Cartel Criminalisation

Exposure Draft

Commerce (Cartels and Other Matters) Amendment Bill

Explanatory material

June 2011

MED1208086

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Information for submitters

Written submissions on the issues raised by the exposure draft Bill are invited from all interested parties. The closing date for submissions is Friday 22 July 2011.

Submissions should be sent to:

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It would be useful if submissions sent in hard copy or faxed were also provided in electronic form (Adobe Acrobat, Microsoft Word 2000 or compatible format).

Submissions will be considered by officials in preparation of advice to Ministers on the criminalisation of cartels and other matters.

Any queries should be directed to Abbe Hutchins, either at the above email address or by telephone at +64-4-462-4285.

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Supporting material

The exposure draft Bill and supporting material are provided for the purposes of obtaining submissions on the policy positions, the design and the drafting of the Bill. Submissions are sought both on design features that represent an improvement to the regime currently set out in the Commerce Act and on features that are likely to raise new issues. The supporting material includes:

- this explanatory material;
- the draft Regulatory Impact Statement; and
- the draft guidelines for immunity.

The draft guidelines for immunity have been developed by the Solicitor-General and the Commerce Commission. If a criminal regime is adopted, the draft guidelines would be an integral part of the regime because leniency is an important tool in the detection of cartels. Under the guidelines, cartel participants may be granted immunity from prosecution in exchange for co-operating with the investigation. The draft guidelines have been provided for the purposes of detailing how the leniency regime might work in a criminal context and to inform comment on the design of the regime more generally. Comment is not sought on the draft guidelines themselves.

1. Background

1. In January 2010, the Minister of Commerce released a discussion document and sought feedback on whether New Zealand should criminalise hard-core cartel conduct.

2. Feedback on the discussion document raised concerns that it would be difficult to express in legislation what constitutes hard-core cartel conduct. If ill-defined, criminal sanctions, may:

    - deter pro-competitive behaviour because people would be more risk averse if there was uncertainty around the scope of the prohibition or exemptions; and

    - increase the costs of doing business because people would be more likely to seek specialist advice where there is a risk that the activity they are considering engaging in may be in breach, they could be personally liable, and if liable, would be subject to criminal sanctions.

3. In response to concerns, an exposure draft Bill has been developed to test whether it is possible to define with sufficient clarity the prohibition and exemptions, such that any downsides of criminalisation are remedied or at least mitigated.

4. The exposure draft Bill, the draft Regulatory Impact Statement, the draft guidelines for immunity and this explanatory material are provided for the purposes of obtaining submissions on the policy positions, the design of the regime and the drafting of the Bill. Submissions are sought both on design features that represent an improvement to the regime currently set out in the Commerce Act and on features that are likely to raise new issues.

5. The draft guidelines for immunity have been developed by the Solicitor-General and the Commerce Commission. If a criminal regime is adopted, the draft guidelines would be an integral part of the regime because leniency is an important tool in the detection of cartels. Under the guidelines, cartel participants may be granted immunity from prosecution in exchange for co-operating with the investigation. The draft guidelines have been provided for the purposes of detailing how the leniency regime might work in a criminal context and to inform comment on the design of the regime more generally. Comment is not sought on the draft guidelines themselves.

6. The purpose of this material is to explain:

    - the key policy positions that underpin the exposure draft Bill; and

    - the reasons why a particular approach has been adopted either in the design of the regime or the drafting of the Bill.

7. Cabinet has yet to make a final decision on whether or not to criminalise hard-core cartel conduct. Consequently, final decisions have not been made on either the design of the regime or the drafting.

8. In order to test whether it is possible to define with sufficient clarity the prohibition and exemptions, the exposure draft Bill presumes that a criminal regime will be adopted, however, there are a number of design decisions that follow. These include decisions on:

- whether the criminal offence and civil prohibition should be parallel or distinguished;
- whether the decision to bring a criminal prosecution should be left solely to prosecutorial discretion or be fettered by factors set out in legislation;
- whether the per se prohibition should define the form of the conduct that is illegal (fixing prices, restricting output, allocating markets and rigging bids), or the outcome (the effect on price);
- whether the exemption should focus on the substance of the collaboration or define acceptable forms (strategic alliance, joint venture, bidding consortia);
- whether to provide a clearance regime; and
- if a clearance regime is provided, how that regime should be structured.

9. The remainder of this material explains the design decisions.

2. Parallel criminal offence and civil prohibition

10. At this stage, the exposure draft Bill provides for a parallel criminal offence and civil prohibition. The only distinguishing feature of the criminal regime is that the criminal offence requires knowledge, at the time the person enters into or gives effect to a contract, arrangement or understanding, that the provision is a cartel provision.

11. In terms of the legislative drafting, the parallel criminal offence and civil prohibition are given effect to by:

    - section 30, which sets out the prohibition;
    - section 80, which provides for liability for a pecuniary penalty; and
    - section 82B, which provides for criminal liability.

12. Section 82B sets out the additional elements needed to prove the offence and the criminal penalty regime. For bodies corporate, the maximum penalty is the same as the maximum civil pecuniary penalty. For individuals, the maximum penalty is a term of imprisonment not exceeding seven years.

13. An alternative approach considered was to differentiate between the criminal offence and the civil prohibition so that the criminal offence only applies to 'serious' hard-core cartel conduct. Australian competition specialists, Brent Fisse and Caron Beaton-Wells, discuss ways to distinguish in their text *Australian Cartel Regulation*.[1] Their suggestions include:

    - providing an additional fault element or elements in the offence[2];
    - narrowing the definition of a cartel provision for the purposes of criminal liability;
    - providing for different penalties and a higher maximum fine for offences; and
    - changing the names given to the criminal and civil prohibitions to reflect the seriousness of committing a criminal offence.

[1] Beaton-Wells, C, Fisse, B, *Australian Cartel Regulation: Law, policy and practice in an international context,* Cambridge University Press, Melbourne, 2011, p 27-34.

[2] This is the approach taken in the UK where the offence includes a dishonesty element. To date the UK Office of Fair Trading has not brought a successful criminal prosecution and currently the UK is considering whether to reformulate the offence. One of the options being considered is introducing the element of secrecy.

14. Creating a bright line between conduct which is legal and illegal was a strong consideration in the design of the offence in the exposure draft Bill because it would give businesses greater certainty. However, there does not appear to be the same need to clearly distinguish between conduct that should be subject to criminal sanctions and conduct that should be subject to civil sanctions. It is not critical for those engaging in illegal activity to know with any degree of precision the exact penalty if they are successfully prosecuted. It would also be potentially confusing to have different types of cartel behaviour, some of which attract civil liability and some criminal. The exposure draft Bill distinguishes using the additional fault element of knowledge. This seems appropriate because deliberate conduct is more culpable than conduct that is engaged in unwittingly.

15. Having a parallel criminal offence and civil prohibition is the same as the approach taken in other jurisdictions, including Australia. It is also the approach in a number of other areas of law, such as the Securities Markets Act. Currently there do not appear to be strong reasons for departing from the Australian approach especially if the scope of the prohibitions and exemptions are aligned so as to minimise any risk of overreach.

2.1 Prosecutorial discretion

16. One consequence of having a parallel criminal offence and civil prohibition is that the decision on whether or not to bring a criminal prosecution or a civil proceeding would be left solely to prosecutorial discretion and would not be fettered by factors set out in legislation.

17. Following the approach in Australia, guidelines would be developed by the Commerce Commission to give greater clarity on the circumstances where the Commission would pursue criminal prosecution, and when proceedings would be commenced civilly. In Australia, under the ACCC prosecution guidelines, cartels are only criminally prosecuted if:

    - they are longstanding;
    - they caused, or had the potential to cause, a significant impact on the market or damage to consumers;
    - participants were previously involved in cartels; and/or
    - the value of affected commerce exceeds $1 million in a year.

18. Other factors could include deliberateness or secrecy. In Australia, the list is not exhaustive; the factors are considered holistically and no single factor is determinative.

19. These factors could be prescribed in the legislation, however, the factors may create strong incentives for parties to dispute the scale of the harm caused or the size of the relevant market. This would require detailed economic evidence and only serve to increase costs and delay trial without any gain in certainty for the accused.

2.2 Specialist prosecution panel

20. The exposure draft Bill does not specifically provide for a specialist prosecution panel because usually the Crown determines how prosecution functions are to be carried out administratively. At this stage, it is intended that the Commission would commence proceedings by laying an information. The case would then be referred to a member of the specialist cartel prosecution panel, to be established by the Solicitor-General.

3. Design of the Prohibition and Exemptions

21. Compared to the current prohibition and exemptions, the exposure draft Bill takes a different approach to defining hard-core cartel conduct. The prohibition is still a per se offence but defines the form of the conduct that is illegal, not the outcome. In contrast to the joint venture exemption, the collaborative activity exemption is a broad principle-based exemption that seeks to ensure that all collaborative activity, regardless of form, is exempt provided it is reasonably necessary for the purpose of the collaborative activity and the collaborative activity does not have the dominant purpose of lessening competition.

3.1 Per se prohibition

22. Per se prohibitions prohibit certain types of conduct, without any assessment of the impact of that conduct on competition. Per se rules provide greater certainty and predictability for businesses and avoid courts having to undertake detailed inquiries into the economic effects of a practice. Section 30 of the Commerce Act is a per se prohibition because it deems certain types of agreement to substantially lessen competition.

23. The exposure draft Bill retains a per se prohibition, however, it no longer uses a deeming provision. Instead the prohibition is separate from and additional to the rule of reason prohibition in section 27, which assesses the competitive effects of the agreement.

3.2 Form based prohibition

24. There are two broad approaches to defining cartel conduct. One is to consider the form of the conduct, in other words price fixing, output restrictions, market allocation and bid-rigging. The other is to consider the outcome; the effect on price.

25. The exposure draft Bill takes a form based approach. It clarifies that the prohibition should apply to all four categories of cartel conduct. It does this by proscribing the purpose of the conduct rather than by reference to its effects or likely effects, although inevitably both are likely to be relevant in any prosecution. This approach gives greater certainty as to the type of conduct that is prohibited. However, it places greater reliance on the exemptions to exclude pro-competitive conduct.

26. An outcome or effects based approach was considered, however, there are a number of problems with such an approach, especially when it is used in the criminal context. Most significantly, defining hard-core cartel conduct by reference to effects would require economic evidence that market allocation, bid rigging and output restrictions affect price. This would make trials considerably more complex. This approach would also concentrate the criminal prohibition on the effects of the perpetrator's behaviour rather than the behaviour itself, when most criminal prohibitions concentrate on the behaviour rather than its effects.

3.3 Principle based exemption for collaborative activity

27. Per se prohibitions sometimes capture pro-competitive or competitively neutral conduct. To remedy this, the exposure draft Bill relies on a broad principle-based exemption to ensure that all pro-competitive arrangements would be exempt,

irrespective of their form. The breadth of the exemption should create greater certainty for businesses that are proposing to enter into collaborative, efficiency enhancing agreements.

28. Consideration was also given to whether it would be possible to supplement the exemption by identifying specific features of agreements that would always be exempt. Given the difficulty in defining these features, at this stage guidelines may be a better way of providing businesses with additional certainty.

29. Arguably the form based prohibition in the exposure draft Bill broadens the scope of the prohibition relative to that currently set out in the Commerce Act. However, this is offset by ensuring that the exemptions are similarly broad. The net result should be that the same conduct - hard-core cartel conduct - would be caught under both the current regime and the new regime. The advantage of the new regime is that it would be clear that legitimate pro-competitive activities are not prohibited, giving businesses greater certainty prior to entering into commercial arrangements.

3.4 Key elements of the prohibition

30. In terms of drafting, where possible the exposure draft Bill seeks to use concepts that already have an established meaning in the Commerce Act. Where this is not sufficient, the exposure draft Bill draws on concepts used in Australia. The intention is that courts and practitioners will be able to make use of existing jurisprudence and Australian jurisprudence.

31. The prohibition has a number of key elements. These are explained below.

3.4.1 Cartel provision

32. The exposure draft Bill implements the OECD recommendations[3] by describing the form of conduct that is prohibited. In terms of the legislative drafting, this is achieved in section 30A, which defines a cartel provision to be a provision that has the purpose of:

- fixing prices;
- restricting output;
- market allocating; or
- rigging bids.

33. Each purpose is then further defined in subsections 30A(2) to (5).

34. The cartel provision may have more than one purpose and the purposes may overlap. For example, a provision that has the purpose of restricting output may also

[3] OECD, *Recommendation of the Council concerning Effective Action Against Hard-core Cartels*, 25 March 1998. The Recommendation defined a hard-core cartel as an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce.

have the purpose of fixing prices. Furthermore, the prohibited conduct is intended to be symmetrical in that each form should apply to both the acquisition and supply of goods or services.

35. In relation to price fixing, two issues are worth noting:

- Firstly, section 30A(2)(b) prohibits the fixing of a discount, allowance, rebate or credit, however, it is questionable whether this prohibition is needed. Section 2(1) defines price broadly as including "valuable consideration in any form, whether direct or indirect". The definition of price appears to include a discount, allowance, rebate or credit. Nevertheless, the phrase has been retained because it is used in the Australian prohibition; and because deletion may signal a deliberate change rather than simplifying the drafting. This would not be the intention.

- Secondly, section 30A(2) does not explicitly provide for resupply because the definition of supply in section 2 is broad and includes resupply.

3.4.2 Enter into or give effect to

36. Section 27 prohibits both the entering into a contract, arrangement or arriving at an understanding, and the giving effect to. In the same way, the prohibition against hard-core cartel conduct in the exposure draft Bill also prohibits both (section 30(1)(a) and (b)).

37. The persons that give effect to the contract, arrangement or understanding are not necessarily the parties that enter into it. Parties to an agreement can change over time, additional parties can join at a later date and an agreement can be suspended and subsequently re-implemented. To be effective the prohibition needs to deter both people that enter into and people that give effect to the contract, arrangement or understanding.

3.4.3 With a competitor

38. The prohibition in the exposure draft Bill only applies to horizontal conduct between competitors, or persons who, but for the agreement, would be competitors. Vertical conduct between entities in different parts of the supply chain can be pro-competitive and should not be prohibited.

39. This is given effect to in the definition of a cartel provision in section 30A and 30B(2) of the exposure draft Bill. The Bill ensures that the prohibited conduct (the fixing, restricting, allocating or rigging) relates to the goods or services, that all or any of the parties, are competing, or would be competing, to supply or acquire.

40. More specifically:

- The prices that are fixed must relate to goods or services that are supplied or acquired by all or any of the parties in competition with each other.

- The production, capacity or supply that is restricted must relate to goods or services that are supplied or acquired by all or any of the parties in competition with each other.

- The market that is allocated must relate to the market in which all or any of the parties would have been in competition to supply or acquire goods or services but for the market allocation agreement.

- It goes without saying, but the bids that are rigged must relate to the same tender process, in which all or any of the parties would have been in competition to supply or acquire the goods or services but for the bid rigging agreement.

41. Section 30B of the exposure draft Bill ensures that interconnected bodies corporate are caught by the prohibition. This means that where a business is vertically integrated, the person who entered into the agreement that contained the cartel provision could not rely on the fact that competition occurred at another functional level to avoid liability.

3.4.4 Purpose

42. The prohibition focuses on the purpose of the provision to avoid the need to consider the economic effect. This should provide greater certainty to businesses that are proposing to enter into collaborative agreements. Nevertheless, the purpose of a provision will generally be inferred from the wider circumstances, including the effect or likely effect.

43. This approach is similar to that taken in the prohibition on exclusionary provisions in section 29. A provision is an exclusionary provision if, among other things, it has the purpose of preventing, restricting or limiting the supply or acquisition of goods or services. There is limited jurisprudence on the meaning of purpose in the context of section 29 and it seems to follow judicial consideration of purpose in the context of purpose, effect or likely effect in section 27. The courts have interpreted purpose to have both objective and subjective elements: it is primarily measured using an objective assessment but subjective evidence is also relevant to the assessment.[4]

3.4.5 Overlap with section 29

44. One consequence of the proposed changes to the prohibition is that some conduct that was prohibited under section 29 would also be prohibited under section 30. This is because conduct that has the purpose of restricting output or allocating markets will usually also have an exclusionary purpose.

45. Currently the exposure draft Bill retains section 29 to ensure that all exclusionary provisions continue to be prohibited under a hybrid per se/rule of reason provision. An alternative would be to repeal section 29 and where the scope of section 30 is too narrow to prohibit exclusionary provisions, rely on the rule of reason prohibition in section 27.

3.5 Exemption for collaborative activity

46. In developing the exposure draft Bill both an ancillary restraints defence and joint venture defence have been considered. However, subsequent to the Cabinet Paper

[4] *ANZCO Foods Waitara Ltd v Affco NZ Ltd* [2006] 3 NZLR 351 at [142] and [255].

a third option of an exemption for collaborative activity has been developed and adopted for the purposes of the exposure draft Bill. It is intended to be sufficiently broad to cover both joint ventures and ancillary restraints.

47. The exemption for collaborative activity focuses on substance over form. It asks whether there is a legitimate collaborative purpose (i.e. that the activity does not have a dominant purpose that is anticompetitive) and whether the cartel provision is reasonably necessary to achieve that purpose.

48. The exemption is given effect to in the exposure draft Bill in section 31. A person would not contravene section 30(1) if the cartel provision is reasonably necessary for a collaborative activity. A collaborative activity is defined as an enterprise, venture or other activity, in trade, that:

- is carried on by two or more persons in cooperation; and
- is not carried on for the dominant purpose of lessening competition.[5]

49. The exemption has a number of advantages:

a. Unlike the joint venture exemption, there is no requirement that the activity be carried on jointly. This ensures that it applies to activities that enhance consumer welfare such as consortia bidding and syndicated loans. Both of these examples represent activities that are carried on in collaboration but may be structured so that parties have separate rights and obligations in respect of the activity.

b. It would not require examination of what constitutes a joint venture. Having further considered the US position and a number of other jurisdictions, it appears to be extremely difficult to define a joint venture because legitimate collaborative activity can take a variety of forms, ranging from strategic alliances to resource pooling.

c. Unlike the ancillary restraints defence, there is no confusion over its scope. In the US the term ancillary restraint is used in two slightly different ways. In one sense, an ancillary restraint is contrasted with a naked restraint. A naked restraint has no purpose other than stifling competition but an ancillary restraint is a component of a joint venture, in that it is necessary to achieve the collaborative objectives of the joint venture. In the second sense, ancillary restraint is applied to restraints that are collateral to the joint venture, such as restraints between the parents to the joint venture. The different interpretations raise uncertainty over whether an ancillary restraints defence is sufficiently broad to be capable of exempting joint ventures and there is a risk that courts could interpret the exemption too narrowly.

d. The exemption for collaborative activity is intended to make it clear that the Act encourages pro-competitive, innovative and efficiency enhancing activities.

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[5] Australian competition law and policy specialists, Brent Fisse and Caron Beaton-Wells advocate for a similar exemption in the *Competition and Consumer Act 2010 (Cth)* in their book *Australian Cartel Regulation: Law, policy and practice in an international context* Cambridge University Press, Melbourne, 2011, at pages 292-295.

3.6 Key elements of the collaborative activity exemption

3.6.1 Reasonably necessary

50. The requirement in section 31(1) that the cartel provision be reasonably necessary was developed from the Federal Trade Commission and US Department of Justice *Antitrust Guidelines for Collaborations Among Competitors*. The guidelines provide:

> "An agreement may be "reasonably necessary" without being essential. However, if the participants could achieve an equivalent or comparable efficiency-enhancing integration through practical, significantly less restrictive means, then the Agencies conclude that the agreement is not reasonably necessary. In making this assessment, except in unusual circumstances, the Agencies consider whether practical, significantly less restrictive means were reasonably available when the agreement was entered into, but do not search for a theoretically less restrictive alternative that was not practical given the business realties."[6]

51. In contrast with the approach in the US Guidelines, the exemption for collaborative activity does not require efficiency enhancing integration. The Cabinet Paper proposed the adoption of a joint venture exemption with the term joint venture being defined in economic terms, requiring the substantial integration of parties' resources, with the prospect of efficiency gains. On further reflection this raises a number of questions, including how to assess whether there is sufficient integration, which is particularly problematic in cases such as consortia bidding or syndicated loan arrangements where integration may not be necessary to achieve benefits. Flexibility to deal with these arrangements appears to be built into the US Guidelines but is more difficult to provide for in a statutory test.

3.6.2 Not carried on for the dominant purpose of lessening competition

52. In developing the exemption for collaborative activity care has been given to ensuring that the exemption does not undermine the benefits of a per se prohibition. The exposure draft Bill requires that the dominant purpose of the collaborative activity not be to lessen competition. In contrast to section 29, the focus is on the purpose of the provision rather than on the purpose, effect or likely effect. As a result, the exemption should retain the benefits of the per se approach to the prohibition because it does not require an assessment of the competitive effects.

53. To distinguish between legitimate and illegitimate purposes, the exposure draft Bill provides that any purpose is okay provided it is not an anticompetitive purpose. In considering the purpose element, two other options were also considered, that the purpose not be:

- A cartel purpose – this approach links to the cartel prohibition and as a result does not undermine the advantages of a per se approach.

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[6] Federal Trade Commission and US Department of Justice, *Antitrust Guidelines for Collaborations Among Competitors,* April 2000, p 9.

- An anticompetitive or otherwise unlawful purpose – unlawful purpose was considered as a possible additional limb to the test. It would ensure that a collaborative activity could not be a front for unlawful activity. However, including an unlawful purpose would mean that competition law could be used as a basis for prosecuting unlawful conduct that has no bearing on competition. Instead such conduct should be prosecuted using the offence provision that makes that particular conduct unlawful.

54. A provision could have more than one purpose so consideration should be given to whether the purpose is a 'purpose', a 'substantial purpose' or a 'dominant purpose'. Dominant purpose best gives effect to the objective of the exemption, in that it ensures the exemption is broad.

55. Similarly the dominant purpose could be to lessen competition or substantially lessen competition. Lessening competition was considered appropriate because the threshold of substantially lessening competition would result in debate over whether the purpose was to lessen competition or to substantially lessening competition. This would allow incompetent cartelists to argue that they should be exempt because while they intended to form a cartel, given the market circumstances, the cartel was always going to be ineffective and therefore the provision could not have had the dominant purpose of substantially lessening competition.

56. All of these considerations are reflected in the drafting of section 31(2)(b).

3.7 Other exemptions

3.7.1 Notified arrangements between bidders

57. Section 32 provides that if a bid is made in circumstances where the person running the bid is notified that the parties intend to form a consortium then the parties would not contravene the prohibition against hard-core cartel conduct.

58. This exemption recognises that there can be pro-competitive collaboration between bidders in a bidding process. Vendors with complementary assets can form consortia to bid, or offer each other mutual discounts for the purposes of separate tenders. Bid rigging is an area where secrecy can be a useful dividing line between pro and anticompetitive behaviour. The exemption requires the parties to make any arrangement known to the person running the bid process. This is because it is the person running the bid process who is likely to suffer loss as a result of the anticompetitive behaviour.

3.7.2 Price recommendations

59. Clause 6 of the exposure draft Bill repeals section 32. Currently section 32 exempts agreements of more than 50 people from the price fixing prohibition. It is intended to allow trade associations to make price recommendations. However, the exemption in section 32 only applies to the extent that the provision recommends a price and the adoption of the recommendation is discretionary. Where the recommendation is

enforced the exemption would no longer apply. There is little economic justification for this exemption and the OECD has specifically recommended it be repealed.[7]

3.7.3 Joint buying

60. Clause 6 of the exposure draft Bill proposes that the joint buying exemption apply to the new cartel prohibitions, but that it is amended to remove the uncertainty about the scope of 'collectively acquired'. More specifically section 33(c) ensures that where there is a collective negotiation of the price for goods or services, followed by individual purchasing at the collectively negotiated price, the joint buying agreement does not contravene the prohibition against hard-core cartels.

61. This reflects that joint buying and promotion agreements can have beneficial effects if the savings achieved through joint buying are passed on to consumers. It can also promote competition by permitting small traders to combine their purchases and thereby to compete more effectively against larger competitors.

3.7.4 Vertical supply agreements

62. The exposure draft Bill defines a competitor broadly to include interconnected bodies corporate. As a result, the per se prohibition may apply to vertical supply agreements because they inevitably involve price setting and non-price restrictions. Vertical supply agreements are commonplace and are generally considered to enhance consumer welfare. Currently the exposure draft Bill follows the Australian approach in that it does not provide a specific exemption for vertical supply agreements, however, a specific exemption may be necessary if the exemption for collaborative activity does not capture these agreements.

3.7.5 Covenants

63. The exposure draft Bill does not amend section 34 of the Commerce Act, which sets out a per se prohibition in relation to covenants. In Australia, covenants are regulated under a rule of reason prohibition not a per se prohibition and consequently covenants are not subject to criminal sanctions. The approach adopted in Australia therefore raises a question over whether a provision is a provision of a covenant or a contract, arrangement or understanding. The Competition and Consumer Act deals with this issue by exempting a cartel provision from the per se prohibition in so far as it constitutes a covenant to which the rule of reason prohibition would apply.

3.7.6 Relying on the exemptions as a defence

64. In criminal proceedings, where a person wishes to rely on one of the exemptions as a defence, that person must notify the prosecution of their intention to rely on the exemption and provide sufficient particulars to enable the prosecution to investigate and verify those particulars.

65. In respect of both the civil proceedings and the criminal prosecution, the defendant must prove on the balance of probabilities that the exemptions apply. The departure

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[7] OECD, *Product Market Competition and Economic Performance in New Zealand,* Economics Department working Papers No. 437, Annabelle Mourougane and Michael Wise ECO/WKP (2005) 24.

from the ordinary burden of proof on the prosecution in criminal cases seems justified because the exemption involves complex arrangements which are within the peculiar business knowledge of the defendant.

4. Managing residual risk through the clearance regime

66. The exposure draft Bill seeks to increase certainty by clarifying the scope of the prohibition and exemption. Nevertheless, to help businesses manage any residual risk, the Bill also introduces a clearance regime for contracts, arrangements or understandings that contain a cartel provision.

4.1 Effect of a clearance

67. Clearance provides confirmation that the collaborative activity is okay, in that it would not contravene the per se prohibition and it would not substantially lessen competition. Section 65B of the exposure draft Bill provides that the effect of clearance is that the applicant and any party to the contract, arrangement or understanding to which the clearance relates cannot be prosecuted under sections 27, 29 and 30 for entering into or giving effect to the contract, arrangement or understanding.

68. Other options considered included only providing clearance for the cartel provision and only in respect of section 30. This would limit the number of applications considered by the Commission. To some extent a clearance regime transfers the costs of assessing risk to the Commission, when the onus should be on businesses to comply with the law on an ongoing basis.

69. Limiting the clearance regime to clearance of the cartel provision would have limited the value of the clearance regime because even though businesses would have increased certainty that the collaborative activity would not be per se illegal and would not be criminally prosecuted, there would still be a residual risk that the collaborative activity might substantially lessen competition.

70. Given the broad scope of the clearance regime in the exposure draft Bill, further consideration will need to be given as to how the clearance regime should be funded.

4.2 Key elements of the clearance regime

71. Where possible, the exposure draft Bill adopts the framework for merger clearances. Key features of the regime include:

- It is prospective, in that applicants must not have already entered into the contract, arrangement or understanding that contains a cartel provision and for which they are seeking clearance (section 65A(1)).
- The contract, arrangement or understanding must contain a cartel provision (section 65A(1)).
- The applicant will not be required to prove it is a cartel provision, rather the applicant must show they have reasonable grounds for believing it is (section 65A(3)).
- The same procedural requirements apply as apply under section 66(2) (section 65C).

- There are two limbs to the clearance test; the Commission must be satisfied that:

    a. the cartel provision is reasonably necessary for the purposes of a collaborative activity (section 65A(2)(a)); and

    b. the collaborative activity would not have, or would not be likely to have, the effect of substantially lessening competition in a market (section 65A(2)(b)).

- The Commission will be able to revoke a clearance (section 65D).

4.2.1 The clearance test

72. The first limb relates to the collaborative activity exemption in section 31 and allows a person to apply to the Commission to seek confirmation that the activity is a collaborative activity. For the most part, it is envisaged that this would be a straightforward process whereby the applicant would set out the scope of the collaborative activity in the application for clearance and justify why the cartel provision is reasonably necessary. The Commission's role would be to verify the elements of the application.

73. A straightforward verification exercise is appropriate for the first limb because the second limb of the clearance test contains the substantive competition test. It examines the fundamental issue – the likely competitive effect of the collaborative activity. This test aligns with the merger clearance test in section 66 of the Commerce Act.

74. The collaborative activity may comprise one or more agreements. The Commission would be required to assess the competitive effects of the overall collaborative activity as defined in the clearance application.

4.2.2 The power to revoke

75. Section 65D of the exposure draft Bill provides the Commission with the power to revoke a clearance where it is satisfied that the clearance was given on information that was false or misleading in a material particular; or there has been a material change of circumstances since the clearance was given. The drafting is based on the power to revoke authorisations in section 65.

76. Unlike merger clearances, which involve a one off event and consequently expire under section 66(5), clearances for collaborative activity continue indefinitely or until the collaboration is terminated by its own specific and express terms. As a result, there is a risk that if circumstances change it may become necessary for the Commission to revoke the clearance, in the same way that it can revoke an authorisation.

4.2.3 Transitional clearance regime

77. In developing the clearance regime in the exposure draft Bill, consideration was given to providing a transitional regime so that all contracts, arrangements and understandings entered into before the criminal regime came into force could obtain clearance. At this stage, the exposure draft Bill only provides a clearance regime for

those contracts, arrangements or understandings that will be entered into in the six months before the regime comes into force.

78. Although the prohibition and exemption in the exposure draft Bill takes a different approach, in that the prohibition focuses on form not the outcome, and the exemption is a broad exemption that focuses on the substance of the collaborative activity, the net effect should be that the same conduct – hard-core cartel conduct – should be prohibited under both the old section 30 and the new section 30.

5. Other matters

5.1 Jurisdiction

79. Developments in communications and transport have had a considerable effect on the New Zealand economy as a significant volume of commerce is now conducted across borders. As a result, anticompetitive conduct that occurs overseas can have harmful economic effects in New Zealand irrespective of where the agreement is reached.

80. Currently jurisdiction for enforcing cartel conduct is limited to:

- Conduct in New Zealand, including conduct by a person who is not resident or carrying on business in New Zealand.[8]

- Conduct outside of New Zealand, which affects a market in New Zealand, if it is carried on by persons who are resident or carrying on business in New Zealand.

81. The jurisdiction requirements mean that individuals or corporate entities may enter into anticompetitive agreements overseas directed at a New Zealand market and can avoid the jurisdiction of the Commerce Act by operating through local entities and taking care not to hold meetings in, or to send communications to, New Zealand.

82. Currently, the Crimes Act 1961 extends jurisdiction for criminal conspiracies by providing that where any act or omission forming part of an offence, or any event necessary to the completion of any offence, occurs in New Zealand, the offence shall be deemed to be committed in New Zealand, whether the person charged with the offence was in New Zealand or not at the time of the act, omission or event. The statutory authority to extend jurisdiction is complemented by a series of treaties relating to extradition. This enables New Zealand to give practical effect to the expanded jurisdiction.

83. There are a number of issues with extending jurisdiction to civil contraventions. Firstly, as raised by the Supreme Court in *Poynter*, the question of complying with principles of international comity and respect for the sovereignty of foreign states in the regulation of conduct occurring within their territory.[9] Secondly, New Zealand would require arrangements to be in place that would enable enforcement of civil sanctions.

84. The New Zealand government is already active in developing trade relationships with other governments and encouraging relationships between competition regulators. Where international arrangements are in place it may be appropriate to extend jurisdiction on a case by case basis. An example of this is Australia, where the New Zealand and Australian Governments agreed to implement a statutory regime that would streamline the process for resolving civil proceedings with a trans-Tasman element and minimise existing impediments to enforcing certain judgments and

[8] Under the Act a corporation outside of New Zealand may be attributed the conduct of its directors, servants or agents in New Zealand.

[9] *Poynter v Commerce Commission [2010] NZSC 38,* at para [30].

regulatory sanctions. This agreement will be given effect to in New Zealand by the Trans-Tasman Proceedings Act 2010 and accompanying regulations that are yet to come into force.

85. In addition, the Government is open to ways of clarifying the law so that persons are not able to circumvent the jurisdiction set out in the Act. One option might be to clarify the concept of 'carrying on business' in section 4 of the Act. In both Australia and New Zealand, an overseas person does not need to have a place of business in the jurisdiction to be found to be carrying on business in the relevant country. An overseas person can be carrying on business through an agent acting on their behalf. However, where business is carried on by a local subsidiary of an overseas person, the relationship between the overseas person and the subsidiary will be important in determining whether the overseas person is carrying on business.

86. Currently, the scope of the New Zealand jurisdiction provision is wider than that in Australia. In Australia, the analogous provision only extends jurisdiction to bodies corporate incorporated in or carrying on business in Australia or to Australian citizens or persons ordinarily resident in Australia. It does not extend to individuals. This is not the case in New Zealand and the drafting could make it clear that individuals could also carry on business in New Zealand provided there was causality between the actions of the individual and the affect on a market in New Zealand.

5.2 Acquisitions by overseas persons

87. The exposure draft Bill repeals subsection 4(3) because is overly broad and even though it asserts jurisdiction over international mergers that affect a market in New Zealand, depending on the circumstances, currently there may be no way of enforcing any finding against an overseas person. Irrespective of the jurisdiction asserted in section 4(3), each year a number of multinationals voluntarily seek clearance for their mergers from the Commerce Commission. One of their reasons for doing this is to ensure they are perceived as law abiding global citizens even though the Commission might not have recourse against them if the merger resulted in a substantial lessening of competition in New Zealand.

88. In Australia, section 50(A) of the Competition and Consumer Act 2010 provides a mechanism to encourage overseas persons to comply with the Act. Section 50(A) applies where an international merger results in a party obtaining a controlling interest in a body corporate carrying on business in Australia. If the acquisition occurs outside Australia and it is likely to result in a substantial lessening of competition in a market in Australia, application can be made for a declaration to that effect. Once a declaration has been made, the party has six months to remedy the situation and if it is not remedied, the party is not permitted to continue to carry on business in Australia.

89. Section 50(A) is primarily an anti avoidance measure and has never been used.

90. This mechanism would encourage overseas persons to apply for clearance by allowing remedies to be imposed on the New Zealand based business but only where the overseas company has a controlling interest in the New Zealand based company.

91. Sections 47A to 47D of the exposure draft Bill set out the declaration mechanism. Section 47A is loosely based on the section 50A of the Competition and Consumer

Act but recognises the differences in the clearance and authorisation processes in New Zealand.

92. More specifically, section 47A deliberately departs from section 47 of the Commerce Act because it only applies where the overseas person acquires a controlling interest in a New Zealand company. Under section 47(2) a reference to a person includes persons that are interconnected or associated. This is because controlling interest sets a higher threshold for intervention, which is appropriate given that the intention of the regime is to encourage persons to apply for clearance so that any competition concerns can be managed to the satisfaction of the Commission. It is not to unreasonably interfere with off-shore, usually multinational, transactions.

93. Section 47B provides that a New Zealand company that is the subject of a declaration made under section 47A must cease carrying on business in New Zealand in the market to which the declaration relates. An order to cease to carry on business is highly interventionist, however, the ability to revoke the declaration under section 47D ensures that negotiated settlements could be achieved.

5.3 Attributing conduct

94. The intention of clause 23 of the exposure draft Bill is to amend section 90 to attribute conduct carried out on behalf of a person, to that person, if the conduct is carried out at the direction of that person. It is intended to clarify that conduct that takes place inside New Zealand can still be attributed to persons outside New Zealand in circumstances where the person outside New Zealand is directing the conduct inside New Zealand.

5.4 Lay members

95. As set out above, the exposure draft Bill no longer uses a deeming provision. This means that lay members would no longer be available for price fixing cases under section 78 of the Commerce Act. In jury trials the role of the judge is principally to direct the jury on questions of law. It is for the jury to determine questions of fact. This is also the role of a lay member who is appointed under section 78. For consistency, the intention is that civil proceedings also be heard by judge alone.