In Confidence

OFFICE OF THE MINISTER
OF COMMERCE AND CONSUMER AFFAIRS

The Chair
Cabinet Economic Growth and Infrastructure Committee

Review of fees for clearance and authorisation applications under the Commerce Act 1986

Proposal

1 This paper seeks agreement for amendments to the Commerce Act (Fees) Regulations 1990 to increase the application fees for clearances and authorisations under the Commerce Act 1986, introduce a refund mechanism to prevent over-recovery, and to set a new application fee for the new collaborative activities clearance regime introduced under the Commerce (Cartels and Other Matters) Amendment Bill.

Executive Summary

2 The Commerce Act (Fees) Regulations 1990 sets the fees payable on application to the Commerce Commission ('the Commission') for clearance or authorisation under the Commerce Act 1986 ('the Act'). Application is voluntary, but if successful, applicants are granted immunity from court action from the prohibitions in the Act. The application fees were set in 1990 and have not been updated since.

3 The Commerce (Cartels and Other Matters) Amendment Bill ('Cartels Bill') currently before the House will introduce a new regime for cartels. Firms will be able to apply to the Commission for clearance for collaborative activities, which are a defence to a cartel prohibition or offence, and if granted, the clearance confers immunity from prosecution. A new application fee for collaborative activities clearances is required to be set to support this regime.

4 In March 2014, Cabinet agreed to the release of a discussion document initiating a review of existing clearance and authorisation application fees and seeking views on options for setting a new collaborative activity clearance fee [EGI Min (14) 5/9 and CAB Min (14) 10/6 refers]. The Ministry of Business, Innovation and Employment (MBIE) received three submissions.

5 I have carefully considered the submissions and the principles set out in the Treasury's *Guidelines for Setting Charges in the Public Sector* and Office of the Auditor General's (OAG) *Good Practice Guide: Charging fees for public sector goods and services.* It is desirable that applicants incur an increased share of the Commission's costs in determining their applications, but this share should not be so high as to discourage applications nor make the regime unaffordable for businesses.

6 It is not possible to determine with any precision what share of the Commission's costs should be split between the applicant and the Crown. There are significant public benefits from these voluntary applications, which are shared by the Commission and the wider public. These benefits include facilitating more cost effective oversight of business arrangements by the Commission and promoting desirable business activity.

7 On balance, given the risk of otherwise discouraging applications and the wider public benefits from these applications, I think it is best to err on the side of conservatism, such

that the Crown should continue to shoulder the majority of the Commission's costs of this work.

8 The following table outlines the recommended increased in application fees:

Type of application	Existing fees (excl. GST)	Proposed fees (excl. GST)	% change
Clearance of mergers (section 66)	$2,000	**$3,200**	**60%**
Clearance for collaborative activity (new regime)	———	**$3,200**	**-**
Authorisation of mergers (section 67)	$20,000	**$32,000**	**60%**
Authorisation of restrictive trade practices (section 58)	$10,000	**$32,000**	**220%**

9 This increase is effectively the 1990 fee levels with an inflation-adjustment (at about 2.2% compound average annual rate of inflation since 1990). I also recommend increasing the application fee for authorisation of restrictive trade practices to align with that for authorisation of mergers, and setting the new application fee for clearance of collaborative activities to align with that for clearance of mergers. There is no reason to have different fees for different types of clearances or authorisations.

10 I consider that a refund mechanism should also be provided through regulations to require the Commission to refund part of an application fee where the cost of the application is less than the cost of the fee.

Background

11 The aim of the Act is to promote competition in markets within New Zealand. In particular, the Act prohibits firms from undertaking practices or mergers if that practice or merger is likely to substantially lessen competition in a market.

12 The Act allows firms proposing to embark on a potentially anti-competitive merger or practice to voluntarily notify the Commission of the transaction through an application for a clearance or authorisation. If granted, a clearance or authorisation provides the applicant immunity against legal action by the Commission and private individuals.

13 The Commerce Act (Fees) Regulations 1990 set the fees payable on application to the Commission. These fees were set in 1990 and have not been updated since. It is likely that the fees are too low. **Table One** shows that existing fees recover less than 5% of the average cost to the Commission of determining each type of application.

Table One: Existing fees as a proportion of the Commission's average costs

Type of application	Average cost to Commission of making determinations (from 1 July 2005 to 30 September 2014)	Proportion of average cost recovered by fee
Clearance of mergers (section 66)	$131,731	**1.52%**
Authorisation of mergers (section 67)	$452,102	**4.42%**
Authorisation of restrictive trade practices (section 58)	$267,631	**3.74%**

14 The Cartels Bill currently before the House will introduce a new regime for cartels. This regime includes redefining the prohibition for anticompetitive cartels, creating a new cartel criminal offence with a sanction of up to seven years imprisonment, and allowing parties to a collaborative activity to seek clearance from the Commission. Collaborative activities include joint ventures and alliances that facilitate innovation and efficiencies.

15 A collaborative activity clearance will have the same effect as a merger clearance. It confirms that the activity carried out between competitors is not anticompetitive and is immune from court action. Firms will be able to apply for clearance immediately following the passage of the Bill, and therefore, a new application fee is required to be set.

16 In March 2014, Cabinet agreed to the release of a discussion document initiating a review of existing clearance and authorisation application fees and seeking views on options for setting a new collaborative activity clearance fee [EGI Min (14) 5/9 and CAB Min (14) 10/6 refers]. The MBIE received three submissions. This paper reports back on the outcomes of that review.

Principles for setting fees

17 This review was guided by the principles set out in the Treasury's *Guidelines for Setting Charges in the Public Sector* and Office of the Auditor General's (OAG) *Good Practice Guide: Charging fees for public sector goods and services*. In particular fees should be set at a level that:

a. is consistent with the objectives and intentions of the empowering Act and does not exceed the cost of providing the service;

b. reflects an appropriate split of costs and benefits between the applicant, the Commission and the wider public;

c. encourages applications or discourages evasion; and

d. does not encourage frivolous applications or result in ineffective use of public funding.

18 The application fees must also be consistent with the regulation-making power for fees in the Act, which requires that the fees:

a. are a flat monetary amount – the Act does not allow for fees to be based on a formula or other method of calculation; and

b. must be paid at the time of application – this restricts options for setting tiered fees that distinguish between classes of transactions or applicants. It is difficult to set objective criteria for tiers that the applicant could correctly self-assess at the time of making an application. Tiered fees would ordinarily require the Commission to assess which tier is applicable after receiving the application.

19 Applying these principles to the particular case of Commerce Act clearances and authorisations, the following matters are relevant:

a. As clearances and authorisations provide immunity to a transaction from court action, which might otherwise result in significant pecuniary penalties and potential incarceration, it is desirable from an equity perspective that firms are able to access the regime at affordable levels.

b. Clearances and authorisations confer private benefits to the applicant by removing a litigation risk for the firm, thereby allowing them to invest or merge with certainty. Therefore, it is appropriate that the private parties share some portion of the Commission's costs in determining the application.

c. The Commission also benefits from voluntary notification of transactions. It enables the Commission to assess the proposed transaction upfront and with the cooperation of the applicant, rather than having to identify breaches after the transaction has been given effect. The voluntary notification of transactions provides the Commission with market intelligence that might otherwise be costly to gather. Even with vigilant policing, the Commission may not identify all transactions at risk of breaching the Act. Enforcement actions can be costly and the harm caused to competition may be difficult to remedy after the fact.

d. As the Commerce Commission has no discretion over the applications it must consider, it is also desirable that the fee discourages applications that have minimal competition impacts. This would not be a good use of public resources. Ideally applicants should seek private legal advice first, which would filter out obviously anticompetitive transactions and transactions with minimal competition impacts. This would focus the Commission's resources on those applications at the margin that require expert judgement given some uncertainty about how the Act would apply.

e. There are also wider public benefits from clearances and authorisations, as it facilitates desirable business activity and discourages undesirable business activity. The Commission's written reasons for each determination also contribute to the body of precedent that educates all market participants on the application of the Act, thereby promoting compliance.

20 Given these principles, the key issue for this review is striking the right balance between Crown funding and applicant funding. Full cost recovery is not considered appropriate, as it would not recognise the public benefits gained from applications. If the fees are set too high, such that clearance or authorisation became unaffordable or applications are discouraged, it would undermine the objectives of the Act and the voluntary regime. If the fees are set too low, there is a risk of inefficient use of the Commission's resources, but the Commission could manage this risk through other means, such as promoting a pre-application notification period. This asymmetrical risk suggests it is best to err on the side of conservatism, with the majority of costs being met by the Crown.

Level of application fees for clearances and authorisations

21 The discussion document outlined four possible options for different levels of application fee. These options are outlined in **Table Two**. All figures in this document are exclusive of GST.

Table Two: Options for application fees in discussion document

Type of application	Option 1 (based on status quo)	Option 2 (based on review in 2004/5)	Option 3 (inflation adjusted 2004/5 fees)	Option 4 (based on Commission's median costs)
Clearance of mergers (section 66)	$2,000	$7,000	$8,600	$31,000
Authorisation of mergers (section 67)	$20,000	$30,000	$36,000	$178,000
Authorisation of restrictive trade practices (section 58)	$10,000	$30,000	$36,000	$71,000
Proposed new collaborative activity clearance (section 65A)	$2,000	$7,000	$8,600	$31,000

22 Option 1 is the existing fee levels with the new application fee for collaborative activity clearances set to align with the fee for merger clearances. While never intended to recover the Commission's full costs, these fee levels are likely to be too low given the passage of time.

23 The fee levels in option 2 are based on a review of the application fees carried out in 2004/5. While approved by Cabinet, these fees were not implemented at that time to allow for the regulation-making powers in the Act to be amended to provide for a new mechanism for the Commission to grant refunds if the fee exceed the Commission's costs in determining the application [EDC Min (05) 8/3.1-3.5 refers]. This amendment only came into force in October 2012, by which time it was thought timely to review the fees again.

24 Option 3 in the table is the 2005 Cabinet-agreed fee levels updated for inflation. Option 4 sets the fee levels equivalent to the Commission's estimate of its average costs of determining each of the types of applications between July 2005 and December 2013.

25 The submissions all agreed that full cost recovery was not appropriate and that setting the application fees at a level to recover the Commission's average costs would discourage some firms from applying (option 4). The submitters also considered that the 2005 Cabinet decisions should not be relied on as a basis for setting fees. Those decisions were based on mid-points of a range of fees that were considered affordable by Ministers at the time – being about 10 to 15% of the Commission's estimated costs.

26 The submitters outlined three further options for fee levels, which are included in **Table Three**. Business New Zealand suggested that the government consider zero fees in order promote business activity and growth. All submissions suggested that, if an increase in fees was required, an inflation adjustment of the existing fee levels should be considered in the first instance. Simpson Grierson submitted that fees should be no more than $5,000 for clearances or $25,000 for authorisations.

Table Three: Further options for application fees following consideration of submissions

Type of application	Option A (zero fees)	Option B (inflation adjusted 1990 fees)	Option C (Simpson Grierson option)	Option D Hybrid option (preferred)
Clearance of mergers (section 66)	$0	$3,200	$5,000	$3,200
Authorisation of mergers (section 67)	$0	$32,000	$25,000	$32,000
Authorisation of restrictive trade practices (section 58)	$0	$16,400	$25,000	$32,000
Proposed new collaborative activity clearance (section 65A)	$0	$3,200	$5,000	$3,200

Proposed fee levels

27 It is not possible to estimate with any precision the proportion of benefits derived from the clearance and authorisation regimes that is enjoyed by the applicants relative to the public. This task is made more difficult by the wide distribution of Commission costs for each type of application. Choosing between the options is a matter of judgement.

28 Existing fees, as outlined in option 1, are likely to be too low in real terms as they have not been adjusted since 1990. While there have been no instances of applicants using the Commission's clearance regime for trivial transactions, these low fee levels mean that applicants are unlikely to be meeting an appropriate share of the cost of an application. Similarly, the fee levels outlined in option 4 are likely to be too high, making the regime inaccessible for some firms thereby undermining the objectives of the regime.

29 Within this range, on balance, my preferred option is option D, which updates the fees at a 2.2% compound average annual rate of inflation since 1990, with some minor rounding to better allow for GST. This results in:

a. a merger clearance application fee of $3,200; and

b. a merger authorisation application fee of $32,000.

30 Under this preferred option, two further adjustments are:

a. the application fee for a collaborative activities clearance is set at the same level as that for merger clearances at $3,200 given the likely similarity in the Commission's costs and processes for considering these applications; and

b. the application fee for restrictive trade practice authorisations is increased to be set at the same level as that for merger authorisations. This reflects that the Commission's costs and processes for assessing these types of applications are similar. While the average costs in **Table Four** show a difference, this is caused by the low number of authorisation applications and the wide distribution of costs. Overtime the average costs should be similar. The submitters did not identify any reason for setting the fees differently.

31 If Cabinet prefers a higher level of fees, the application fee for merger and collaborative activities clearances could be further increased to $5,000. This increase above the inflation-adjusted level would reflect the increased complexity of clearance applications since 1990.

32 I consider that application fees at these levels are consistent with objectives of the Act and the principles for setting fees in the public sector. The fee levels under my preferred option would increase the proportion of the Commission's costs met by the applicant, but it continues to be conservative as outlined in **Table Four**.

Table Four: Proportion of Commission's average costs of proposed fees

	Average cost of processing an application (2005-2014)	Proportion of average cost recovered by existing fees	Proportion of average cost recovered by proposed fees
Clearance of mergers (section 66)	$131,731	1.52%	**2.42%**
Authorisation of mergers (section 67)	$452,102	4.42%	**7.07%**
Authorisation of restrictive trade practices (section 58)	$267,631	3.74%	**11.95%**

33 Even at the proposed fee levels, the Government will continue to shoulder the vast majority of the cost of most applications. Firms are likely to engage legal, accounting or economic experts in the first instance, and in preparing applications to the Commission. The costs of this private advice are likely to be much higher than the application fee. It is therefore unlikely that many potential applicants would be deterred from applying due to the increase in fees at the levels outlined in this paper.

Refund mechanism

34 I consider that a refund mechanism should also be provided through regulations to require the Commission to refund part of an application fee where the cost of the application is less than the cost of the fee.

35 In some cases, the application fee for a clearance or authorisation may exceed the cost of processing the application itself. Although the proposed increases to the application fees are conservative, the potential for this over-recovery to occur becomes more likely if fee levels are to increase. Providing a refund mechanism addresses this potential for over-recovery and supports the Office of the Auditor General's *Good Practice Guide: Charging fees for public sector foods and services* which states that fees should not be set at a level that exceeds the cost of providing the service.

36 Processing these refunds is unlikely to impose a significant administrative burden on the Commission. Even with the conservative increase to application fees, overpayment by applicants is likely to be rare given that the fee represents a small part of the cost of most applications. The Commission has advised that its existing systems and processes are capable of processing refunds.

Consultation

37 In May 2014, MBIE released a discussion document seeking feedback on the existing application fee structure and whether an increase in the fees is warranted. Three submissions were received from Business NZ, Simpson Grierson and Bell Gully. These stated that there was generally little appetite for an increase in fees, and that any proposed increase should be limited. The views of submitters are reflected in this paper.

38 The Ministry of Transport and the Treasury were consulted on this paper. The Department of the Prime Minister and Cabinet was informed.

39 The Commerce Commission, which administers the Commerce Act and the clearance and authorisation regimes, has been consulted during the process of reviewing the existing fees structure. The Commission has indicated that it does not have strong views on the level of the fees, as the fees would still only recover a small proportion of the cost of most applications.

Financial Implications

40 The total fee revenue for clearances and authorisations received by the Commission in 2013/14 was $27,000. This is non-departmental revenue retained by the Commission. This fee revenue is insignificant relative to the Commission's total costs for this work, which is funded under *Vote Commerce: Non-departmental Output Expense: Enforcement of General Market Regulation*.

41 All else equal, if the proposed fees had applied in 2013/14 and the Commission had received the same number of applications, the Commission's total fee revenue would have been $67,500. Compared to the counterfactual of no fee increases, this increase in fee revenue reduces the case for an increase in Crown funding equal to the forecast increased fee revenue. Any greater increase in application fees would likely be counterproductive, particularly if it resulted in evasion of the regime by businesses.

Human Rights

42 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993. There are no gender or disability perspective implications from the proposals in this paper.

Legislative Implications

43 The Commerce Act (Fees) Regulations 1990 will need to be amended to incorporate the changes to the fees regime recommended in this paper. Regulation-making powers are provided under the Commerce Act for regulations to be made for these purposes.

Regulatory Impact Analysis

44 The Regulatory Impact Analysis requirements apply to the proposed changes to the fees regime of the Commerce Act. A Regulatory Impact Statement has been prepared and is attached to this Cabinet paper.

Quality of the Impact Analysis

45 The General Manager, Strategic Policy Branch and the Ministry of Business, Innovation and Employment Regulatory Impact Analysis Review Panel have reviewed the attached Regulatory Impact Statement (RIS) prepared by the Ministry of Business, Innovation and Employment. They consider that the information and analysis summarised in the RIS meets the criteria necessary for ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Publicity

46 The Commerce Commission will publicise the new application fees on its website. I also seek Cabinet agreement to release this paper on MBIE's website.

Recommendations

It is recommended that the Committee:

1 **Note** that fees for parties voluntarily applying to the Commerce Commission for clearance or authorisation are prescribed in the Commerce Act (Fees) Regulations 1990;

2 **Note** that at its meeting of 14 March 2014, Cabinet EGI Committee agreed to the release of a discussion document initiating a review of existing clearance and authorisation application fees and seeking views on options for setting a new collaborative activity clearance fee [EGI Min (14) 5/9 and CAB Min (14) 10/6 refers];

3 **Agree** to increase the existing application fees to the following levels (GST exclusive):

3.1 clearances for mergers – $3,200

3.2 authorisations for mergers – $32,000

3.3 authorisations for restrictive trade practices – $32,000;

4 **Agree** to set the application fee for the new clearance for collaborative activities at $3,200 (GST exclusive);

5 **Agree** that the Commerce Commission should be required to refund part of an application fee if the cost of processing an application is less than the application fee paid;

6 **Direct** the Ministry of Business, Innovation and Employment to initiate the next review of the Commerce Act clearance and authorisation fees by 1 June 2018;

7 **Invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to Parliamentary Counsel Office in order to give effect to the recommendations above;

8 **Authorise** the Minister of Commerce and Consumer Affairs to make further minor or technical changes on any issues that arise during the drafting process; and

9 **Agree** that the Ministry of Business, Innovation and Employment may post this Cabinet paper to its website.

Hon Paul Goldsmith
Minister of Commerce and Consumer Affairs

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