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Suspensory Effects of Merger Notifications and Gun Jumping - Note by New Zealand

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This document reproduces a written contribution from New Zealand submitted for Item 5 of the 130th OECD Competition committee meeting on 27-28 November 2018.

More documents related to this discussion can be found at

www.oecd.org/daf/competition/gun-jumping-and-suspensory-effects-of-merger-notifications.htm

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New Zealand

1. Gun jumping under the New Zealand mergers regime

1. Section 47 of the Commerce Act 1986 (the Act) prohibits the acquisition of assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition (SLC) in a market in New Zealand. There are no de minimis or control thresholds under section 47 – the prohibition applies to any acquisition of business assets or shares, including minority stakes.

1.1. Voluntary notification

2. New Zealand has a voluntary notification regime, under which parties can apply to the Commerce Commission (Commission) for clearance. The Commission will grant clearance if it is satisfied that an acquisition would be unlikely to SLC. Clearance applications comprise the bulk of the Commission's merger review activity.

3. Merging firms can also apply for authorisation for an acquisition. The Commission will grant authorisation if it is satisfied that the merger will be likely to result in such a benefit to the public that it should be permitted, despite any SLC. Authorisation applications are relatively rare.[1]

4. Because New Zealand has a voluntary notification regime, there is no gun jumping offence for failure to notify.

5. If an acquisition receives clearance or authorisation, section 47 is deemed not to apply to the acquisition, so long as the acquisition is completed within one year of receiving clearance or authorisation.

6. The Commerce Act provides that clearance or authorisation can be obtained only when an acquisition is 'proposed', ie, not completed. Where an acquisition is conditional on clearance or authorisation, we do not consider that a person has acquired an equitable or legal interest in the relevant assets or shares at that time. Where an acquisition is conditional on matters other than clearance or authorisation, a person may have acquired an equitable interest, depending on the terms of the contract itself.

7. For the purposes of assessing jurisdiction to give clearance or authorisation, we may treat the acquisition of an equitable interest as completion of the acquisition. In *NZ Bus v Commerce Commission*, the Court was required to consider whether there was an acquisition for the purposes of s 47, in circumstances where the parties had waived a condition of the sale and purchase agreement to obtain clearance. The Court found that "…on the waiver [of the condition in the agreement to seek clearance], the agreement between NZ Bus and Mana became unconditional and NZ Bus acquired an equitable interest in the shares of Mana". There was, therefore, an acquisition for the purposes of s 47.

8. Because New Zealand has a voluntary notification regime, the Commission has a well-developed mergers surveillance function. The purpose of its surveillance function is

[1] Since 2000/01, the Commission has considered eight authorisations, compared to around 300 clearances.

to identify potentially anticompetitive acquisitions where the businesses involved do not seek clearance or authorisation from the Commission. We discuss below the options open to the Commission if it identifies a potentially anticompetitive acquisition.

1.2. No standstill obligation

9. There is no standstill obligation under the New Zealand mergers regime. Businesses can choose to proceed to complete an acquisition at any stage.

10. If a business completes an acquisition during the Commission's review of a clearance or authorisation application, the Commission loses jurisdiction to grant clearance or authorisation. However, the Commission may subsequently bring proceedings under section 47 if it believes the acquisition would be likely to substantially lessen competition.

11. Such a situation occurred during the Commission's review of NZ Bus' proposed acquisition of a majority stake in Mana Coach Services. In that case, NZ Bus withdrew its clearance application and, as noted above in paragraph 7, proceeded to acquire an equitable interest in Mana Coach Services.

12. The Commission successfully prosecuted NZ Bus in the High Court for breach of section 47. NZ Bus was penalised $500,000 for the breach, following it voluntarily assigning the sale and purchase agreement to a third party.

13. Other than the withdrawal of the clearance application in the *NZ Bus* case, no other businesses have completed while a clearance or authorisation is on foot.

14. While there is no standstill obligation, there are steps available to the Commission to prevent the completion of an acquisition, or prevent further integration where an acquisition has completed already.

1. The Commission may file proceedings in the High Court seeking interim relief, including a preliminary injunction. The most recent instance of the Commission seeking interim relief was in relation to Platinum Equity's proposed acquisition of OfficeMax. Following the Commission filing proceedings, Platinum Equity agreed not to complete the acquisition. The competition concerns were eventually resolved through a divestment of Platinum Equity's New Zealand office supplies business, Winc NZ.
2. The Commission may request an informal written undertaking from the businesses involved. The most recent instance of this related to Fulton Hogan's proposed acquisition of Stevenson's construction materials business, where the acquirer gave the Commission a written undertaking not to complete the acquisition for a certain period while the Commission investigated the proposed acquisition. The competition concerns in that case were resolved by the merging parties agreeing to carve out certain assets from the acquisition.
3. The Commission may also request a formal court-enforceable undertaking from the businesses. Court-enforceable undertakings is a new feature of the mergers regime, having been legislated for in October 2018.

15. Whether the Commission exercises the above options depends on a number of factors, including the state of the investigation and extent of evidence collected, and enforcement criteria such as the extent of harm.

16. As noted above, we can bring proceedings under section 47 for completed acquisitions. Recently, we brought proceedings against Wilson Parking alleging that it breached section 47 in relation to its acquisition of a car park. We discovered the acquisition following a complaint from a customer that prices had increased at the car park following the acquisition. The proceedings allege that the acquired car park was the strongest constraint on Wilson Parking in a local car parking market, and that the acquisition substantially lessened competition in that market. The Commission is seeking divestment of the car park and a penalty. The maximum penalty for a breach of section 47 is $500,000 for individuals and $5 million for businesses.

17. There are limitation periods for bringing enforcement proceedings. The Commission must bring proceedings within two years of the acquisition if the Court is to order a divestment, and within three years if the Court is to order a penalty.

1.3. Substantive gun jumping

18. As a voluntary notification regime, the Commerce Act does not prohibit "gun jumping" in the sense used in other jurisdictions. However, any pre-merger arrangements between the parties may be assessed under the Act's coordinated conduct (section 27) and cartel (section 30) prohibitions. These could arise during planning or negotiations, as an in-principle agreement, or as part of the transaction documentation. This type of pre-merger coordination is what we would assess as gun jumping.

19. While parties to proposed mergers must naturally engage with each other to explore the merits of a transaction prior to binding themselves and consummating a deal, competition concerns may be raised when pre-merger discussions and coordination occur between competitors. These concerns arise for at least two reasons:

- If the merger does not proceed, because negotiations break-down or regulatory approvals are not obtained, the parties may be in receipt of each other's competitively sensitive information. This may in turn be used to dampen continuing competition between them – detailed knowledge of a competitor's pricing, costs, strategic plans and other core material can hamper the competitive dynamic that once prevailed, especially in markets where the parties to a proposed merger are each other's closest competitors or where the information exchanged can be used readily with long term anticompetitive consequences (e.g., to inform a competitive bid for valuable long-term contracts);
- Whether or not the merger proceeds, the parties to a proposed transaction are separate and distinct entities prior to consummation and are held out to the public as such. Conduct purportedly in preparation for an eventual merger may extend beyond what is permissible to include, for instance, one party ceding control over pricing decisions or an agreement not to compete for each other's customers in the interim. Prior to completion of a merger, such conduct is effectively collusion.

20. The types of pre-merger coordination that we have observed as occurring or potentially occurring include:

- Agreements to restrict customer acquisition, cease expansion or otherwise directly limit competition;
- Agreements to exchange information that go beyond normal due diligence, and lack the usual confidentiality protections (for example, the provision of customer information);

- Implementation of the merger, through co-ordination of management functions, joint decision making or other integration.

2. Pathology testing merger

21. The Commission has to date taken one enforcement proceeding in relation to pre-merger co-ordination, *Commerce Commission v New Zealand Diagnostic Group & Others* (the "**Waikato Pathology**" case).[2] At its heart, the case involved a moratorium on competition between two providers of community pathology testing services in the Waikato area (the **Moratorium**).

22. Civil proceedings were filed in the New Zealand High Court in 2008, and the litigation was ultimately the subject of an agreed resolution with defendants admitting certain of the allegations made by the Commission. The Court imposed an agreed penalty of $100,000, together with costs of $20,000.[3] The following discussion is based on the publicly available High Court's penalty decision and the non-confidential version of the agreed summary of facts upon which that penalty was imposed.

23. The conduct in question occurred between April 2004 and about June 2006. At that time the defendants, New Zealand Diagnostic Group (**NZDG**) and Pathology Associates Limited (**PAL**) provided community pathology testing services in the Waikato region.

24. Prices for these services were set by the relevant health funding authority, in this case the Waikato District Health Board (**WDHB**). Patients were not charged, and there was no competition on the price of testing services.

25. Community laboratories negotiated arrangements with medical practices for the collection of samples from such practices. The laboratories would compete on quality and the terms of service, including payments to the medical practices known as 'collection payments'.

26. NZDG and PAL were the two major suppliers in the Waikato region, with NZDG having a greater share of the market than PAL. NZDG also operated in a number of other geographic markets throughout New Zealand.

27. At the relevant time, District Health Boards (**DHBs**) throughout New Zealand were at that time seeking more cost effective service provision to bring down the overall cost of health care services, including the cost of community pathology testing services.

28. DHBs and providers discussed the potential reform of community pathology testing services to improve the cost effectiveness of service provision. Strategies proposed by DHBs included awarding exclusive regional provision contracts (channelling all testing through a single provider to generate economies of scale and lower costs of provision).

29. In January 2004, the Waikato Hospital Laboratory (part of the WDHB) itself sought to enter the relevant markets by offering community testing services to certain medical practises.

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[2] *Commerce Commission v New Zealand Diagnostic Group Ltd, Hamilton Medical Laboratory Holdings Ltd, and Pathology Associates Limited (**Commerce Commission v NZDG & Ors**)*, HC Auckland, CIV 2008-404-4321.

[3] *Commerce Commission v NZDG & Ors*, HC Auckland, CIV 2008-404-4321. 19 July 2010.

30. Partly as a result of this entry, and partly as a result of the national trend towards consolidation, between February 2004 and late 2005, NZDG negotiated to acquire PAL. This was one of a number of pathology mergers that occurred nationally at that time or in the following years.

31. In March 2004, representatives of NZDG and the WDHB met discussed the potential for increased co-operation between NZDG and PAL, the WDHB's recent entry into the market, and the desirability of limiting competition, which was driving up collection payments.

32. On or about 14 May 2004, the WDHB convened a meeting with NZDG and PAL. At that meeting the WDHB sought and obtained the agreement that:

- NZDG and PAL would not compete to win customers through the use of collection payments;
- The WDHB would refrain from seeking to provide community testing pathology services; and
- NZDG and PAL would look at options for work that they may be able to direct to the hospital laboratory rather than elsewhere.

33. This agreement was referred to as "the moratorium", no doubt because it sought to hold in place the existing competitive position while NZDG and PAL negotiated to merge.

34. The WDHB exited community testing in May 2004. NZDG and PAL continued their efforts to negotiate appropriate terms for a merger. It was accepted that the purpose and likely effect of the moratorium was to substantially lessen competition, although NZDG and PAL continued to compete to some extent.

35. In July 2005 NZDG sought clearance for the merger of NZDG and Sonic, another provider of pathology services. The merger concerned three other geographic markets some distance from the Waikato region. NZDG submitted that PAL was a potential entrant in those areas.

36. As a result of the inquiries the Commission undertook in relation to the NZDG/Sonic merger, the Commission became aware of the potential for pre-merger co-ordination between NZDG and PAL. The Commission opened a separate investigation into NZDG/PAL. The moratorium ceased to be given effect to at some point after NZDG and PAL learnt of the Commission's investigation.

37. In September 2005, the Commission declined clearance for the merger of NZDG and Sonic.[4] Perhaps unsurprisingly, the Commission's concerns included the potential for co-ordination.[5] Following the publication of the reasons for the NZDG/Sonic decision in November 2005, further work on the potential NZDG/PAL merger ceased.

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[4] Hawke's Bay Newco/Canterbury Newco/O&S Newco (Otago & Southland); New Zealand Diagnostic Group Limited / Sonic Healthcare Limited Decision No 559, 29 September 2005

[5] The Commission also investigated alleged pre-merger co-ordination between New Zealand Diagnostic Group Limited and Sonic Healthcare Limited in the three different locations around New Zealand. The Commission concluded that the exchange of information was unlikely to have had the effect of substantially lessening competition or controlling or maintaining prices in breach of the Commerce Act.

38. The prosecution brought by the Commission was resolved on the basis that the moratorium had the purpose or likely effect of substantially lessening competition in the Waikato market for community testing services. It was accepted that the Commission could not establish a breach of the cartel prohibition, section 30, which at that time was focused on agreements with the purpose or effect of fixing prices.

39. In reaching a view on the appropriate penalty, the Court endorsed the Commission's submission that parties who propose to take steps towards merger must not in the meantime enter into anti-competitive arrangements or understandings.[6] The Court noted it was no answer that an eventual merger might well involve significant countervailing benefits.

40. The penalties imposed were modest. The Court also noted the involvement of the WDHB, a government agency, in the breaches, and that this had significantly mitigated the penalty in this case.[7] The Court noted WDHB could have been prosecuted, and that parties to similar conduct in the future should not expect such lenient penalties as were imposed here.

41. In 2017 the Commerce Act was amended to update the cartel prohibition in line with the OECD Recommendation, and it now expressly prohibits output restriction and market allocation. Today a similar arrangement between competitors seeking to merge would be treated as a cartel arrangement by the Commission and prosecuted accordingly.

3. Horticultural merger

42. The Commission has detected other instances of potential pre-merger coordination.

43. In 2017, the Commission investigated a non-notified acquisition in the horticultural sector. The Commission discovered the acquisition following media reports that a sale and purchase agreement had been signed and that completion would occur shortly. Our initial enquiries revealed some key facts:

- The acquirer had already received the target's customer lists;
- The was some indication that the target had been encouraging its customers to shift to the acquirer;
- The acquirer had already entered into some employment agreements with the target's employees, conditional on completion of the acquisition.

44. Shortly after discovering these facts, the sale and purchase agreement went unconditional after the target satisfied the final remaining condition in the agreement. While the acquirer expressed some interest in applying for clearance for the acquisition, our view was that it had acquired an equitable interest in the target once the agreement had gone unconditional and that the acquisition was therefore no longer "proposed". As such, the Commission did not have jurisdiction to consider a clearance application.

45. The Commission was concerned that integration steps had been taken prior to the completion of the merger. The employment agreements may have been a permissible step towards integration upon completion of the merger (given that the agreements were

[6] Judgment at [41]

[7] Ibid at [43].

conditional on completion), however, the receipt of the target's customer lists and the target's possible encouragement of its customers to switch to the acquirer raised concerns about pre-merger coordination. These steps could be viewed as dampening competition between the merging parties in advance of completion of the merger.

46. Ultimately, the Commission did not pursue the pre-completion integration steps as substantive gun jumping (ie. a breach of its coordinated conduct and/or cartel provisions), but focused on whether the merger itself was likely to breach section 47. The Commission closed its investigation without filing enforcement proceedings on this particular occasion, either in relation to the merger or the potential pre-merger coordination. However, as with other agencies, the Commission views substantive gun jumping as a potentially serious breach of competition law and is prepared to enforce against such breaches.

47. Absent a clearance or authorisation, the Commission retains the right to file proceedings against the merging parties in this case, as do private parties. The merging parties can therefore obtain legal certainty only once the limitation periods have expired after two (divestment) or three years (penalties). While the investigation is closed, the Commission continues to monitor the effects of the acquisition.