract (Deed) was entered into by SPT and Allen. Although JCA was not a signatory the Deed embodies an arrangement or understanding to which it is a party. Allen has covenanted on JCA's behalf as to its conduct for the term of the Deed and is clearly able to ensure it complies. Although Allen and JCA are separate legal persons JCA is, in effect, merely the vehicle for Allen to engage in trade.

31. Clauses 4.02(3) and (4) clearly have the "purpose of preventing, restricting or limiting ... the acquisition of goods from [a] particular class of persons ... [i.e. all suppliers of tyres and related products other than SPT, its subsidiaries or "nominees"] ... by JCA". JCA is prevented until 31 December 1990 and restricted or limited for a further two years.

32. The Commission concludes that there is a contract, arrangement or understanding between SPT, JCA and Allen (s.29(1)(a)) which meets the terms of s.29(1)(b).

33. Section 29(1)(a) also requires that 2 or more of the parties be in competition with each other. In terms of s.29(2) "party" includes interconnected bodies corporate of that person. SPT (and/or its subsidiaries) and JCA both currently retail tyres and related products.

34. Specifically, s.29(1)(a) refers to, for example, "[an] arrangement entered into between persons any 2 of whom are in competition with each other ...". That is the parties must be in competition with each other at the time the "arrangement" is entered into. The Australian Trade Practices Act 1974 contains a similar provision at s.4D(1)(a). In ABC Parish & Ors [1980] ATPR 40-142 St John J. stated at pp42-082, and 42-083:

"To be noted in that definition is the tense of the phase "are competitive"; and

"The question arises as to whether the parties to the contract were in competition in May 1979 or in early November 1979 when the May agreement was ratified".

35. Further, in TPC v TNT Management Pty Ltd & Ors (1985) ATPR 40-512(9), Franki J stated; at p46-135:

"(1) There must be a provision of an arrangement or understanding made between persons any two or more of whom are competitive with each other. I consider that the time when the question of competition is to be determined is the time when the arrangement was made or the understanding arrived at".

36. On or about 30 August 1988 Allen as trustee for a company to be formed [JCA] entered into an agreement to acquire the assets of the general automobile servicing and

repair business of John Cooper Automotive Ltd. JCA was established shortly after and completed the acquisition and commenced trading on or around 5 September 1988. The Deed with SPT was signed on 30 September. However an "understanding" involving SPT, Allen and JCA was "arrived at" before JCA commenced operations as a tyre retailer.

37. For the purposes of s.29(1)(a) it is not necessary that the parties actually be in competition with each other. It is sufficient, in terms of 29(2), that they:

"[are] or [are] likely to be"; or
 "but for the relevant provision would be or would be likely to be"

38. Thus s.29 is not avoided, for example, by entering into an otherwise "exclusionary arrangement" prior to one party entering the relevant market. In this case, SPT claims, Allen was restrained from entering the market by "restraint of trade" arrangements that did not contravene the Act. While JCA was not a party to those arrangements it was, in effect, Allen's vehicle for entry into the market. Had JCA commenced trading in the absence of the "arrangement or understanding" embodied in the Deed SPT would have claimed rights to action against Allen and JCA.

39. Notwithstanding that, Allen/JCA were likely to be in competition with SPT (including its subsidiaries) at the time the arrangement was entered into. Allen clearly wished to re-enter the market in his own right. JCA was the vehicle. SPT was prepared to countenance that - despite its claim to the existing restraint. The issue was how, not whether, he would re-enter the market.

40. The Deed was negotiated to enable re-entry before the existing restraint expired with the 'exclusion' negotiated in consideration for waiving SPT's claims to any rights under the restraint. If the parties were not likely to be in competition, i.e. Allen was not re-entering, there would be no Deed.

41. The Commission concludes that s.29 applies to clauses 4.02(3) and (4) i.e. they are exclusionary provisions.

BALANCING TEST

42. Having concluded that the practice is one to which s.29 (but not s.27) applies the Commission is now required to assess the matter in terms of s.61(7) viz:

"(7) The Commission shall not make a determination granting an authorisation under section 58(1)(e) or (f) of this Act unless it is satisfied that -

(a) The entering into of the contract or arrangement or the arriving at the understanding; or

- (b) The giving effect to the exclusionary provision of the contract, or arrangement or understanding -

as the case may be, to which the application relates, will in all the circumstances result, or be likely to result, in such a benefit to the public that -

- (c) The contract or arrangement or understanding should be permitted to be entered into or arrived at; or
- (d) The exclusionary provision should be permitted to be given effect to."

43. The Commission's views on public benefit generally are well established in previous Decisions relating to both mergers and restrictive practices. Public benefits are to be primarily adduced by the applicants. These benefits must be properly demonstrated as a matter of likelihood and must flow from the practice.

44. The applicant in this case submits that the Deed:

- (a) preserves the integrity of the contract originally entered into between Allen and Abacus;
- (b) allows Allen to re-enter, and apply his considerable expertise in, the tyre retailing market; develop the business, build up a clientele and after a limited period be free to expand and choose suppliers;
- (c) provides another substantial competitor in the Glenfield area which will employ local staff and import Allen's expertise.

In the absence of the Deed SPT claims it would remain entitled to require Allen not to enter the market until December 1990.

45. Quite aside from issues of enforceability the initial restraint was exempt from the provisions of Part II of the Act - and thus, by implication, not in conflict with the public interest. However the Deed involves an exclusionary provision in consideration for waiving any claims to the benefit of that restraint. It changes the nature of the arrangement - from one exempt from the Act to one prohibited by the Act.

46. In effect then the issue is what benefit flows to the public in allowing Mr Allen re-entry to the market 28 months before he could do so unchallenged by SPT's claimed rights under the restraint. Market entry conditions are an important factor in any assessment of effective competition. In this case the market is competitive and the conditions of entry, and expansion by existing operators, are unrestricted. The Commission is unable to attach any weight to the public benefits claimed under para 44(b) above.

47. Nor does the Commission accept the claimed employment benefits as public benefits. The claimed additional employment arising from the conversion of a garage/repair shop business to a specialist tyre outlet is minimal. Further, considering the Auckland tyre retailing market overall there need not be a net increase in employment.

48. In view of the s.29 finding and the nature of the test in s.61(7) public benefit is required to be established before authorisation can be granted.

DETERMINATION

49. The Commission determines that:

- (a) Section 27 does not apply to the Deed and the Commission has no jurisdiction to grant an authorisation in terms of ss58(1)(a) and (b);
- (b) Clauses 4.02(3) and (4) of the Deed are exclusionary provisions in terms of s.29 and the Commission has jurisdiction to consider these under ss58(1)(e) and (f).

50. In terms of s.61(1)(b), the Commission determines to decline authorisation to the "exclusionary provisions" in clauses 4.02(3) and (4) of the Deed.

Dated at Wellington this 3rd day of May 1990.

The Seal of the Commission
was affixed hereto in the
presence of:



Kerrin M Vautier
Member

