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Primary Health Organisations - Commerce Act Advice

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1. Introduction

1.1 You have asked for advice on issues that may arise under the Commerce Act 1986 in respect of Primary Health Organisations ("PHOs"). These issues can be broadly classified as relating to:

- (a) the structure of PHOs; and
- (b) contracting with PHOs.

1.2 Underlying both these issues is the question as to whether the Ministry and DHBs are "engaged in trade" in this context for the purposes of the Commerce Act. Accordingly, we discuss the "in trade" question first, and then address any residual matters for the Ministry/DHBs in respect of the two issues listed in paragraph 1.1.

2. Summary

2.1 Where the Government wishes to impose requirements for PHOs that could give rise to Commerce Act liability for DHBs, we consider that the Minister should exercise her statutory powers under sections 10, 32, and 33 of the New Zealand Public Health and Disability Act 2000 ("NZPHD Act"). Specifically, we consider that the Minister should exercise her statutory powers in respect of the minimum requirements for PHOs, targeting "high need" PHOs and applying the funding formula. By removing DHBs' discretion in these areas (which relate to core Government policy requirements), the Ministry and DHBs will be protected from actions under the Commerce Act.

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- 2.2 PHOs will be subject to the Commerce Act, both in terms of the actions of PHOs and its member practitioners¹, and their internal arrangements. PHOs themselves, not DHBs or the Ministry, are responsible for ensuring that PHOs comply with all relevant laws, including the Commerce Act.
- 2.3 Aside from those requirements covered by a section 10 agreement, section 32 direction, or written notice under section 33, however, DHBs should not place requirements on PHOs relating to PHO structures that would require a PHO to engage in conduct that may contravene the Commerce Act. In particular, DHBs should not impose requirements of the following nature in relation to the structure and rules of PHOs:
- (a) membership exclusivity – ie, restricting PHO member practitioners from contracting with/being members of other PHOs and/or contracting individually with DHBs;
 - (b) membership criteria that restrict entry other than for legitimate business reasons;
 - (c) information sharing arrangements between member practitioners; and
 - (d) restrictions on collateral arrangements with non-member practitioners.
- 2.4 The decision whether or not to contract with a particular PHO is a commercial one – that is to say, DHBs will be “engaging in trade” for the purposes of the Commerce Act when they make the decision to enter (or not to enter) into a service agreement with a PHO.
- 2.5 Section 36 is of particular relevance to DHBs as they are monopsony funders/purchasers of primary health care services. However, DHBs can protect themselves from a successful challenge under section 36 by ensuring that they make contracting decisions on the basis of:
- (a) quality of service;
 - (b) range of services able to be provided by the PHOs or other entity; and
 - (c) efficiencies inherent in the structure of the particular PHO or other entity.
- 2.6 If co-payments are to be set in agreements between PHOs and DHBs, in our view it would be preferable to specify a *maximum* co-payment level. This preserves the ability of member practitioners to continue to compete on price.
- 2.7 Although exclusive contracts are not prohibited by the Commerce Act, in some instances, depending on the market in question, Commerce Act issues may arise if a DHB entered into an exclusive, long term, contract with one PHO. However, we presume that DHBs would not commit themselves to exclusively purchasing primary

¹ We use the term “member practitioner” to denote both practitioners who are members of a PHO – for example, where the PHO is an incorporated society – and practitioners who are contracted by the PHO to provide the relevant services.

care services from only one PHO or to not contract with practitioners/entities outside the PHO in question.

- 2.8 Long term and evergreen contracts by themselves are not prohibited by the Commerce Act. However, when a long term contract has other restrictive elements that give rise to Commerce Act issues – for example, it has exclusivity provisions - then a long term is likely to increase the Commerce Commission’s concerns about those restrictive elements.
- 2.9 If a DHB wished to restrict the ability of a PHO to provide services within the DHB’s area (for example, if a DHB contracted with one PHO to provide services in the main metropolitan area and then restricted another PHO to suburban practice), this is unlikely to raise Commerce Act issues unless further restrictions are also imposed – for example, if the contract is also exclusive, and/or for a long period of time. When coupled with these other factors, territorial restrictions may have the effect or likely effect of substantially lessening competition.
- 2.10 As with the structure and rules of PHOs, when DHBs enter into contracts with PHOs, they should avoid imposing contractual conditions that would require PHOs to engage in conduct that may contravene the Commerce Act. In particular, DHBs should not impose contractual requirements of the kind described in paragraph 2.3 above.

3. **Background**

District Health Boards

- 3.1 District Health Boards (“DHBs”) are established under section 19 of the NZPHD Act. The objectives and functions of DHBs are set out in the NZPHD Act. DHBs are both providers and funders of health and disability services to the public.
- 3.2 There are two methods by which a DHB may fund health and disability services:
- (a) *Section 25 service agreements*: DHBs are able to enter into service agreements under section 25 of the NZPHD Act. A service agreement is an agreement under which one or more DHBs agree to provide money to a person in return for that person providing health services and/or disability support services. Section 25 does not add anything to the contracting powers that a body corporate would ordinarily possess.
 - (b) *Section 88 notices*: DHBs may give notice of the terms and conditions on which they will make payments to a person or persons. Such a notice must be published in the *Gazette*. If a person accepts payment after the notice is given, the person is deemed to have accepted the terms and conditions contained in the notice.

Primary Health Care Strategy

- 3.3 The Primary Health Care Strategy (“the Strategy”) was issued in February 2001. A cornerstone of the Strategy is the establishment of PHOs, which will be the structures through which the Government (via DHBs) will implement the Strategy.
- 3.4 The Strategy reflects a strong preference for population-based funding as opposed to fee-for-service based funding. Population-based funding will be allocated through, first, Crown funding agreements between the Ministry and DHBs, and second, service agreements between DHBs and PHOs and/or section 88 notices issued by DHBs.
- 3.5 Key features of PHOs are as follows:
- (a) PHOs will be funded by DHBs for the provision of primary health care services to enrolled populations;
 - (b) the services will be directed towards improving and maintaining the health of the enrolled population and restoring people’s health when they are unwell;
 - (c) PHOs will be required to involve their communities in their governing processes;
 - (d) PHOs must demonstrate that all their providers and practitioners can influence the organisation’s decision-making rather than one group or person being dominant;
 - (e) PHOs must be not-for-profit bodies and are required to be fully and openly accountable for all public funds that they receive;
 - (f) primary healthcare practitioners will be encouraged to join PHOs but membership will be voluntary.

4. Discussion

Application of the Commerce Act – “in trade” question and protecting the actions of the Minister and DHBs

- 4.1 The Commerce Act applies to the Crown to the extent that it “engages in trade” (section 5). Similarly, the Commerce Act applies to Crown corporations that are engaged in trade (section 6). DHBs are bodies corporate that are owned by the Crown (section 21 of the NZPHD Act) and accordingly are “Crown corporations” for the purposes of the Commerce Act. The full range of penalties is therefore available for Crown corporations that engage in trade and contravene the Commerce Act.
- 4.2 In *Re NZ Medical Association* (1988) 7 NZAR 407 the words “engages in trade” were considered. In that case the Minister of Health and the Medical Association had reached agreement as to the benefit payable in respect of practitioners’ fees for child patient consultation. The Association sought an authorisation of the agreement. The Commission declined jurisdiction, saying:

... The words “engages in trade” may be argued to connote acting “in the course of trade” as distinct from “carrying on trade”. If this first sense were taken, then it could at least be argued that the Crown, though not itself engaged in trade, was acting in the course of trade, i.e. in relation to a series of activities involving trade. However, the Commission considers that the better view of ‘engages’ is that it is necessary for the Crown to be carrying on trade. In this case, the Crown is not itself engaging in a business activity in respect of this arrangement, and for that reason, in the view of the Commission, is not engaged in trade in terms of the [Commerce] Act.

- 4.3 In *Glaxo v Attorney General* [1991] 3 NZLR 129, the High Court and Court of Appeal approved the Commission’s decision in *Re NZ Medical Association*. In *Glaxo*, the Minister of Health rejected an application from Glaxo to remove restrictions concerning payment of a subsidy under the Social Security Act by the Crown for a particular pharmaceutical. The Court of Appeal held that:

It is clear that the Minister was not engaging in trade as such, or in any business, industry, profession or occupation ... it [the Minister’s decision] certainly has commercial effects, but the activity itself is a regulatory function under the [Social Security] Act...

- 4.4 In our view, the reasoning in both the above cases is applicable to the actions of the Ministry and DHBs in respect of a number of the matters that the Ministry of Economic Development and the Commerce Commission² have identified as raising Commerce Act concerns. Specifically:
- (a) determining who can be a PHO - i.e. requiring PHOs to be not-for-profit and to fulfil a number of other requirements, for example, involving communities in the PHOs governing processes;
 - (b) the preference for funding PHOs with “high need” populations; and
 - (c) the use of a funding formula.

Determining who may be a PHO and targeting PHOs with “high need” populations

- 4.5 Determining who can be a PHO and funding of PHOs is a cornerstone of the Government’s framework for funding primary health care as outlined in the Strategy. Limiting the conferral of PHO status to entities that meet specific minimum requirements is part of the funding framework, and, accordingly, we do not consider that specifying minimum requirements constitutes “engaging in trade”.
- 4.6 Targeting PHOs with “high need” populations for funding is an important part of the government’s social welfare objectives – specifically its primary health care objectives. Regardless of whether or not DHBs are considered to be engaging in trade in this context, we do not consider that any Commerce Act issues would arise out of targeting funding for this purpose because it is not an anti-competitive purpose.

² Letters dated 7 March 2002 and 1 May 2002 respectively.

Directions/written notice under the NZPHD Act relating to minimum requirements for PHOs and targeting PHOs with “high need” populations

- 4.7 However, to protect both the actions of the Ministry and DHBs, we consider that the Minister should remove DHBs’ discretions in relation to those issues that relate to clear Government requirements. The Minister has the power to achieve this by giving one or more directions under section 32, and/or a written notice under section 33 of the NZPHD Act.
- 4.8 We consider that this is an appropriate use of the direction and notice powers under the relevant sections. In giving such directions or notices, the Minister would not be acting in trade. Once a direction or notice is given, the fact that a DHB is required to comply with it would give DHBs absolute protection from action under the Commerce Act.
- 4.9 In our view, the Minister should direct DHBs under section 32 to only confer PHO status on particular entities that fulfil certain minimum requirements. Similarly, we consider that, to protect DHBs, the Minister should, by written notice under section 33, require DHBs to arrange the provision of primary care services to “high need” populations.

Use of funding formula

- 4.10 We understand that DHBs will use a national funding formula to fund PHOs according to each PHO’s enrolled population, and that the Ministry (along with DHBs) will develop the formula taking into account factors such as age, gender, ethnicity, high user health card status, deprivation (high needs areas) and a health promotion variable.
- 4.11 In our view the development and application of a set funding formula by the Government, in consultation with DHBs, does not constitute engaging in trade for the purposes of the Commerce Act. It is a regulatory function – the funding formula will set the subsidy (formerly set by the Social Security Act) for the provision of primary health care services to the public.

Use of statutory instruments to compel DHBs to apply the funding formula

- 4.12 However, to bolster that position it would be appropriate to use one of the statutory instruments under the NZPHD Act for imposing obligations on DHBs, namely section 10 Crown funding agreements or the Minister’s power under section 32 to issue directions. DHBs’ discretion will be removed if the funding formula is either entrenched in a Crown funding agreement, or a direction is issued to the effect that DHBs must use the formula. DHBs would then be protected against action under the Commerce Act in respect of the development and application of the funding formula.

Summary – “in trade” question

- 4.13 Although we do not consider that the Minister, Ministry or DHBs are “engaging in trade” for the purposes of the Commerce Act in respect of the matters described in paragraph 4.4 (provided that the relevant statutory powers are exercised as outlined

above), DHBs' other actions will constitute engaging in trade and DHBs will be subject to the Commerce Act in respect of those actions.

Application of the Commerce Act to PHOs

- 4.14 PHOs will be subject to the Commerce Act, both in terms of their actions, the actions of their member practitioners, and their internal arrangements. PHOs themselves, not DHBs or the Ministry, are responsible for ensuring that PHOs comply with all relevant laws, including the Commerce Act.

Structure and rules of PHOs

- 4.15 While the Ministry/DHBs are not responsible for ensuring that PHOs comply with the Commerce Act, aside from those requirements covered by a section 10 agreement, section 32 direction or written notice under section 33, DHBs should not place requirements on PHOs that would require a PHO to engage in conduct that may contravene the Commerce Act.
- 4.16 Accordingly, it is important for DHBs to be aware of characteristics in the structure of a PHO that are likely to raise Commerce Act concerns. In our view, DHBs should not impose requirements of the following nature in relation to the structure and rules of PHOs:

- (a) *Exclusive membership* – i.e., a requirement that a PHO's member practitioners only to belong to that particular PHO and/or that member practitioners will not seek to contract individually with the DHBs for the provision of primary health care services. Although in most cases, exclusivity of this nature will not raise Commerce Act issues, PHOs with exclusivity requirements would be at risk where there are only a small number of PHOs in the area, or the PHO concerned has already established a substantial degree of market power. Commerce Act concerns would be exacerbated where PHO membership is for a mandatory, lengthy period or includes strong disincentives for member practitioners to withdraw from PHO membership;
- (b) *Restrictive membership criteria* – membership criteria that restrict entry other than for legitimate business reasons (for example, a legitimate restriction would be refusing membership to a provider because that provider does not have a good quality record);
- (c) *Information sharing* – information sharing is not *per se* illegal, but requiring PHOs to entrench certain information sharing between member practitioners may raise issues under sections 27 and 30 of the Commerce Act. Information sharing arrangements in respect of the following areas will be particularly susceptible to challenge under the Commerce Act:
- operating costs of member practitioners;
 - the price that an individual member practitioner will accept from the PHOs and/or DHB to provide primary care services;

- pricing of services provided outside the PHO structure, or to persons who are not enrolled with the particular PHO;
 - collateral arrangements with other providers – for example specialists, or other secondary care service providers (this is related to the exclusive dealing point discussed below);
 - prices that a member practitioner receives through any other PHO, or under a separate agreement in respect of the provision of primary care services.
- (d) *Restrictions on collateral agreements* – collateral arrangements that restrict PHOs to sourcing of goods/services from certain providers and/or preclude member practitioners from sending patients to other secondary care or specialist providers. Similarly, DHBs should not require referrals to only be within the particular PHO.
- 4.17 While the above characteristics do not, as a rule, necessarily raise Commerce Act issues, if they are imposed across all PHOs, some PHOs will be forced into a position where they have no choice but to breach one or more provisions of the Commerce Act.

Entering into contracts with PHOs

- 4.18 While we consider that the development and application of the funding formula, and certain minimum requirements associated with the PHO structure do not involve the Ministry or DHBs “engaging in trade”, common law has established that the decision to enter into a contract with a particular individual or entity is a commercial decision.³
- 4.19 When a DHB decides whether or not it will enter into a contract for the provision of primary care services with a PHO, or other individual entity, the DHB will be “engaging in trade” for the purposes of the Commerce Act. Accordingly the DHBs must comply with the Commerce Act. Because DHBs will be monopsony funders, section 36 is of particular relevance. Section 36 prohibits a person with a substantial degree of market power from taking advantage of that power to:
- (a) restrict the entry of a person into a market; or
 - (b) prevent or deter a person from engaging in competitive conduct in a market; or
 - (c) eliminate a person from a market.
- 4.20 DHBs can protect themselves from a successful challenge under section 36 by ensuring that, when they decide whether or not to enter into a contract with a PHO (or other entity/individual), that decision is based on:
- (a) quality of service;
 - (b) range of services able to be provided by the PHO or other entity;

³ *O’Leary v Health Funding Authority* (High Court, Wellington CP129/00, 6 June 2002 Chisholm J), *New Zealand Private Hospitals Association – Auckland Branch (Inc v Northern Regional Health Authority* (High Court, Auckland, CP440/94, 7 December 1994, Blanchard J)

- (c) efficiencies inherent in the structure of the particular PHO or other entity.
- 4.21 It is important to note that there is no *obligation* on DHBs to enter into a contract with a particular PHO, every PHO, or any PHO at all. A DHB is entitled to decide that it would prefer not to contract with a particular PHO because, for example, the DHB thinks it could get a better mix of services from another PHO, even though the effect of this decision is that the first PHO may not receive funding.
- 4.22 Accordingly, provided that DHBs make their contracting decisions on the above basis, it is unlikely that the decision to contract or not contract with a particular provider or PHO will be considered to be taking advantage of the DHB's market power.

Co-payments

- 4.23 The Ministry's draft PHO funding paper, states that "co-payment rates would not be dictated centrally. Instead, they would be agreed between the PHO and DHB for a fixed period of time and set out in the service agreement."⁴ Such co-payment levels would then, presumably, have to be carried through to the agreement between the PHO and a specific practitioner.
- 4.24 In our view, it would be preferable to specify a *maximum* co-payment level. The *Tru Tone*⁵ case establishes that specifying maximum price levels between two parties not in competition with each other is not *per se* illegal. In fact, the maximum price level in that case was considered to be pro-competitive because it would provide a check on retailers who had less competition-induced constraints and who would not otherwise pass on cost savings to customers. A key part of that decision was that the maximum price chosen, in the context of a highly competitive market, still preserved the ability of retailers to compete (vigorously) on price.
- 4.25 We consider that maximum co-payment levels would also preserve the ability of member practitioners to continue to compete on price, in addition to service quality and other factors. Such a provision would be unlikely to substantially lessen competition in the relevant market (primary care services).

Restrictions on DHBs contracting with other PHOs or providers

- 4.26 We presume that DHBs would not commit themselves to exclusively purchasing primary care services from one PHO and not contracting with practitioners/entities outside the PHO in question. However, depending on the market in question, Commerce Act issues may arise if a DHB entered into an exclusive contract with one PHO. This is because the effect of an exclusive contract, particularly if the contract is for a long period of time, is to act as a barrier to entry into the relevant market. We are happy to discuss this aspect further.

⁴ Page 6 of the Draft PHO funding paper dated 24 May 2002

⁵ *Tru Tone v Festival Records Retail Marketing Limited* [1988] 2 NZLR 352.

Long term and “Evergreen” contracts

- 4.27 Long term and evergreen contracts by themselves are not prohibited by the Commerce Act. However, when a long term contract has other restrictive elements that give rise to Commerce Act issues – for example, it has exclusivity provisions - then the long term is likely to increase the Commerce Commission’s concerns about those restrictive elements.

Geographical restrictions

- 4.28 We presume that, in a case where a PHO straddles the boundaries of two (or more) DHBs, DHBs would not wish to constrain a PHO from contracting with each DHB in whose region the PHO wished to provide services.
- 4.29 If a DHB wished to restrict the ability of a PHO to provide services within the DHB’s area (for example, if a DHB contracted with one PHO to provide services in the main metropolitan area and then restrict another PHO to suburban practice), this is unlikely to raise Commerce Act issues unless further restrictions are also imposed – for example, if the contract is also exclusive, and or for a long period of time. When coupled with these other factors, territorial restrictions may have the effect or likely effect of substantially lessening competition.

Other contractual provisions

- 4.30 As with the structure and rules of PHOs, when DHBs enter into contracts with PHOs, they should avoid imposing contractual conditions that would require PHOs to engage in conduct that may contravene the Commerce Act. To re-iterate, we consider, for the reasons outlined in paragraph 4.16, that DHBs should not impose contractual requirements of the following kind in relation to PHOs:

- (a) exclusive membership;
- (b) restrictive membership criteria;
- (c) information sharing – specifically, information sharing arrangements in respect of the following areas:
 - operating costs of member practitioners;
 - the price that an individual member practitioner will accept from the PHOs and/or DHB to provide primary care services;
 - pricing of services provided outside the PHO structure, or to persons who are not enrolled with the particular PHO;
 - collateral arrangements with other providers – for example specialists, or other secondary care service providers (this is related to the exclusive dealing point discussed below);

- prices that a member practitioner receives through any other PHO, or under a separate agreement in respect of the provision of primary care services.

(d) restrictions on collateral agreements.

Conclusion

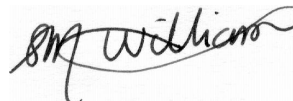
- 4.31 The Commerce Act is relevant to several aspects of establishing and contracting with PHOs. However, the exposure of the Ministry and/or DHBs to actions under the Commerce Act may be limited by use of the Minister's statutory powers in the NZPHD Act.
- 4.32 While PHOs themselves, not the Ministry or DHBs, are responsible for ensuring that PHOs comply with the Commerce Act, DHBs should not impose restrictions or requirements on PHO structure that would require PHOs to engage in conduct that may contravene the Commerce Act. Similarly DHBs should not require the inclusion of provisions in contracts with PHOs that would require DHBs to engage in conduct that may contravene the Commerce Act.
- 4.33 When a DHB determines whether or not to enter into a contract with a PHO, the DHB's actions will be subject to the Commerce Act. However, we consider that it is unlikely that DHBs would be subject to successful action under section 36 of the Commerce Act.
- 4.34 Co-payments, collateral contracting and geographical restrictions, and long term or evergreen contracts are other areas where Commerce Act issues may arise. However, we consider that DHBs can conduct themselves in a way that minimises any Commerce Act risk either to themselves or PHOs.
- 4.35 Please telephone us if you would like to discuss any of the above.

Yours sincerely



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