

Submission

By



to

MED

on the

Draft Commerce (Cartels & Other Matters) Amendment Bill

22 July 2011

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**DRAFT COMMERCE (CARTELS & OTHER MATTERS) AMENDMENT BILL
SUBMISSION BY BUSINESSNZ¹
22 JULY 2011**

1. INTRODUCTION

- 1.1 BusinessNZ welcomes the opportunity to comment on the draft Commerce (Cartels & Other Matters) Amendment Bill (referred to as 'the Bill').
- 1.2 While we strongly support the Government's decision to consult on the Bill before it is introduced to Parliament to ensure it adequately supports pro-competitive business arrangements, we remain unconvinced of the need to apply criminal sanctions to conduct deemed to be in the nature of a cartel.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 BusinessNZ does **not support** the:
- a) Criminalisation of hard core cartels (p.6);
 - b) Proposed changes to the penalties regime (p.8);

BusinessNZ **supports** the:

- c) Revised definition of hard-core cartel conduct (p.7);
- d) Proposed collaborative activity exemption (p.7);
- e) Establishment of a clearance regime for collaborative activities (p.7);

BusinessNZ **recommends** that:

- f) The Bill introduced to the House should accurately reflect the overall views of submitters (p.9).

3. BUSINESSNZ'S OVERALL VIEW ON CARTEL BEHAVIOUR

- 3.1 BusinessNZ would first like to point out that we fully support competition law that provides for an effective and efficient market. We also support moves by the Government that eliminate clear cases of hard core cartel behaviour. However, the point we have raised previously is whether the introduction of stronger sanctions is required in the absence of clear evidence that existing sanctions have been unsuccessful. Plainly put, are many of the proposals a solution looking for a problem?

¹ Background information on BusinessNZ is attached in the appendix.

4 2010 DISCUSSION DOCUMENT

4.1 BusinessNZ submitted on the *Cartel Criminalisation* discussion document in 2010. In our submission, we took the opportunity to highlight what we believed to be some fundamental issues that should be examined before action (if any) was taken.

4.2 Specifically, our main concerns involved the following:

- Despite a 98-page discussion document, there was little attempt to establish the extent of the problem of hard-core cartel behaviour in New Zealand (not a single recent New Zealand case study was mentioned).
- Aligning New Zealand with offshore practices was stated as a major factor in wanting to introduce changes but with no attempt to show there would be a net benefit to the New Zealand economy.
- Comments by the Minister of Commerce and others when the discussion document was released appeared to reflect a view that the proposed changes were a *fait accompli*. This would undermine the purpose of the discussion document which should be to gauge public opinion and make regulatory changes accordingly.

4.3 Given these considerable concerns, we concluded that the Government should not make changes to existing competition laws involving cartels, until such time as another investigation taking into account BusinessNZ's concerns was conducted.

5. CURRENT ROUND OF CONSULTATION

Level of current consultation

5.1 First, we congratulate the Minister for releasing a draft Bill for consultation. Given the controversial nature of what is proposed, BusinessNZ believes a further consultative step between the discussion document and a Bill being introduced into Parliament is an appropriate step.

5.2 Indeed, we would be supportive of a step of this kind becoming more of a regular feature when other discussion documents are presented. BusinessNZ is increasingly coming across instances of an illogical disconnection between the recommendations of some discussion documents and the Bills that follow them.

Regulatory Impact Statement

5.3 Although the draft Bill has been released for comment, much of our focus is on its draft Regulatory Impact Statement (RIS). Taking into account the fundamental policy process issues we raised in our previous submission, it appears the RIS provides the best proxy in terms of a proper investigation that takes into account our earlier concerns.

- 5.4 Therefore, there are aspects of the RIS we would like to discuss in the context of the details of the Bill, especially concerning criminal sanctions.

The Evidence in New Zealand of Hard Core Cartel Behaviour

- 5.5 As stated in paragraph 9 of the RIS, *“New Zealand-specific data is limited and the relatively small number of cases means that it is not statistically meaningful”*. Paragraph 10 then mentions that *“many of the detected domestic price fixing incidents in New Zealand are local, minor in scope or degree of damage and resulted in a warning”*. While it is good to see that MED has at least examined past data to provide interested parties with an updated picture of hard-core cartel behaviour in New Zealand (compared with the 2010 discussion document that failed to even look into this issue), it is glaringly obvious that the attempt to scope the level of the problem as part of any justification for stronger sanctions falls at the first hurdle.

Problems Identified with the Current Regime

- 5.6 In terms of problems identified with the current regime, paragraph 19 states that *“a lack of detection of cartels via leniency may be an indicator that New Zealand’s penalty regime is not a sufficient deterrent to cartel behaviour”*. We find this statement puzzling. It could equally be stated that a lack of detection of cartels via leniency may be an indicator that there are minimal problems regarding cartels in New Zealand in the first place. The following point raised in paragraph 19 mentions that reducing cartel behaviour through increased deterrence would encourage production inputs to be more competitively priced. While one could argue that this makes intuitive sense, it again does not come across as a solid justification for change. Therefore, the notion that the low number of cases of cartel behaviour in New Zealand is due to a perception of sub-standard penalties cannot be seriously considered as a ‘problem’ with New Zealand’s current cartel penalty regime.
- 5.7 Paragraph 20 states that *“many large cartels affecting New Zealand are international and are detected from work in other jurisdictions. It is therefore important that New Zealand can effectively cooperate with other jurisdictions to sanction behaviour”*. In addition, paragraph 25 mentions the importance of the Single Economic Market (SEM) with Australia as a reason for change. Namely, the SEM framework has a medium-term goal that firms operating in both Australia and New Zealand markets should be faced with the same consequences for the same anti-competitive conduct. Paragraph 54 then states that *‘criminalisation would advance the SEM objectives by ensuring that competition laws in Australia and New Zealand establish comparable standards of behaviour and sanctions for illegal conduct’*.
- 5.8 In our previous submission, we outlined our concerns regarding international harmonisation as a leading reason for introducing criminal sanctions. BusinessNZ has repeatedly commented on this argument when used in other regulatory areas, namely that any harmonisation needs to show a clear net economic benefit for New Zealand. Also, we remain particularly suspicious of the ongoing need to replicate business law on both sides of the Tasman.

5.9 Regarding the ongoing relationship between New Zealand and Australia, BusinessNZ commissioned a major report entitled “*Trans-Tasman Business Law Harmonisation*” in 2010, undertaken by Franks & Ogilvie². The report summarised the responses from BusinessNZ members to the questionnaire on the Government’s SEM outcomes framework, and had assistance from key professionals and MED. The report’s intent was to provide a business view to Government on the prioritisation of, and unexpected fishhooks in, SEM outcomes.

5.10 The majority of responses were from major companies from a cross-section of the economy, with some doing businesses on both sides of the Tasman and some having parent companies in Australia. Therefore, the respondents involved were well versed on trans-Tasman issues.

5.11 Competition policy was one of the various issues examined, including cartel criminalisation. Paragraph 10 on page 37 of the report stated that:

10. The majority of members did not support the criminalisation of cartel behaviour. Many stated that it was not necessary, and lacks a strong policy basis. None considered harmonisation or being seen internationally as a ‘good citizen’ as a good reason for criminalising. Comments included:

“Financial penalty is enough. Ability for a competitor to obtain immunity by informing on others that could lead to their criminal conviction is distasteful.”

“In a small market like NZ there are often valid, pro-competitive reasons for businesses to cooperate with each other. The criminalisation of cartels could deter such legitimate cooperation.”

5.12 The comments in the report highlight the view by the majority in the business community that assimilation of New Zealand’s laws is not always a step in the right direction as some regulatory competition is actually healthy. Also, the report outlined that proper cost/benefit appraisals of outcomes are necessary before criminalisation options proceed. As pointed out by ourselves and other submitters, it is far from obvious that criminalisation would have any clear long term benefits for the New Zealand economy.

6. COSTS OF CRIMINALISATION

6.1 Pages 15-16 of the RIS outline four main costs identified by both MED and previous submitters regarding the introduction of criminal sanctions. BusinessNZ wishes to discuss three of these issues.

Costs of Imprisonment

6.2 Although listed last in terms of cost within the RIS, MED’s defence of the cost of jail terms if criminal penalties proceed does more to support such proceedings not going ahead. Paragraph 61 states that cartel offences would be unlikely to have a measurable effect on the overall prison population, with statistics showing the United States imprisoning fewer than 400 people over the last 10 years.

² Trans-tasman Business Law Harmonisation – Initial Findings (Franks & Ogilvie) 2010.

Administration and Enforcement Costs

- 6.3 Paragraph 59 states that given the low number of prosecutions expected in any given year (which we have reaffirmed in 6.3 above), the magnitude of the additional cost in terms of investigations is unlikely to be significant. Also, the resources required will depend on the design of the final regime and the level of certainty created.
- 6.4 While we agree that the level of some costs will be depend on additional measures introduced that we discuss below, invariably the costs associated with the introduction of criminal investigations will increase because the Commerce Commission's starting point will be the possibility of a criminal prosecution.
- 6.5 Even the possibility of conducting criminal investigations would require resources such as new staff, retraining of existing staff and other forms of administrative assistance to put the Commission into a position to properly conduct the investigations.
- 6.6 Also, the RIS does not discuss the costs incurred by those being investigated. While there would already be costs associated with the current civil regime, it is reasonable to assume that heightened sanctions would lead persons prosecuted to put additional resources into proving their innocence. In addition, there would also be opportunity costs given individual business resources could instead be put into more productive activity.
- 6.7 Therefore, on balance, while paragraphs 59 and 60 of the RIS tend to give the impression that costs may in fact be lower, BusinessNZ disagrees. Even though additional changes as discussed below may help reduce some of the additional costs, overall we believe there will be sizeable extra administration and enforcement costs associated with the introduction of criminal sanctions.

Chilling Effect on Pro-Competitive Activity

- 6.8 Paragraph 55 mentions that previous submissions on the discussion document highlighted the fact that criminal sanctions may deter legitimate and pro-competitive business activity if there is uncertainty regarding the conduct covered by the prohibition. BusinessNZ agrees, but does not intend to go over the issues again as many submitters have discussed these in-depth. However, MED states that these concerns may be allayed by some of the additional changes that are discussed below. While we agree that some concerns may be allayed, exposure to the risk of criminal prosecution remains a large elephant in the room for businesses considering competitive conduct. Therefore, we believe MED needs to place more weight on the fact that criminal sanctions will still have a sizeable effect on activity by discouraging actions that may otherwise be perfectly legal.

In Summary

6.9 When examining the issues raised in the RIS, many of the reasons outlined for introducing criminal sanctions could equally be listed as reasons not to introduce criminal sanctions. Also, we believe the RIS underplays the reasons why criminal sanctions should not be introduced. Overall, while we are pleased to see an RIS being drafted for the Bill, it still falls short of providing compelling reasons for the introduction of criminal sanctions.

Recommendation: That hard-core cartels should not be criminalised.

6.10 Notwithstanding our overarching recommendation above that there is insufficient evidence that the current cartel regime in New Zealand is inadequate, we would, without prejudicing our overall view, like to comment on some of the other proposed features of the Bill.

7. OTHER CHANGES/ADDITIONS TO THE SCHEME

7.1 Option 2 in the discussion document, labelled "*improvements to existing civil regime*" outlines three options to improve the current regime, in the absence of criminalisation. These have come about due to previous submissions highlighting areas that require improvement.

Disconnect between Criminalisation Sanctions and other Options

7.2 First, BusinessNZ would like to point out that we do not believe the introduction of the additional options below should primarily represent a pathway for the introduction of criminal sanctions. Paragraph 26 outlined views from submitters that the current framework lacks clarity regarding the scope of the prohibition and the exemptions from it. Therefore, moves to rectify these concerns are welcome. However, we view the proposed criminalisation of hard-core cartel behaviour and the additional options as separate issues.

The Prohibition

7.3 We note that the Bill provides a new approach to defining hard-core cartel conduct by way of defining the forms of conduct that would be illegal:

- Fixing prices
- Allocating markets
- Restricting output
- Rigging bids

This is different from the current situation of examining the outcome (i.e. the effect on price). As the Ministry has stated, this approach has been chosen to give greater certainty as to the type of conduct prohibited.

7.4 As background, we note that these options were discussed in the discussion document which asked which of the OECD categories of hard-core cartel behaviour should be explicitly covered by the cartel offence.

7.5 Overall, BusinessNZ agrees with the inclusion of these categories. As the RIS mentions on page 8, previous submitters highlighted the fact that section 30 prohibits conduct where there is an effect on price, although depending on circumstances, it can be unclear whether the prohibition would always extend to output restrictions, market allocation and bid rigging.

Recommendation: BusinessNZ broadly supports the revised definition of hard-core cartel conduct.

The Collaborative Activity Exemption (the exemption)

7.6 The Bill proposes a broader scope to the current exemption for joint ventures, namely that it will apply to all pro-competitive arrangements rather than just to joint ventures as is currently the case. The new exemption would also be principle-based as opposed to form-based.

7.7 BusinessNZ agrees that the breadth of the exemption should create greater certainty for businesses that are proposing to enter into collaborative, efficiency-enhancing arrangements.

Recommendation: BusinessNZ broadly supports the collaborative activity exemption.

The Clearance Regime

7.8 Given the Commerce Act currently provides a clearance regime for mergers, the Bill looks to introduce a clearance regime to assist businesses in managing any residual risk that a proposed collaborative activity might be in breach of the Act. As the Ministry has pointed out, the clearance regime for mergers allows parties proposing to acquire assets or shares to test with the Commerce Commission whether the acquisition would raise competition concerns.

7.9 Some of BusinessNZ member industry associations have previously taken the opportunity to point out that some form of clearance regime would be extremely desirable given there will sometimes be unique scenarios which may fall into grey areas.

7.10 The RIS states that there would be an additional cost to the Commission from businesses seeking clearance, but this would be mitigated to some degree by requiring an application fee from interested firms. We agree that the usage of this regime may not be relatively high if other options regarding prohibition and exemptions are clarified. However, we believe that the clearance regime still provides a positive option for businesses to take up, not to mention that each business will weigh up the costs associated with seeking clearance compared with the level of uncertainty apparent. Therefore, BusinessNZ generally supports the recommended changes to the clearance regime.

Recommendation: BusinessNZ broadly supports the establishment of a clearance regime for collaborative activities.

Updating the penalty regime

- 7.11 Paragraphs 40-42 examine the possibility of revising the penalty regime given the Government's view that the current regime may not impose optimal penalties. While we agree with the document's end conclusion that raising penalties is probably not the most desirable thing to do, the reasoning for this view again shows why criminal sanctions are not required. The maximum financial penalty has never been imposed in New Zealand - not a great surprise given the almost non-existent occurrence of hard-core cartel behaviour in this country.
- 7.12 We agree with MED's view that imposing maximum penalties may be enough to bankrupt some firms and that is undesirable from a competition perspective. Interestingly, one could also apply the same logic to criminal sentences given the loss of a business and/or the associated damage to brand once the criminal prosecution became public.
- 7.13 Overall, BusinessNZ believes that the change to the penalties regime should not proceed.

Recommendation: That changes to the penalties regime should not be introduced.

8. THE PROCESS AHEAD

- 8.1 As stated above, we support the Minister's intention to consult on the Bill before it is introduced to Parliament to ensure it adequately supports pro-competitive business arrangements. We note that paragraphs 75-76 of the RIS outline the overall views of the 2010 consultation, with 25 submissions received. Of these, seven were in favour of criminalisation, nine were against and seven did not offer a view either way but highlighted issues that needed to be considered in the design of a criminal cartel offence.
- 8.2 Regarding whether New Zealand should criminalise hardcore cartel behaviour, paragraph 63 states that *"on balance, we consider that there could be benefits from having a criminal offence in addition to the civil prohibition, provided costs of criminalisation can be mitigated by effective design. Clarifying the prohibition and exemptions as outlined under option 2 will be particularly important"*. Although BusinessNZ accepts that the Ministry is still in the consultation phase, there still seem to be too many 'ifs' and 'buts' about the process ahead to give any clear indication of whether criminal sanctions are justified.
- 8.3 In our submission to the Minister during last year's round of consultation, we pointed out that *'comments from the Minister and others appear to reflect the view that proposed changes are a fait accompli, which we believe would undermine the purpose of the document which is or should be to gauge views from the public and make regulatory changes accordingly'*. Given the weight of submissions was against criminalisation and the fact that recent comments by the Minister are seeking a clear mandate of support for the most effective solution for hardcore cartel behaviour, BusinessNZ hopes that both the

Minister and MED ensure that any future decisions accurately reflect the overall views of submitters.

Recommendation: That the Bill introduced to the House should accurately reflect the overall views of submitters.

9. APPENDIX

Background Information on BusinessNZ

- 9.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association, Employers' Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), its 71 member Major Companies Group comprising New Zealand's largest businesses, and its 76-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is New Zealand's largest business advocacy body. BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 9.2 In addition to advocacy on behalf of enterprise, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 9.3 BusinessNZ's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.