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Submission to the Ministry of Business, Innovation and Employment

Review of section 36 of the Commerce Act and other matters

1 April 2019

INTRODUCTION

1. Russell McVeagh is grateful for the opportunity to submit to the Ministry of Business, Innovation and Employment ("**MBIE**") on the January 2019 "Review of Section 36 of the Commerce Act and other matters" Discussion Paper ("**Discussion Paper**").

2. During MBIE's Targeted Review of the Commerce Act in 2015 we provided in depth submissions on why the current section 36 remains fit for purpose in achieving the Commerce Act's stated purpose "to promote competition in markets for the long-term benefit of consumers within New Zealand".[1] We remain of the opinion that when weighed against the regulatory uncertainty and other commercial costs of legislative reform of s 36, at this point in time the case for reform is not made out.

3. In this submission, we do not intend to re-traverse the reasons why reform of s 36 is unnecessary and unhelpful. Rather, we focus on the specific issues with adopting the new Australian prohibition and what could be done to improve the Australian test to make it more workable in the New Zealand context.

EXECUTIVE SUMMARY

4. In summary:

Section 36

(a) It is premature to adopt the Australian provision given that provision remains untested in Australia;

(b) Any move to adopt the Australian provision should be restricted to conduct that has "the purpose or likely effect" (not "purpose, effect or likely effect") of substantially lessening competition, in order to properly focus the prohibition on foreseeable consequences of unilateral actions;

(c) There should be a defence for conduct that has a legitimate business justification, a concept that has precedent in both US and EU case law;

(d) Ancillary changes to s 36 should be kept to the minimum necessary to improve the effectiveness of the law;

[1] See Russell McVeagh *Submission to the Ministry, of Business, Innovation & Employment: Targeted Review of the Commerce Act 1986* (9 February 2016) available at https://www.mbie.govt.nz/have-your-say/targeted-commerce-act-review/ and Russell McVeagh *Cross-submission to the Ministry, of Business, Innovation & Employment: Targeted Review of the Commerce Act 1986* (21 July 2016) available at https://www.mbie.govt.nz/have-your-say/cross-submissions-consultation/.

Intellectual Property exceptions

(e) We do not support the repeal of the IP exceptions (in s 36(3) and 45). If there is any repeal of the existing exceptions, they need to be replaced by alternatives to give firms the confidence to invest in IP and to license IP to third parties;

Treatment of covenants

(f) It would be problematic to extend the per se cartel prohibitions to land covenants without providing a defence for firms who use land covenants to protect legitimate business interests; and

(g) If MBIE's proposal is adopted it should be made clear that it only applies prospectively, and there should be a grace period to allow businesses the opportunity to review their covenants for compliance with the new regime before any enforcement of covenants is captured by the new regime.

SECTION 36

Submission 1: It is premature to adopt the Australian provision given it remains untested in Australia

5. We understand that the currently preferred option is to replace the existing s 36 with the wording now contained in s 46 of the Australian Competition and Consumer Act 2010 ("**the new Australian provision**").

6. The statutory language adopted in the new Australian provision is unique and remains untested as a prohibition against unilateral conduct. There is significant uncertainty as to how the new test will be applied by the Australian Competition and Consumer Commission ("**ACCC**") and ultimately by the Australian courts. For example, it is not clear if the Courts will import into the test some degree of foreseeability of the consequences of actions, through a mens rea standard or otherwise, or whether the test will truly be strict liability, in that the company with market power is responsible for all anticompetitive consequences of its actions, even if objectively unforeseeable and unintended. We would therefore caution against adopting the Australian provision until it is clear how it will be applied in practice.

7. We understand that the ACCC are currently investigating two or three cases under the new s 46 test and expect to bring at least one case – and maybe two – in 2019.[2] We encourage MBIE to adopt a watching brief on the experiences in implementing the new Australian provision before reforming s 36. This approach would be consistent with the MBIE's Regulatory Impact Statement (Process Options) from its last review, which provided:

> **MBIE recommends seeking further evidence before moving to an options paper by the end of 2018**
>
> MBIE recommends that further work be undertaken to seek empirical evidence of harm occurring to consumers under the current test, with a view to moving to an options paper later (for instance in 2018). This strikes a balance between (a) seeking further evidence in an effort to better inform decision making and (b) managing the risks of harm occurring or likely to occur under the status quo.

[2] See Speech by Rod Sims, Chairman of the ACCC, *2019 Compliance and Enforcement Policy 2019* delivered on 26 February 2019 at the Committee for Economic Development Australia available at https://www.accc.gov.au/speech/2019-compliance-and-enforcement-policy.

> Seeking further evidence would involve monitoring potential or actual instances where the regime fails to adequately deter or penalise misuse of market power and, if possible in the time available, **assessing the changes Australia is making to its equivalent provision and any subsequent behavioural changes or developments in its case law**. [emphasis added]

8. Regardless of how that Australian test is ultimately applied, it is even more important in New Zealand that our Parliament gets s 36 right. Because of the small size of New Zealand's economy, there are many more markets (even when compared to Australia), in which there is a firm that could be alleged to have a substantial degree of market power in one or more narrowly defined markets. Any amendment to s 36 is therefore likely to have a broad impact across the entire New Zealand economy. It would be adverse to New Zealand's economic interest to introduce a misuse of market power prohibition that risks incentivising firms to refrain from engaging in competitive conduct. Given the importance of this legislation, it is worth taking the time to observe whether the new Australian provision achieves the desired policy outcomes and does not result in unintended side effects that chill pro-competitive behaviour.

9. Our remaining submissions on reforming s 36 relate to what we consider to be potential issues that would arise if we were to adopt the Australian test.

Submission 2: The prohibition should be restricted to conduct that has "the purpose or likely effect" of substantially lessening competition

10. Section 46(1) of the Australian Competition and Consumer Act 2010 prohibits corporations that have a substantial degree of market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition in a market.

11. MBIE's third decision-making criterion is that any changes "provide businesses with predictability for pro-competitive decision making and reasonable compliance costs".[3] We agree that this is an important criterion to consider. The introduction of a true "effects test" simply cannot provide businesses with the predictability necessary for efficient decision making even after incurring reasonable compliance costs.

12. Both "purpose" and "likely effect" are established at the time when the conduct is engaged in (given "likely" incorporates the concept of reasonable foreseeability). At that point in time, a firm with market power should be taken to know all relevant facts that are knowable by it about the state of the market and the likely impact of its actions, in order to make an informed assessment as to whether a proposed course of conduct would have the purpose or likely effect of substantially lessening competition in a market.

13. The same is not true with respect to conduct that has the "effect" of substantially lessening competition. By definition, it is not possible to ascertain the actual effect of conduct until after the conduct has occurred and the effects have materialised. It is by necessity a retrospective assessment. The best a responsible corporate citizen could do in advance is obtain external legal and economic advice as to the *likely* effect of its conduct. Even after undertaking extensive due diligence, responsible corporate citizens would remain exposed to the unforeseen and unforeseeable consequences of their actions.

14. Such a concern was shared by the US Department of Justice in their 2008 report on Single-Firm Conduct Under Section 2 of the Sherman Act:

[3] Discussion Paper at 10.

critics note that the complexity of administering the effects-balancing test would make it difficult for firms to determine at the outset whether specific conduct would violate section 2, thereby potentially chilling procompetitive conduct and reducing consumer welfare. Moreover, a legal rule under which every action of a monopolist must be scrutinized for net consumer-welfare effects threatens to chill a monopolist's incentives to engage in procompetitive conduct out of fear of antitrust investigation, litigation, or even mistaken liability – again, potentially harming consumer welfare.

15. This concern is not academic. Members of our team have had experience advising firms with market power in Europe where there is arguably a type of "effects test". In our experience, it was not uncommon for dominant firms to decide not to engage in procompetitive conduct such as offering customers discounts, or attractive rebate schemes, out of fear of the competition law consequences. The chilling effect in New Zealand would be even greater given that:

(a) from a micro-perspective, a number of New Zealand firms that arguably have substantial market power are nonetheless small firms that do not have the budgets to obtain specialist competition law advice, or contract detailed econometric analysis, for all their business decisions; and

(b) from a macro-perspective, a higher proportion of markets in New Zealand are likely to involve a firm with a substantial degree of market power given our small geographically dispersed population.

16. By advocating for the removal of the effects limb of the prohibition, we are not suggesting that the actual effect of conduct is irrelevant. It merely changes the reason why the actual effect of the conduct is relevant. Under the new Australian provision, the actual effect is relevant as it is a potential route to establishing liability under s 46. Under our proposed approach, the actual effect is relevant as strong (yet rebuttable) evidence as to the purpose or likely effect of the conduct. In the event that a firm with market power engages in conduct that has an anticompetitive effect, the firm would need to show some change in market circumstances that was not reasonably foreseeable to credibly argue that the conduct did not have the likely effect of substantially lessening competition at the time it was engaged in.

17. The Discussion Paper considers that an authorisation regime and/or Commission guidance could be used to provide greater certainty to businesses:

(a) although we agree that an authorisation regime should be made available for unilateral conduct and that the Commission should issue guidance, we do not consider that these tools remove the inherent uncertainty involved in implementing an effects test. In particular, the authorisation process is expensive, time-consuming and equally as unpredictable when the Commission have been granted a wide discretion as to what they are permitted to take into account and are even free to depart from their own guidelines mid-process;[4] and

(b) businesses can take little comfort from any guidance issued by the Commission. The guidance issued by the Commission to date, and the experience in Australia,[5] demonstrates that such guidance typically states more obvious examples without

[4] *NZME Ltd v Commerce Commission* [2018] NZCA 389 at [55] - [65].

[5] For example, see the ACCC's *Guidelines on misuse of market power* (August 2018).

engaging in more nuanced circumstances. Furthermore, such guidance offers no legal protection to firms who follow it as it does not bind the Commission.[6]

Accordingly, the adoption of an authorisation regime and/or Commission guidance does not cure the inherent uncertainty of an effects test that, in our experience, is likely to chill procompetitive conduct by larger firms.

18. On the other hand, introducing secondary legislation could provide greater certainty to businesses given it would be binding. However, we agree with MBIE that although the Commission would be best placed to create such legislation there are natural justice concerns with the Commission having the power to both create and enforce such legislation. We would encourage MBIE, as an alternative, to look into the Block Exemption regime that has been successfully used in the EU to provide certainty to businesses. Block Exemptions operate by providing a legally binding safe harbour for conduct that falls within prescribed criteria. If a business complies with a Block Exemption, they are protected from prosecution. However, the converse is not necessarily true. If a firm does not comply with a Block Exemption there is no presumption, or inference drawn, that the conduct is in breach of the competition rules. We consider that there is merit in providing the Commission with the power to create legally binding safe harbours.

Submission 3: There should be a defence for conduct that has a legitimate business justification

19. We are concerned that the "likely effects" and "effects" limbs of the new Australian provision could inadvertently capture business conduct, which is demonstrably justified to protect a legitimate business interest. For example, a firm with a substantial degree of market power should be permitted to refuse to supply a downstream customer/competitor irrespective of the likely effect, or effect, where the customer is a bad debtor, has become a credit risk or has failed to observe its reasonable contractual obligations. Similarly, a firm with a substantial degree of market power should be permitted to introduce a new product even if it is so innovative and attractive to customers that it puts its competitors out of business (eg, the impact of smart phones on dumb phone manufacturers). Such conduct, irrespective of its potential effect or likely effect, would not be caught under the current s 36 test nor would it be caught in most jurisdictions including those with an effects test.

20. In the EU, it is a defence to an abuse of dominance claim if the defendant has an objective justification for its conduct.[7] In order to avail themselves of the defence, the defendant must demonstrate that it has pursued a legitimate interest other than its own commercial advantage and that it has behaved in a proportionate manner.[8] For example, the following have been accepted in the EU as potential objective justifications for refusing to supply:

(a) The customer is a bad debt or credit risk;[9]

(b) The customer will use the input for an illegal purpose;[10] or

[6] *NZME Ltd v Commerce Commission* [2018] NZCA 389 at [55] - [65].
[7] See Whish and Bailey *Competition Law* (Oxford, 9 ed, 2018) at 217-218
[8] Case 27/76 *United Brands* EU:C:1978:22 at [189] and Whish and Bailey *Competition Law* (Oxford, 9 ed, 2018) at 724.
[9] Whish and Bailey *Competition Law* (Oxford, 9 ed, 2018) at 724
[10] OFCOM Decision *Disconnection of Floe Telecom Ltd's Services by Vodafone Ltd* (3 November 2003) and OFCOM Decision *Disconnection of VIP Communications Ltd's Services by T-Mobile Ltd* (31 December 2003).

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(c) The dominant firm has capacity constraints that make it impossible for access to be given.[11]

21. We would therefore suggest introducing a specific defence to s 36 that mirrors the approach adopted in the EU. We would suggest the following drafting:

> Nothing in this section applies to any conduct carried out by a person where that person can demonstrate that:
>
> (a) it engaged in the conduct for the dominant purpose of protecting a legitimate business interest; and
>
> (b) the conduct was reasonably necessary to protect that legitimate business interest.

Submission 4: Ancillary changes to s 36 should be minimal and only implemented where strictly necessary to improve the effectiveness of the law

22. The Discussion Paper raises the question of whether a number of other aspects of New Zealand competition law should be amended if the Australian test under s 46 is adopted. We would discourage making more changes than are strictly necessary to bring about the main purpose of this exercise, which we understand is to reform the "taking advantage" limb in s 36. When considered in isolation, we do not consider that a case has been made to change any other elements of s 36. When considered collectively, such additional changes will increase the uncertainty surrounding the reform and increase the potential chilling effect on procompetitive conduct.

23. In particular, we are not convinced that there is any case to:

(a) stop treating interconnected bodies corporate as if they were a single firm (this approach is standard across all the major jurisdictions with developed competition law regimes);

(b) depart from using "a substantial degree of power in a market" as the appropriate threshold for s 36;

(c) introduce superfluous legislative provisions (ie equivalents to ss 46(4)-(7) of the Australian Act) to codify principles that are already established in the New Zealand case law;

(d) repeal s 36B or depart from New Zealand's current approach for assessing purpose; or

(e) use a different standard for the new provision when the "substantial lessening of competition" test in ss 27 and 47 is well understood.

INTELLECTUAL PROPERTY EXCEPTIONS

Submission 5: We do not support the repeal of the IP exceptions (in s 36(3) and 45). If there is any repeal of the existing exceptions, they need to be replaced with

[11] *Frankfurt Airports* OJ [1998] L 72/30 at [74] –[88]: Although on the facts, the European Commission rejected the argument, it accepted that it could be an objective justification if the claims are substantiated.

alternative protections to give firms the confidence to invest in IP and to license IP to third parties

24. We disagree that "it is not clear that a strong rationale exists for treating IP differently under competition law to any other property".[12] IP is fundamentally different from physical property. IP satisfies the classic definition of a public good in that it is both nonrivalrous and nonexcludable. IP is nonrivalrous in that if one person uses the IP it does not reduce the amount of that IP available for another person to use. IP is nonexcludable in that once produced, in the absence of any legal protections, you cannot stop anyone from benefiting from it. It is a direct result of these characteristics that public goods are underprovided by the market, as people are able to free ride on the investment of others. Statutory IP rights such as patents, copyrights, and trademarks were created to cure this problem so as to encourage investment in IP.

25. There is therefore an inevitable tension between the creation and enforcement of IP rights and the desire to have workably effective competition in markets in New Zealand. In our opinion, the current limited exceptions for IP in the Commerce Act are effective at preserving the incentive to invest in IP but nonetheless leaving scope to challenge IP-related conduct that is beyond the scope of the IP right and which has an anticompetitive effect.

26. We do not consider that the current limited IP exceptions in the Commerce Act are protecting anticompetitive conduct. The IP exceptions have not prevented the Commission from actively investigating and enforcing against anti-competitive IP-related conduct:

    (a) In 2015, the Commission issued a warning letter to Consolidated Alloys, following an investigation into whether aspects of a patent litigation settlement agreement breached the Commerce Act. Consolidated Alloys had sought to prohibit Edging Systems from selling its own flashing products (EZ-Edge), which Consolidated Alloys claimed infringed the patent of its softedge flashing product. The settlement agreement, which allowed Edging systems to continue to sell EZ-Edge in exchange for a royalty payment, included a clause restricting Edging Systems from selling any other softedge flashing product other than EZ-Edge until 2023. However, Consolidated Alloys' patent expired in August 2015, meaning the restriction in the settlement agreement was eight years longer than its patent right. Despite the investigation relating to an IP settlement agreement, the Commission did not refer at all to the Commerce Act's IP exceptions. We presume that the Commission took the view that the s 45 IP exception did not apply on the basis that Consolidated Alloys was not "authorising an act" that would otherwise be prohibited by an IP right, but rather that it was seeking to prohibit an act that would otherwise be allowed at the expiry of the patent period. The Commission only took issue with the agreement during the time after the patent had expired; and

    (b) In 2010 the Commission reached the view that the four major New Zealand music recording companies' licensing agreements lessened competition as they each granted a single copyright collecting society, PPNZ, the exclusive right to license their music, thereby, creating a monopoly. The Commission considered those exclusivity clauses went beyond the scope of their respective IP rights and did not "authorise an act" that would otherwise be prohibited. The Commission concluded its investigation by accepting an undertaking from the recording companies to enter into a settlement whereby they agreed to remove the exclusivity clause and develop their own direct dealing regime.

[12] Discussion Paper at 240.

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27. These cases demonstrate that the Commerce Act does not give IP owners *carte blanche* immunity to engage in anticompetitive conduct. The Commission has a good track record of investigating when it considers that parties have attempted to extend their IP rights beyond what is contemplated by the statutory IP regimes.

Section 36(3)

28. In our view, s 36(3) is not truly an exception. The effect of s 36(3) is to codify the generally accepted position that enforcing an intellectual property right, without more, does not amount to the taking advantage of market power.[13]

29. Such a principle is not unique to New Zealand:

(a) The European Union, which has a reputation for adopting a more interventionist approach to unilateral conduct, has established case law that holds that "a refusal to grant such a licence [to IP] cannot in itself constitute an abuse of a dominant position";[14] and

(b) Similarly, in the United States, there is a body of case law supporting the proposition that an IP owner has an absolute right to enforce their IP rights provided it is not part of an illegal scheme (eg illegal tying, fraud on the US Patent and Trademark Office or sham litigation).[15]

30. The repeal of s 36(3) sends a dangerous signal to firms with market power that they could be held liable for merely enforcing their IP rights. This will have a profound effect on the value that firms derive from investing in IP, with the result that investment expenditure is diverted away from critically important R&D activities. Although s 36(3), properly interpreted, is merely an evidentiary provision it is nonetheless viewed as important confirmation that the courts will not lightly interfere with IP rights. IP rights are after all a statutory construction and their value is directly related to the degree with which they are respected by the courts. This is completely different to other types of property rights, which have intrinsic value, which firms can physically protect from the misappropriation by others.

Section 45

31. We agree with MBIE's proposition that "IP-related conduct is unlikely to be anti-competitive in most instances".[16] It is therefore important to balance the risks of removing the protection of s 45 against the benefits of subjecting more IP-related conduct to the full scrutiny of the Commerce Act. Although the current drafting of s 45 is not flawless, we consider that its application leads to a just and efficient solution in most cases. As discussed above, s 45 has not been an impediment to the Commission investigating cases of firms attempting to extend their IP rights beyond the scope of their grant.

32. In assessing whether s 45 should be repealed, it is important that MBIE take a holistic approach and consider the broader context of the Commerce Act - particularly the recent and proposed changes to it. Currently s 45 offers protection to conduct that is within the scope of grant of an IP right. This protection affords comfort to clients to license their IP to other parties including their competitors. The introduction of the more technical s 30 cartel prohibition

[13] See Noonan *Competition Law in New Zealand*, at 685.

[14] Case 24/67 *Volvo v Erik Veng* EU:C:1988:477 at [8].

[15] See discussion in *Independent Service Organizations Antitrust Litigation*(*CSU v Xerox*), 203 F.3d 1322 (Fed. Cir. 2000), cert. denied, 531 US 1143 (2001).

[16] Discussion Paper at 53.

combined with the imminent prospect of cartel criminalisation will have a chilling effect on licensing decisions. Firms will increasingly question whether it is worth licensing their IP to a competitor given their increased exposure to Commerce Act liability. Although we recognise that there are a number of exceptions to the cartel provision, these are very technical and do not provide the same degree of certainty as the current IP exception. At a bare minimum, s 45 should be retained as a defence to proceedings under s 30.

33. For example, a pharmaceutical company may have a patent for manufacturing a drug, which treats a particular condition in humans. The drug faces intense competition from other drugs that can treat the human condition. If a coating is applied to the drug immediately after manufacturing, it can treat a similar condition in equine animals. The pharmaceutical company lacks the necessary veterinarian capabilities to develop the coating and has no plans or desire to enter that market. The pharmaceutical company is prepared to license its patent to an equine company, but only if such licensing does not undermine its investment in the human drug market. The pharmaceutical company plans to license the patent to the equine company solely for use in the production of equine medication. Currently, section 45 would protect such a license from liability under ss 27 and 30. If s 45 were repealed, the restricted use provision has the effect of allocating markets between the pharmaceutical company and the equine company and would breach s 30. On its face, none of the existing exceptions to s 30 would apply as the parties are not engaged in a collaborative activity, and arguably the dominant purpose of the exclusive equine use provision is to prevent competition between the parties. Such a result would mean that the patent is not licensed, and consumers in the equine market are worse off.

34. Recognising the real risk of chilling pro-competitive licensing practices, if s 45 is to be repealed it is paramount that something is put in its place to provide firms with comfort that licensing IP will not give rise to Commerce Act liability. Both the EU and US have provided such comfort by instituting safe harbours.

(a) The EU has created a number of Block Exemptions relating to IP-conduct to provide comfort to parties. The Block Exemptions include:

(i) *Technology Transfer Block Exemption Regulation*: This applies to the grant by the IP owner of a licence to a third party authorising the licensee to exploit the IP by manufacturing, marketing and selling certain goods and services. It applies to agreements concerning "technology rights" such as software copyright, design rights, utility models, patents and/or knowhow. Licensing of trade marks, copyright or other IP is not covered unless it is directly related to the production or sale of the contract products; and

(ii) *Research and Development Block Exemption Regulation*: Applies to agreements to pursue R&D of contract products or contract technologies and joint exploitation of the results of that R&D; joint exploitation of the results of R&D carried out pursuant to a prior agreement between the same parties; or joint R&D of contract products or contract technologies.

The Block Exemptions operate by shielding from competition law scrutiny arrangements that satisfy the prescribed criteria. For example, the Technology Transfer Block Exemption applies where:

- There is an agreement between two parties;

- The agreement is a patent licence, a know-how licence, a software copyright licence or a mixed patent, know-how and software copyright licence. It also covers the licensing of trade marks and copyright to the extent that these are directly related to the production or sale of the contract products;

- If the parties are actual or potential competitors in either the relevant product or technology markets, their combined market shares on the relevant product and technology markets must not exceed 20%;

- If the parties are not actual or potential competitors in either the relevant product or technology markets, their combined market shares on the relevant product and technology markets must not exceed 30%;

- The agreement does not contain a hardcore restriction (essentially the NZ equivalent of a cartel provision) subject to some exceptions; and

- The agreement does not any excluded restrictions (eg a no challenge clause).

The Block Exemption is legally binding on the European Commission, Member States and third parties. In our experience, parties find comfort in the Block Exemptions and structure their licensing agreements with these criteria in mind. It should be noted that if an arrangement does not satisfy the Block Exemption criteria there is no presumption that it is anticompetitive.

(b) The United States have also implemented antitrust "safety zones" to provide comfort to businesses:[17]

> Absent extraordinary circumstances, the Agencies will not challenge a restraint in an intellectual property licensing arrangement if (1) the restraint is not facially anticompetitive[18] and (2) the licensor and licensees collectively account for no more than twenty percent of each relevant market significantly affected by the restraint.
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> …
>
> Absent extraordinary circumstances, the Agencies will not challenge a restraint in an intellectual property licensing arrangement that may affect competition in a technology market if (1) the restraint is not facially anticompetitive and (2) there are four or more independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement that may be substitutable for the licensed technology at a comparable cost to the user.
>
> …

[17] US Department of Justice and Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property* (12 January 2017) at 24.

[18] "Facially anticompetitive" refers to restraints that normally warrant per se treatment, as well as other restraints of a kind that would allow or almost always tend to reduce output or increase prices.

> Regarding potential effects in a research and development market, the Agencies, absent extraordinary circumstances, will not challenge a restraint in an intellectual property licensing arrangement if (1) the restraint is not facially anticompetitive and (2) four or more independently controlled entities in addition to the parties to the licensing arrangement possess the required specialised assets or characteristics and the incentive to engage in research and development that is a close substitute of the research and development activities of the parties to the licensing agreement.

As in the EU, the US guidelines emphasise that "licensing arrangements are not anticompetitive merely because they do not fall within the scope of the safety zone".

35. We raise these overseas examples not as an endorsement of the specific safe harbours created but rather to demonstrate to MBIE the level of detailed guidance that would be required to avoid a chilling of procompetitive licensing if the statutory exception were repealed.

36. In this context, we do not agree that there is a compelling case to repeal either s 36(3) or s 45 and, to the contrary, consider it will result in worse outcomes for New Zealand.

TREATMENT OF LAND COVENANTS

Submission 6: It is dangerous to extend the per se prohibitions contained in the cartel prohibition to land covenants without providing a defence for firms who use land covenants to protect legitimate business interests

37. While redefining contracts to include covenants would close off a potential loophole in the treatment of covenants, such an approach would have unintended consequences.

38. Contracts and covenants are different instruments that operate differently under the law:

(a) Contracts operate under the doctrine of privity of contract under which a contract cannot confer rights or impose obligations upon any person who is not a party to the contract; whereas

(b) Covenants not only bind the initial parties but also run with the servient land under the doctrine of privity of estate such that a subsequent landowner is bound by the covenant despite not entering into it with the initial beneficiary.

39. The difference in how these instruments operate reflects the fact that they are used for different purposes. The current exceptions to the cartel prohibitions have been designed with contracts in mind. They are not fit for purpose when it comes to land covenants. In particular, it is difficult to envisage a scenario where the existing "collaborative activities" or "vertical supply contract" exceptions would provide protection for a covenant imposed for legitimate reasons. For example, none of the current exceptions are likely to apply in the following cases:

(a) Under the Resource Management Act, a polluter, occupier and current owner can all potentially be liable for land contamination and the cost of remediation. Firms that have successfully remediated land prior to its disposal often include a land covenant preventing the land from being used for the same purpose, so as to avoid the risk of expensive and protracted litigation establishing who was responsible for any future contamination. There is a risk that if the land was later owned by a competitor, the enforcing of the covenant would amount to an output restriction and be prohibited under s 30 irrespective of whether there are alternative available sites in the same area for the competitor to operate a competing business. Given the countervailing public benefits for such covenants, it is not appropriate to impose strict liability on the enforcement of such covenants. It is better assessed, from a competition perspective, under s 28 (as is currently the case today); or

(b) A firm purchases a large site to develop into a destination retail experience (eg a shopping mall or entertainment precinct). Having completed the development there is land that remains unused. The firm has invested extensively in developing an experience that consumers are willing to travel to. The firm wishes to dispose of the land that is surplus of their requirements but does not want direct competitors to free ride in their extensive investment so includes a covenant preventing the adjacent land from being used by a competing business. Again, in the event that the land ends up being owned by a competitor, there is a real risk that enforcing the covenant may amount to an output restriction and be prohibited under s 30 irrespective of whether there are alternative available sites in the same area for the competitor to operate their own competing retail experience. Given the legitimate need to protect one's investment from freeriding, it is not appropriate to impose strict liability on the enforcement of such covenants and the risk of doing so would deter investment in providing competitive offerings. It is better assessed, from a competition perspective, under s 28 (as is currently the case today).

40. In both of the above examples, if s 30 also applied to covenants, it is conceivable that the counterfactual is that firms do not develop the land in the first place, or do not dispose of land that is surplus to their requirements, or are only willing to lease the land so as to maintain control over its use. This is inconsistent with the purpose of the Commerce Act as it would lead to an inefficient allocation of land, which would not be in the long-term interests of New Zealand.

41. Although we consider the risk of covenants being used as an anti-avoidance measure to be low, if MBIE is minded to extend s 30 to also apply to covenants, we would strongly advocate for the introduction of a new defence to s 30:

> **Exception for covenants**
>
> Nothing in section 30 applies to a person in relation to a cartel provision included in a covenant where it is reasonably necessary for the protection of a legitimate business interest that relates to the land subject to the covenant

42. The effect of such a defence is to, for the most part, treat covenants the same as contracts but to recognise that there are legitimate business reasons for imposing covenants, and those covenants should not be subjected to per se liability when there is no adverse impact on competition in the relevant market.

Submission 7: If MBIE's proposal is adopted, it should be made clear that it only applies prospectively, and there should be a grace period to allow businesses the opportunity to review their covenants for compliance with the new regime before any enforcement of covenants is captured by the new regime

43. When the Commerce (Cartels and Other Matters) Amendment Act 2017 was enacted, it was made clear that:

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(a) s 30(a), which relates to entering into a contract, arrangement, or arriving at an understanding, that contains a cartel provision, only applied to contracts, arrangements, or understandings that were entered into or arrived at after the new regime came into force;[19]

(b) s 30(b), which relates to giving effect to a cartel provision in a contract, arrangement, or understanding, only applied to conduct occurring after s 30 came into force, but applied whether the contract, arrangement, or understanding was entered into or arrived at before or after section 30 came into force, and whether or not the contract, arrangement, or understanding had been suspended at any time;[20] and

(c) no proceedings under ss 80, 80B, 80C, 81 or 82 could be commenced for a breach of s 30(b) or 80A for a nine-month transitional period starting from when the new regime commenced.[21]

44. Such transitional provisions demonstrate best practice in legislative reform in that they:

(a) provide additional comfort to businesses that they would not be liable for arrangements that they had already entered into that may breach the new prohibition despite being compliant with the previous regime; and

(b) give businesses the opportunity to review their pre-existing arrangements to ensure that they complied with the new legislative regime.

45. The same grace period should also apply to any extension of s 30 to also apply to land covenants. When the new regime was implemented, businesses focussed on reviewing their contracts and arrangements for compliance with the amended legislation. In our experience, businesses did not review their approach to land covenants, as the new regime did not apply to them. Accordingly, it is appropriate that the same grace period is now applied to covenants if the scope of the cartel prohibition were to be extended to also capture covenants.

CONCLUDING COMMENTS

46. As noted, Russell McVeagh is grateful for the opportunity to submit to MBIE on its Discussion Paper. Our submissions are designed to assist MBIE to make recommendations that achieve the best policy outcomes for all New Zealanders.

47. We are available to make a verbal presentation to MBIE and its officials if requested.

48. All enquiries on this submission may be directed to:

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[19] Commerce Act 1986, Schedule 1AA, Part 1, s 2(1).
[20] Commerce Act 1986, Schedule 1AA, Part 1, s 2(2).
[21] Commerce Act 1986, Schedule 1AA, Part 1, s 2(4).