FACT SHEET

COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Health series

Powerful purchasers

This fact sheet explains how the rules in the Commerce Act against fixing prices, and other anti-competitive agreements and behaviours, apply to powerful purchasers of goods and services.

In the health sector, many services are wholly or partly funded by purchasers such as the Ministry of Health (MoH), the Accident Compensation Corporation (ACC), District Health Boards (DHBs), or private health insurers. In turn, many health sector providers are largely or wholly reliant on securing contracts or funding from these purchasers.

Consequently, the way these purchasers behave can have a significant effect on individual providers and the market more generally. These purchasers are powerful because they usually have a number of providers to choose from, whereas providers often only have a few potential purchasers.

Sometimes individual competitors are adversely affected by the behaviour of powerful purchasers, but that behaviour is not caught by the Commerce Act. The Act protects the competitive process for the benefit of consumers; it does not protect individual competitors. Symptoms of a less competitive market are higher prices or lower quality over the longer term.

Like all firms, powerful purchasers are prohibited from making agreements that are likely to substantially lessen competition, including agreements with any of their competitors that fix prices. And like powerful sellers, powerful purchasers are prohibited under the Commerce Act from using their market power for an anti-competitive purpose.

What is the price fixing rule?

Any agreement between competitors, whether they are providers or purchasers, that sets the price of a good or service, or interferes with how that price is reached, is illegal under the Commerce Act.

You can read more in our fact sheet *Price fixing and cartels* at www.comcom.govt.nz/price-fixing-and-cartels

What is the rule against anti-competitive agreements?

Any agreement among any two or more parties that is likely to substantially lessen competition is illegal under the Commerce Act.

You can read more in our fact sheet *Agreements that substantially lessen competition* at www.comcom.govt.nz/slc-agreements

Sometimes individual competitors are adversely affected by the behaviour of powerful purchasers, but that behaviour is not caught by the Commerce Act.

Some agreements between publicly-funded health sector purchasers are exempt

Certain publicly-funded health sector organisations are treated by the Act as though they were interconnected. This means that they can act together as though they were a single entity.

Agreements among those organisations are therefore seen as internal business decisions. So agreements among them are, in effect, exempt from the rules against price fixing and anti-competitive agreements. The exemption applies to:

- all the DHBs
- MoH
- any other Government Ministry or Department
- PHARMAC
- Health Benefits Limited
- Health Promotion Agency.

For example, any agreement between any two or more DHBs would not be subject to those rules, nor would an agreement between the MoH and Canterbury DHB, or all the DHBs and Health Benefits Limited.

These organisations are still subject to the rules when entering into agreements with any other parties.

Agreements between health sector purchasers and other parties

Agreements among parties who are not considered interconnected are subject to the normal rules. Agreements that are likely to substantially lessen competition in any market are illegal. Both purchasers and their providers need to ensure that they do not enter into agreements that breach the Act in this way. Even if the agreement was initiated by the purchaser, all parties to the agreement can be liable.

Contracts with providers should not contain clauses that prevent providers from competing with one another. All parties to such a contract would be potentially liable under the Commerce Act.

In other circumstances, purchasers may compete with providers they fund. For example, a DHB may fund contracts for private providers, and provide those same services itself. Both the DHB and its providers need to ensure that they do not make agreements that substantially lessen competition.

EXAMPLE

The DHBs had identical contracts with each pharmacy in New Zealand for pharmaceutical dispensing. The Pharmacy Guild lobbied on behalf of its members to have a clause added to the contracts that prevented pharmacists from discounting the co-payment. The Commission advised that the likely overall effect of this clause would be to substantially lessen competition because it would have removed the ability to compete on the price of the co-payment. On hearing the Commission's view, the DHBs removed the clause from the contract. All DHBs and pharmacies nationwide were warned by the Commission for entering into agreements that could substantially lessen competition. The Pharmacy Guild was also warned for its role in advocating for the inclusion of the 'no discounting' clause in the contracts.

EXAMPLE

A DHB both funded and provided community pathology testing services in a particular region. The DHB agreed with the competing pathology service providers that the DHB and the providers would not compete for each other's customers. The effect of the agreement was to substantially lessen competition in that region. The Court noted that the DHB was not a defendant in the subsequent proceeding, but might well have been. The two privately-owned pathology services companies were convicted and fined under the Commerce Act.

One business buying another?

You can read about how the Commerce Commission assesses mergers and acquisitions in the fact sheet *Mergers and acquisitions – merger assessment* at www.comcom.govt.nz/merger-assessment

Can a purchaser break the price fixing rule when purchasing services?

Yes, if that purchaser competes with other parties to purchase goods or services (with whom they are not considered interconnected). The price fixing rule applies to purchasers just as it does to sellers. It would be illegal, for example, for competing insurance companies to agree the price (or maximum price) they will pay for a certain service or procedure. Such agreements interfere with the purchaser's ability to individually decide what it will pay, and are considered anti-competitive.

In contrast, an insurance company is not prevented from acting alone and deciding the level of fee it will pay for certain services. Each insurance company is likely to want the best value for its clients' dollars, and may work to control costs by setting caps on what it is willing to pay for certain procedures.

In some situations, purchasers may work together to collectively acquire goods or services. For example, a number of competing small providers may join together to purchase supplies in order to take advantage of bulk rates. In those situations, an agreement to buy at a set price may be exempt from the price fixing rule under the joint buying exemption.

The joint buying exemption is unlikely to be widely used by publically-funded purchasers in the health sector because of the effective exemption from the price fixing rule for many of them. Purchasers intending to rely on the exemption should seek legal advice.

Health sector purchasers taking advantage of market power

The Commerce Act does not prevent either purchasers or providers from having substantial market power. It is illegal, however, for either a purchaser or a provider to take advantage of their market power for an anti-competitive purpose.

However, in most cases powerful purchasers in the health sector will not be aiming to harm competition. They will usually be trying to put downward pressure on prices both in the short and longer terms to try to get the best value for tax payers' money. While the result of the steps they take to achieve this may be that some providers lose their funding and exit the market, this is not illegal under the Commerce Act.

EXAMPLE

A sole purchaser of long-stay beds in private hospitals in one region in New Zealand was accused by the Private Hospitals Association of taking advantage of its market power to reduce the number of providers of long-stay beds. The Court ruled that no anti-competitive purpose was apparent, although it acknowledged that the effect of the behaviour was likely to be a reduction in competition. However, it noted that the purchasing organisation had a budgetary limit for spending, and wished to spend that budget in the most cost effective way. The purchaser chose to rationalise its contracts to achieve this goal. It recognised that the supply was higher than the demand, and that some providers were likely to exit the market. Its solution was to rationalise its contracts by concentrating its purchasing requirements on fewer (and better quality) providers. The Court also noted that the purchaser was unlikely to have a purpose of reducing competition, as it benefited from the competition to supply the beds.

Frequently asked questions

All the DHBs have now adopted contracts with uniform pricing – can they do that?

Yes. Because all DHBs are considered interconnected, agreements between DHBs are not subject to the price fixing rule, or the rule against anti-competitive agreements.

Can competing insurance companies agree to adopt uniform reimbursements for certain procedures?

No. Unless they are interconnected (in other words, both owned by the same company or one owned by the other), insurance companies would be caught by the price fixing rule if they agreed, for example, to pay out the same rate for certain procedures.

Can an insurance company decide to only use providers who have agreed to provide services at a certain rate?

Yes. As purchasers, insurance companies are entitled to decide what prices they are willing to pay.

Why can powerful purchasers set the price they are willing to pay, and in some cases effectively control the market, while providers cannot work together to set their prices?

A purchaser of goods or services in the health sector – like any purchaser – is entitled to decide what prices it is willing to pay for goods or services.

The rules against price fixing and anti-competitive agreements apply to agreements between parties; neither applies where a purchaser is acting alone. And in the health sector, many publicly-funded purchasers are able to make agreements among themselves without risk of breaching the Commerce Act because they are treated as if they were interconnected.

My services are largely funded by DHBs and my contract with the DHB stipulates the maximum co-payment I can collect from patients. Why can the DHB control what I charge in that way?

When a DHB or another funding agency contracts with you to provide services to the public, it is purchasing those services to provide them to the public. As the purchaser of your services, the DHB or other funding agency controls how much of the service to the public is funded, and can specify whether or not you are entitled to recover any fees from your patients. Your contract may therefore set out a maximum co-payment that may be collected, or that no co-payment may be charged. The purpose of this stipulation is not to prevent competition among providers, but to ensure that your services are accessible to the public.

Why can't the Commission regulate the prices that ACC and the MoH pay for services in the health sector so that they don't drop below a sustainable rate?

Under the Commerce Act, price control is only possible in markets where there is little or no competition for the supply of goods or services. The acquisition of goods and services by purchasers cannot be regulated under the Commerce Act.

My contract with my funding agency allows me to collect co-payments from patients. Does this mean my local group of service providers can agree what co-payment we will charge, or if we will charge one?

No. Such an agreement between competitors would break the price fixing rule, as it would interfere with the provider's ability to individually determine the price it will charge.

The ACC used to award several contracts for the services I provide, but has combined all those contracts into one. Why is that not considered to substantially lessen competition?

Reducing the number of contracts or tenders does not in itself result in a substantial lessening of competition. The number of opportunities to compete is reduced, but that does not necessarily lessen the overall level of competition. Instead, the competition that occurred for each of the different tenders now takes place at one time.

Where contracts that were once separate are combined, it may mean that providers will have to work together to compete for these contracts. Such providers need to be careful in their collaboration to ensure that they are not breaching the Commerce Act.

More information about how such collaboration could breach or be exempt from the Act can be found in our fact sheet *Setting your fees* at www.comcom.govt.nz/health/setting-your-fees

Why should powerful purchasers consider the effects of their procurement on competition?

A substantial lessening of competition is likely to result in higher prices or lower quality to the purchaser. It is in the best interest of powerful purchasers to procure services with the long-term effect on competition in mind.

More information for procurers can be found in our Guidelines for procurers at www.comcom.govt.nz/how-to-recognise-and-deter-bid-rigging-guidelines-for-procurers

This fact sheet provides guidance only. It is not intended to be definitive and should not be used in place of legal advice. You are responsible for staying up to date with legislative changes.

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