Matthews Law
COMPETITION · REGULATION · POLICY · STRATEGY

KEY COMPETITION LAW AND CONSUMER LAW ISSUES

LegalWise Seminar – 9 March 2016, Stamford Plaza, Auckland
Andrew Matthews & Nicko Waymouth, Matthews Law, www.matthewslaw.co.nz

INTRODUCTION

1. Competition and marketing law (consumer protection) is not always intuitive. We frequently see potential (and alleged) breaches of the Commerce Act (**CA**) and Fair Trading Act (**FTA**) which are missed by clients and often their legal advisors.

2. We have seen these mistakes (nearly) being made and see this as a risk for colleagues. Especially given legal developments (new cases, new legislation and an assertive regulator).

3. This paper seeks to highlight common mistakes to protect you and your clients. We discuss:

    - How many distribution models likely breach the CA.
    - When restraints of trade likely breach the CA.
    - Pitfalls of trade associations and industry groups.
    - "New" law on unsubstantiated representations.

KEY COMPETITION LAW AND CONSUMER LAW ISSUES

How many distribution models likely breach the CA

4. Multi-channel distribution arrangements can raise significant competition law challenges. Suppliers are increasingly supplying end-customers directly online while many traditional bricks and mortar retailers also have an online presence. This development has increased the risks of arrangements inadvertently breaching the CA where parties act as both a supplier and competitor.

5. Arrangements often involve a supplier that has both a vertical (supplier - customer) and horizontal (competitor - competitor) relationship with its customers. This can be further complicated where customers are also competing with each other. Importantly genuine agencies and franchises are not explicitly exempt from the CA's price fixing prohibition.

6. Whenever there is a risk that suppliers and their customers could be viewed as competing care needs to be taken around any horizontal understandings between the parties in respect to how each party will compete. This is particularly the case in respect of pricing. Issues can arise in

arrangements where suppliers retain the right to supply customers directly. This will often occur where a supplier considers that a distributor is under performing.

7. Where suppliers or head franchisors seek to appoint exclusive distributors or franchisees it is important that territories are well defined. Poorly defined territories which allow competition at the fringes can create ongoing competition concerns that are difficult to resolve without raising serious competition law risks. Where arrangements have allowed intra-brand competition issues will arise if further arrangements are entered into to remove that competition. Therefore it is important to carefully consider proposed distribution arrangements to minimise the risk of inadvertently creating competition issues in the future.

Real examples

Real example 1 - Allowing a distributor to supply outside its territory

We advised a supplier who had earlier entered into an arrangement with a distributor to distribute the supplier's products to a particular customer segment (territory). However over the years the distributor supplied customers outside of its territory and on a number of occasions competed with the supplier. The supplier never sought to rein its distributor in and restrict it to the territory which gave the appearance that it acquiesced to the distributor's conduct. In other words, the contract did not reflect how the parties competed in practice.

This raised the risk that the parties could be viewed as competitors despite the territory restriction. In these circumstances the parties had to be alert to the risk that any communications around pricing could be viewed in a horizontal (competitor – competitor) context rather than a vertical (supplier – distributor) context.

Real example 2 - Poorly defined territories

We advised a supplier who had earlier appointed a number of dealers to distribute its product. The supplier also supplied its products directly to end-customers. The dealers' territories were not clearly defined and the supplier received a number of complaints from dealers that other dealers were "under cutting" them on prices. A meeting was held between the supplier and its dealers and rules were developed to settle disputes and avoid future competition between dealers. The rules risked being viewed as an arrangement between competitors.

Real example 3 - *Eli Lilly case* – subsequently changing arrangements to remove competition

In the *Eli Lilly* case[1] a manufacturer and wholesaler of animal health remedies entered into an agreement with a competing wholesaler of its products that they would not compete for customers. The parties agreed that the manufacturer and wholesaler would supply larger customers and its competing wholesaler (customer) the smaller customers. This agreement also included both businesses knowing the minimum prices the manufacturer and wholesaler would offer to smaller customers. The parties admitted that their market sharing conduct breached the CA's price fixing prohibition.

[1] *Commerce Commission v Eli Lilly & Co (NZ) Ltd* (HC) Auckland CL 19/98, 30 April 1999.

Real example 4 – the *Flight Centre* case – price fixing between agent & principal

In the *Flight Centre* case[2] the Australian Federal Court found that Flight Centre (an agent), on a number of occasions between 2005 and 2009, sought to prevent three airlines (its principals) from offering cheaper international airfares directly to consumers than the airlines offered to Flight Centre. Accordingly the Court held that Flight Centre attempted to fix prices with the airlines and Flight Centre was fined AUD11 million.

Many practitioners may be asking themselves how the Court determined that Flight Centre fixed prices if it did not have any planes to provide air services? While the Court accepted that Flight Centre did not provide air services, it did find that Flight Centre competed with certain airlines for the supply of air travel "booking and distribution" services to consumers. The price for the booking and distribution services was the retail or distribution margin (ie for the agent its commission), which was included in the headline price for the fare. Therefore the Court considered that Flight Centre's attempt to control the price of the fares the airlines were offering to consumers amounted to fixing the price for air travel booking and distribution services.

The Flight Centre case challenged the orthodox view that an agent is its principal's alter ego and therefore the parties should not be viewed as competing.

On appeal the Full Court of the Federal Court of Australia (Full Court) overturned the lower court's decision. The Full Court found that there was no separate market for booking and distribution services to consumers. Instead it found that the supply of booking and distribution services was an ancillary part of the supply of international air travel, in which Flight Centre acted as agent for the airlines. Accordingly, Flight Centre and its principal airlines did not compete with each other and could not fix prices.

However the Full Court noted that an agency relationship between two parties does not always mean that those parties cannot be in competition with each other. Each case will turn on its own facts. The Australian Competition and Consumer Commission is seeking special leave to appeal the decision.

Distribution models - practical tips for practitioners and their clients

- Is the territory clearly defined taking into account online and telephone sales?
- Is the supplier/head franchisor competing (or may compete) with its distributors/franchisees?
- Is a supplier proposing to change existing arrangements to remove competition between itself and its distributors?
- Don't assume genuine agencies are immune from competition laws.

[2] *ACCC v Flight Centre Limited* (No 2) [2013] FCA 1313 (6 December 2013); *Flight Centre Limited v Australian Competition and Consumer Commission* [2015] FCAFC 104. Also see *ACCC v Australia and New Zealand Banking Group Limited* [2015] FCAFC 103).

Recent fines imposed for breaches of the CA's price fixing prohibition

Party	Conduct	Fine
PGG Wrightson 2015	Entering into three anti-competitive agreements to set fees at livestock saleyards	$2.7M
Rural Livestock 2015	As above	$425,000
Enviro Waste and Darrell Askew 2015	Attempting to reach an understanding to compete less competitively for existing customers and to not enter the separate waste tallow market	$425,000, $5,000 for Mr Askew
Carter Holt 2014	A 7 month arrangement to increase prices for certain timber products in Auckland	$1.85M
Visy 2013	Collusion on 3 tenders between 2001 - 2004 for packaging materials	$3.6M
Air NZ 2013	Fixing fuel and security surcharges	$7.5m
Whirlpool 2011	Conduct over 2 years regarding an arrangement to seek price increases for compressors	$3m

When restraints of trade likely breach the CA

8. We are increasingly reviewing restraints between competitors. Restraints of trade between competitors that appear seemingly innocuous but restrain how competitors compete can raise serious competition law concerns including price fixing. ("Competitors" includes potential competitors and competitors "but for" an arrangement not to compete.)

9. These restraints risk being viewed:

   a. as forms of market sharing or price fixing; or

   b. otherwise anti-competitive under the CA's general prohibition against arrangements containing a provision that has the purpose, or has or is likely to have the effect of, substantially lessening competition in a market.

10. The CA's price fixing prohibition is broad. It captures a broader range of conduct than competitors merely explicitly agreeing prices. The penalties for breaching the CA are also high.[3]

11. The price fixing provision prohibits contracts, arrangements or understandings (collectively arrangements) between two or more competitors which contain provisions that have the purpose or (likely) effect of fixing, controlling or maintaining (collectively fixing) a price (or any component of price), discount, allowance, rebate or credit of one or more competitors. Such arrangements are deemed to substantially lessen competition in a market regardless of their actual impact on price (if any). It is a per se prohibition with limited exemptions which has been

[3] Fines of up to $500,000 (individual) or for a body corporate, the greater of $10M; 3 x commercial gain (if gain readily ascertainable); or 10 per cent of turnover (if gain not readily ascertainable) per breach.

broadly interpreted by the courts. Conduct that can be caught includes arrangements between competitors that fix prices, rig bids, allocate markets/customers or restrict output.[4]

12. In our experience both clients and practitioners have found aspects of the price fixing prohibition somewhat counter-intuitive. It may also not be obvious that parties could be viewed as competing, at least from the Commerce Commission's (**Commission**) perspective. While arrangements involving restraints often have a legitimate commercial rationale and make "good commercial sense" to both clients and advisors, they are red flags to competition lawyers. Therefore such restraints need to be carefully worked through.

13. Importantly the CA contains an exemption from Part 2 of the CA (which includes the price fixing prohibition) where :

> "*…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****:"*[5] (emphasis added)

Real examples

Real example 1 - Excessively long restraints

Restraints of trade that are excessively long and clearly unnecessary to protect the goodwill of the purchaser eg exceeding 5 years. Such restraints can appear to be mechanisms to permanently exclude a competitor from a market. Restraints in relation to concentrated markets with high barriers to entry raise greater risks under the CA's general prohibition against anti-competitive arrangements given their potential to either effect competition or be viewed as having that purpose. The ACCC has had concerns with restraints in relation to highly skilled professions including ophthalmologists, radiologists, nuclear physicians, radiographers and sonographers. The Common Law also applies to restraints of trade.

Real example 2 – trans-Tasman restraint

We advised a client in relation to a proposed triangular arrangement between the vendor of a trans-Tasman business and two purchasers (purchasers A and B) whereby:

- purchaser A would acquire the New Zealand assets of the vendor and agree not to supply goods to Australian customers; and
- purchaser B would acquire the Australian assets of the vendor and agree not to supply goods to New Zealand customers.

This proposal obviously raised market sharing risks on both sides of the Tasman and was clearly not solely for the protection of the purchaser in respect of the goodwill of the business.

[4] The Commerce (Cartels and other Matters) Amendment Bill, which has been progressing through the parliamentary process since 2011, would specifically define price fixing, market allocation and output restrictions.
[5] Section 44(d).

Real example 3 – Sale and purchase of building restraint

We advised a client in relation to a provision in a sale and purchase agreement for a building where the vendor and purchaser, who would likely be viewed as competitors, agreed that the sale was conditional on the parties agreeing that each party would only supply services to different customer segments.

Real example 4 - Longstanding restraint

We advised a client in relation to a longstanding arrangement between members of a business group that each member, which operated as independent businesses, would not compete for the existing customers of another member. They also agreed that if approached by another member's customer that member would refer those sales back to the incumbent business.

Real example 5 – IP patent settlement restraint

Last year the Commission issued a formal warning to Consolidated Alloys (NZ) Limited (**CAL**) for the inclusion of an "anti-competitive clause" in a "negotiated settlement" with its competitor Edging Systems (NZ) Limited (**ESL**). The parties entered into the settlement agreement to resolve a commercial dispute involving an alleged breach of CAL's registered patent for soft-edge flashing products used on residential metal roofs.

CAL and ESL are the only manufacturers and distributors of soft-edge flashing products in New Zealand. CAL, a wholly owned subsidiary of Amalgamated Metal (Australia) Limited, registered a patent for a particular type of soft-edge flashing in 1995 which expired in 2015. ESL was founded in 2008 and produced a soft-edge flashing product, EZ-Edge. CAL alleged that ESL's EZ-Edge product breached its patent and issued proceedings. However a few days before the trial commenced the parties entered into a settlement agreement, under which ESL agreed to:

- pay CAL a lump sum and royalties on annual sales of EZ-Edge for an undisclosed period of time and subject to a minimum annual payment; and
- not sell any other soft-edge flashing products covered by the patent other than EZ-Edge until June 2023 ie eight years past the expiry of the patent (the restraint).

The Commission concluded in its view that while the restraint did not breach the price fixing prohibition, it did have the purpose and (likely) effect of substantially lessening competition in the markets for edge products and soft-edge flashing products.

14. All of these examples involve an agreement between competing parties that restrains how one or more competitors competes. Such restrictions risk being viewed, at least by the Commission, as raising serious concerns including price fixing. At their most basic each provision risks being viewed as an agreement between competitors that there will be no price competition for particular customers as between the parties to the agreement.

15. As noted price fixing is a "per se" prohibition ie "no defence". Therefore there is no weighing of the pro and anti-competitive effects to determine whether the arrangement substantially lessens competition in a relevant market(s). Businesses often have difficulties grasping the breadth of the price fixing prohibition. It is not always intuitive that a restraint will be deemed to lessen competition in a market overall. Businesses are often perplexed as in their view there is no actual harm to competition as a result of the arrangement given that there are numerous

other firms in the market or barriers to entry are low. Accordingly practitioners need to provide clear guidance to clients to minimise the risk that clients inadvertently breach the CA.

Restraints - practical tips for practitioners and their clients

- Could the parties be viewed as (potential) competitors?
- What is the purpose of the restraint – is it solely to protect goodwill for the purchaser?
- Is the restraint reasonable and what is the likely effect on the relevant markets?
- Just because the arrangements have been in place for a long time does not exclude the application of the CA.

Pitfalls of trade associations and industry groups

"So much for the good part of trade associations, the bad part of trade associations is cartels. Unlike the good and the ugly aspects of trade associations, there really is nothing legally ambiguous about cartels. They are always bad. You can see the effects of a very successful cartel on your lives every time you spend about $2.30 per gallon to fill your tank with gas"

Jon Leibowitz, Former Chairman of the Federal Trade Commission " The Good, the Bad and the Ugly: Trade Associations and Antitrust" American Bar Association Antitrust Spring Meeting, Washington, DC March 30, 2005

16. Groups of merchants and individual artisans in various industries have been forming trade associations for centuries and they continue to play an important role in modern commerce. However while trade associations provide many industry benefits they can be a "hot-bed" for inappropriate communications between competitors. Adam Smith recognised this risk stating "[p]*eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.*[6]

17. Many cartels have their origins in trade associations and industry working groups. Because of the inherent risks of competitors meeting we are increasingly preparing protocols. These are based on international best practice and clearly set out processes to minimise the risk of breaching competition laws. This can include a competition lawyer being present during trade association or industry working group meetings as a precaution and minute taker. This is particularly the case where the matters being discussed could be inadvertently misreported or misconstrued.

[6] Adam Smith L.L.D & F.R.S, 1776 – *The Wealth of Nations*, Book I, Chapter X.

18. That said the Commission does acknowledge the benefits noting that "[t]*rade associations play a useful role in enabling businesses to meet and discuss industry-wide issues and practices and to share knowledge and technical information*".[7]

19. Importantly the Act deems that any arrangement entered into by a trade association is considered to be entered into by all the association's members. This is regardless of an individual member's involvement or knowledge of the arrangement, unless a member can:

    a. demonstrate that they expressly notified the association in writing that they wish to disassociate themselves from the arrangement, and then took such steps; or

    b. establish that they had no knowledge, and could not reasonably have been expected to have any knowledge of the arrangement.

20. Additionally any recommendation made by an association to its members is deemed to be an arrangement made between those members and between the association and those members.

Real examples[8]

Real example 1 – The *laundry powder* case

In 2013 Proctor & Gamble (P&G) [9] and Unilever were fined €315.2M by the European Commission for fixing the price of laundry detergents.[10] The price fixing arrangements arose out of an industry working group involving P&G, Unilever and Henkel for the purposes of reducing the environmental impact of laundry detergents.

The parties had originally sought to reduce the size of detergent boxes, energy consumption, packaging and shipping, storage and selling space. The purpose of the working group was to shift the market to greater sustainability. However the parties went one step further.

Having developed cold-water concentrated detergents, which reduced energy consumption by 90% or more, the parties faced a dilemma. It was believed that consumers would prefer a greater quantity of standard detergent for the same price as a concentrated product. Therefore there would be a first mover "disadvantage" for the party that introduced their concentrated detergent first. To avoid this scenario the parties agreed to launch their products at the same time, not to initially decrease prices and later to increase prices.

Real example 2 – "Off the cuff" comments at business functions can lead to investigation

The following example illustrates how easy it is for comments in relation to how competitors should compete to result in an investigation. On 25 March 2015 it was reported in the Australian Financial Review that Andrew Forrest, Chairman of Fortescue Metals Group Ltd stated the following at a business dinner in Shanghai on 24 March 2015:[11]

"…he was "absolutely happy to cap [his] production right now" at 180 million tonnes

…..the other major players, Rio Tinto, BHP Billiton and Brazil's Vale should also cap their production "and we'll find the iron ore price goes straight back up to US$70, US$80, US$90"

[7] NZCC Guidelines for Trade Associations Commerce Act, 20 September 2010, page 1.
[8] Also see "*The Commerce Commission has concluded its investigation into an allegation of price-fixing by the Committee of Gisborne Farmers Market*": http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2010/gisborne-farmers-market-agrees-to-remove-pricing-rule ; *"The Commerce Commission has told New Zealand Winegrowers it went beyond reasonable bounds by telling its members to limit the amount of grapes they harvested"*: http://www.stuff.co.nz/marlborough-express/news/3795170/Winegrowers-warned-after-complaints
[9] http://ec.europa.eu/competition/antitrust/cases/dec_docs/39579/39579_2633_5.pdf
[10] http://europa.eu/rapid/press-release_IP-11-473_en.htm?locale=en
[11] http://www.afr.com/news/world/fortescues-andrew-forrest-calls-for-iron-ore-production-cap-20150325-1m6xl

"I'm happy to put that challenge out there, let's cap our production right here and start CAing like grown-ups".

Following that article the ACCC launched an investigation. While the ACCC ultimately concluded that it would take no further action Mr Fortescue had to endure the regulator's scrutiny for some time and likely incurred considerable legal costs

Trade associations - practical tips for practitioners and their clients

Clients involved in trade association should at the very least undertake the following steps to minimise risk:

- Ensure that the trade association is a legitimate organisation, has a clearly defined purpose and has an effective competition law compliance regime in place.
- Ensure that agendas are circulated prior to meetings and topics not on the agenda are not discussed, including outside of formal meetings.
- At the start of each meeting the Chair should remind members that they are not to discuss prices or strategy with other members and seek members' acknowledgment.
- If prices or how members should compete is discussed clients should immediately object and request that their objection is noted in the minutes. If a discussion continues the lowest risk option is for the client to leave the meeting. A file note (marked privileged and for the purposes of seeking legal advice) should also be taken recording the client's objection and removal from the meeting (if applicable). Advice should also be sought as to whether any further steps are required in the circumstances.
- Ensure that advice is obtained before providing or receiving sensitive commercial information or participating in surveys.

Unsubstantiated representations and how to protect your clients from breaching the FTA

21. We are also 18 months into the FTA's new unsubstantiated representations prohibition.[12] This new prohibition is widely considered to significantly increase the Commission's enforcement tool kit. The Commission has already warned one business[13] and signalled during its December 2015 Stakeholder briefing that it expects to bring its first proceedings this year.[14] Under similar legislation the ACCC has taken action against businesses including "…*in relation to claims* [a business] *made about the alleged weight loss and fitness benefits*".[15]

22. We are increasingly advising clients on these issues, including challenging claims their competitors are making. Recently we raised concerns in respect of statistical claims a client's competitor was making which resulted in the competitor withdrawing the offending claims.

[12] Section 12B.
[13] http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2015/baa-baa-beads-warned-over-health-claims
[14] Commerce Commission Stakeholder Briefing 11 November 2015, Rydges Hotel, Auckland.
[15] http://registers.accc.gov.au/content/index.phtml/itemId/1188939

23. For those practitioners unfamiliar with the new regime, businesses that make claims about goods or services (whether express or implied) must have "reasonable grounds" for making those claims, at the time they are making the claim. Even if a business makes an unsubstantiated claim that later turns out to be true, this will still breach the prohibition if the business did **not** have reasonable grounds for making that claim at the time they made the claim. The Commission's fact sheet on unsubstantiated representations notes that "reasonable grounds" can come from information provided by reputable suppliers/manufacturers, information the business making the claim holds, or any other reasonable source (eg scientific or medical journals).

24. The prohibition is effectively designed to stop businesses "jumping the gun", deliberately or otherwise, and making claims before those claims have been sufficiently validated. That validation may come in the form of rigorous and/or scientific testing carried out by a necessarily qualified and reputable party. Prohibiting businesses from making unsubstantiated claims promotes competitive markets. It prevents rogue businesses from gaining an unfair competitive advantage by making claims they do not have reasonable grounds to support, to the detriment of the competitive process.

25. Proceedings for unsubstantiated representations may be bought by the Commission – no other parties may initiate proceedings for alleged breaches. It was considered that if other parties could bring proceedings the process may be open to abuse by competitors bringing proceedings against each other for the purposes of accessing confidential information during the discovery process.

26. If the Commission issues proceedings the onus is on the defendant to prove on the balance of probabilities that they had "reasonable grounds" for making the claim (at the time the claim was made).

Real example

Baby bead claims "lack independent and credible scientific evidence"

The Commission investigated Baa Baa Beads following complaints about its Baltic amber necklaces for babies. The Commission sought evidence from Baa Baa to substantiate its website claims regarding the therapeutic benefits, composition, and popularity of its products. This included Baa Baa's products that were targeted at treating teething babies.

The Commission concluded that in its view Baa Baa failed to substantiate its claims. In the Commission's view "there was a lack of independent and credible scientific evidence to substantiate the claims made about the health benefits of Baltic amber products."[16]

[16] http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2015/baa-baa-beads-warned-over-health-claims

27. In our experience particular claims in relation to health and therapeutic benefits can be risky and businesses need to be confident that they have sufficient independent evidence supporting claims before they are made. Such claims often also raise issues under the Medicines CA 1981.

Unsubstantiated representations - practical tips for practitioners and their clients

- Always test whether a client has evidence to support a claim
- Is the evidence from an independent and reputable source?
- Ensure clients keep records showing that evidence existed at the time the claim was made

Andrew (Andy) Matthews Principal
p + 64 9 972 3753
m +64 22 100 1000
www.matthewslaw.co.nz

Nicko Waymouth Senior Associate
p + 64 9 972 3754
m +64 222 333 666
www.matthewslaw.co.nz