SUBMISSION TO THE MINISTRY OF ECONOMIC DEVELOPMENT ON THE CARTEL CRIMINALISATION DISCUSSION DOCUMENT 31 MARCH 2010

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1. INTRODUCTION

1.1 This submission responds to the Ministry of Economic Development's ("**MED**") invitation for comment on its *Cartel Criminalisation Discussion Document* released in January 2010 ("**Discussion Document**").

1.2 As a frequent advisor to clients on the Commerce Act 1986 ("**Commerce Act**"), Russell McVeagh has assisted clients in relation to a wide range of conduct potentially captured under Part II of the Commerce Act. We have presented seminars and prepared papers in respect of the scope of the application of section 30, accessory liability jurisdiction and on cartel criminalisation.[1] Russell McVeagh partners who have assisted with this response include the author of a preeminent text on the New Zealand Bill of Rights Act 1990 ("**BORA**") and a member of the Crown and SFO panel of prosecutors.

1.3 Our experience is that this is a particularly complex area of law where it is not always easy to determine which conduct is prohibited under the price fixing provisions of the Commerce Act. In our view, in these circumstances, criminalisation of such conduct should not occur unless there is a compelling need for extra deterrence/public condemnation that criminalisation can be thought to bring. At the same time, we recognise that criminalisation of cartels undoubtedly carries a strong deterrent effect and that there may indeed be benefits in aligning New Zealand with the international trend.

1.4 The key issue for New Zealand in introducing criminalisation will be to adopt a very high degree of precision regarding the scope and operation of the regime in order to ensure that commercial certainty can be preserved to the fullest extent possible and that the presence of this threat does not overly chill pro-competitive conduct.

1.5 We have addressed in detail in our submission the matters which we consider to be particularly important in the context of this review. For completeness, we have responded to each of the questions posed by the MED in its Discussion Document at Appendix 1 to this submission.

1.6 Please contact the below partners in respect of any queries in relation to this submission:

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2. EXECUTIVE SUMMARY

2.1 Russell McVeagh's key recommendations regarding the Discussion Document are that:

(a) There should be a clear distinction between conduct that is subject to criminal sanctions and that which may be subject only to civil liability. Not only is certainty critical in the drafting of criminal provisions to resist chilling potentially pro-competitive conduct, but any law criminalising conduct ought to be

[1] Sarah Keene and Andrew Fincham, Russell McVeagh, Lexis Nexis Conference May 2007, *Cartels and Price Fixing: Avoiding Claims In The Current Legal Environment*; Derek Johnstone and Sarah Keene, Russell McVeagh 2007, *The Long Arm of Accessory Liability in New Zealand - How Far Is Too Far?* Julian Miles QC and Chris Graf, Russell McVeagh, CLPINZ Conference 2-3 August 2008, *The Australian Criminal Cartel Regime: A model for New Zealand?*

expressed concisely and unambiguously to the fullest extent possible. The scope of criminal provisions should not be left to prosecutorial discretion.

(b) A high degree of precision is required when defining conduct that will be exempt from the criminal process.

(c) Greater consideration of whether to allow vicarious criminal liability for corporations in the criminal context will be needed, given the potential for the New Zealand regime to be prone to over-reach.

(d) There should be a clear legislative direction as to the investigative processes that are permitted to be undertaken when a person's liberty may be at stake as is the case in a criminal regime. Specifically, the Discussion Document provides no persuasive grounds for the removal of essential criminal law protections such as the right to silence in an investigation which may result in a criminal prosecution. The Commerce Commission ("**Commission**") should demonstrate a need before further powers, such as those proposed under the Search and Surveillance Bill, are added.

(e) Clarity around the jurisdictional reach of the criminal provisions is necessary. The Commission's case in *Harris & Ors v Commerce Commission,*[2] in which it seeks to bring within the Commerce Act conduct that occurred overseas, outside the specific types of conduct provided for in section 4(1) of the Commerce Act, demonstrates a level of uncertainty in respect of the current reach of the Act, which is not acceptable in a criminal context. If expanded, then any extended jurisdiction appears to apply only to the cartel offence and not to other more idiosyncratic provisions of New Zealand competition law.

(f) It is important to ensure that any cartel provisions will only take effect prospectively.

(g) There is no reason why limitation provisions should be relaxed in a criminal context and in the interests of consistency, the existing civil limitation period should apply equally in the criminal context.

2.2 We have our reservations as to the merits of criminalisation as set out in section 10 below. From our perspective, a real and practical benefit to the commercial community of reform in this area will be that an amendment to the price fixing provisions of the Commerce Act will bring with it the benefit of the opportunity to look afresh at the substance of the Part II offences, which have remained largely unchanged for the last 25 years. For that reason, we welcome this review of the cartel provisions.

3. HOW SHOULD THE OFFENCE BE DEFINED?

3.1 What is 'cartel conduct'? Despite the MED's 'you know it when you see it' definition of the archetypal hard core 'smoke filled room' cartels, the reality is that the term covers a wide spectrum of behaviour, including other non-covert horizontal agreements, some of which may even be (at least in the minds of the parties to those arrangements) pro-competitive.

3.2 Certainty as to what will be a 'hard core cartel' goes directly to the fundamental tenets of a successful competition law regime. The International Competition Network ("**ICN**") Working Group on Cartels observes (in its report, *Building Blocks for Effective Anti-Cartel regimes*):

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[2] (2009) 12 TCLR 379.

> A first building block in the fight against cartels is the clear identification of prohibited behaviour – conduct that is considered hard core cartel conduct. A clear delineation of such conduct provides guidance to the business community subject to the law and **distinguishes hard core cartel behaviour for the purposes of punishment and deterrence as compared to less pernicious violations**.

3.3 At the ICN cartel working group plenary session of 4 June 2009, it was noted that:[3]

> Authorities must give examples of "concrete cases" to persuade both their governments and the public that cartel activity is a serious crime that warrants criminal sanctions.[4]

3.4 The MED has made it clear that it is not intended that conduct which inherently lacks the moral reprehensibility flavour and secrecy of a hard core cartel, such as instances of technical price fixing or conduct at the margins, be captured by the scope of the criminal provisions. The sentiment is also repeated in the following definitions of a 'cartel':

(a) Commerce Commission's definition in the media release in the *Osmose* proceedings:[5]

> Cartels are groups of businesses or individuals who, instead of competing against each other to offer consumers the best deal, secretly agree to work together and keep prices high. Cartels harm competitors by sharing customers with other cartel members, and by squeezing non-cartel members out of the market. Cartels harm the New Zealand economy by making other businesses pay inflated prices for goods, resulting in more expensive end products that cannot compete overseas. An OECD survey has confirmed that the **parties to cartel agreements, for the most part, were not honest business people who inadvertently become involved in a technical violation. Rather, they fully realised that their conduct was harmful and unlawful, causing them sometimes to go to great lengths to keep their agreement secret**.

(b) United Kingdom Office of Fair Trading:[6]

> In its simplest terms, a cartel is an agreement between businesses not to compete with each other. **The agreement is usually secret**, verbal and often informal. Typically, cartel members may agree on prices, output levels, discounts, credit terms, which customers they will supply, which areas they will supply, or who should win a contract (bid rigging).

(c) European Commission:[7]

> Commission action against cartels – Questions and answers": "What is a cartel? It is a **secret** agreement concluded between firms carrying out comparable activities with a view to restricting competition and gaining more effective control of the market. The agreement may take a wide variety of forms but often relates to sales prices or increases in such prices, restrictions on sales or production capacities, sharing out of markets or customers, and collusion on the other commercial conditions for the sale of products or services. [emphasis added]

3.5 A clear theme in these definitions is the covert nature of hard core cartel conduct.

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[3] See ICN media release attached at Appendix 2.

[4] Ana Paula Martinez, director at Brazil's Secretariat of Economic Law.

[5] http://www.comcom.govt.nz/MediaCentre/MediaReleases/200607/osmosefined18millioninnzsbiggestca.aspx .

[6] http://www.oft.gov.uk/advice_and_resources/resource_base/cartels/what-cartel;jsessionid=A77BD456D29BB89F5467B12B0FE7EC59

[7] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/184&format=HTML&aged=0&language=EN&guiLanguage=en

3.6 The Australian Competition and Consumer Commission has also clarified its position in this respect in its notice under the new Trade Practices Amendment (Cartel Conduct and Other Measures) Act 2009:[8]

> The definition of 'cartel provision' includes four varieties of cartel conduct:
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> - price fixing
> - output restrictions
> - allocating customers, suppliers or territories
> - bid rigging. …
>
> As did s. 45A of the TPA (now repealed), the cartel provision addresses price-fixing agreements on a 'purpose' or 'effect' basis. It remains the case that the prohibition on cartel conduct in the form of output restrictions, allocation of customers and bid-rigging is based on purpose. …
>
> The element that distinguishes the cartel offence from the civil prohibition in the Act is the need to establish certain fault elements under the *Criminal Code Act 1995*. …
>
> **Making a CAU containing a cartel provision**
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> It will be necessary to establish that an individual or corporation **intended** to enter into a CAU and that they **knew or believed** the CAU contained a cartel provision.
>
> **Giving effect to a cartel provision**
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> It will be necessary to establish that an individual or corporation **knew or believed** a CAU contained a cartel provision and that they **intended** to give effect to that cartel provision.

3.7 In our view, it ought to be possible to ensure that the criminal provisions are drafted with sufficient precision to capture only hard core cartels. The provisions cannot be vague or arbitrary. The business community must be able to know in advance what the rules are and be able to order their affairs accordingly. If the OECD's inclusion of price fixing, output restriction, market allocation and bid rigging conduct are to be adopted, greater clarity will be necessary as to the scope of those definitions.

3.8 Unlike major overseas antitrust jurisdictions, New Zealand lacks the volume of litigation that would provide precedent and real guidance at this stage to help define what conduct comes within each of those particular categories. Even if the Commission increased its efforts to bring test cases, this is highly unlikely to alleviate the certainty for many years, or ever, if the legislation is not clear at the outset.

3.9 Even in those jurisdictions, there remain a number of cases, covering situations that do not fall within the scope of the traditional smoke filled room. For example, in 2006, the US Department of Justice ("**DOJ**") opened an investigation into the way private equity firms bid for takeover targets. At issue were 'club deals' in which several private equity firms formed syndicates to submit a joint bid.[9] Concurrently, shareholders of takeover targets sought damages in private civil lawsuits. Naming private equity firms as defendants, shareholders contended that they were deprived of the full economic value of their holdings, receiving artificially reduced prices as club deals dampened competitive pressures that would exist if firms bid separately. Initial public offering

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[8] http://www.accc.gov.au/content/item.phtml?itemId=717078&nodeId=feda740e39f8ef706f88f67626945aeb&fn=Important%20Notice_Trade%20Practices%20Amendment%20Act%202009%E2%80%94long%20notice.pdf

[9] For further discussion see, Andrew M Peterson (2008), *Private Equity and Competition Regulation* 15 Competition and Consumer Law Journal.

syndicates were sued on similar grounds. According to Securities and Exchange Commission ("**SEC**") commissioner Paul Atkins, the suit sought to "trump the securities laws with the antitrust laws", and an unfavourable ruling "could devastate America's process of capital formation, wreak unprecedented havoc and jeopardize the stability in our capital markets".

3.10 The alarm on the part of the SEC reflected a significant difference in perspective between the SEC and the DOJ. In the US, syndicate bidding is pervasive in financial markets, from angel investors and venture capital firms to underwriting to primary equity and commercial lending. In recent years, a majority of venture capital funding and nearly half of large private acquisition were by syndicates rather than single firms. Conversely, "syndication" among bidders is often seen as a euphemistic expression for collusion by the DOJ, which pursues more criminal convictions for bid rigging than for other market conspiracies combined.

3.11 Similarly, early commentary already suggests that the club bidding situation may be vulnerable to criminalisation in Australia.[10]

3.12 In New Zealand it is simply not appropriate to leave the question unsettled as to whether this type of arrangement would be criminally prosecuted, and rely on prosecutorial discretion (which is what occurs in Australia). First, such a solution is contrary to fundamental precepts of the rule of law. Second, to subject commercial obligations to that level of uncertainty is problematic. Criminalisation will exacerbate the effect of uncertainty on commercial decisions, and the cost to the New Zealand public in the Commission taking test cases is an inherently questionable use of scarce public resources.

3.13 If criminalisation is to be implemented it should be targeted at the minimum of offences required to provide effective deterrence. As it stands, the trade off in policy and drafting terms will be between:

(a) more open ended drafting that is principle based, reducing the risk of avoidance; or

(b) tighter drafting which ensures certainty and predictability.

3.14 For the reasons described above, it is more critical for New Zealand, even than Australia, to err on the side of tighter drafting on the basis that it is worse to impugn conduct which is in fact legitimate than to miss conduct at the margins which is or should be egregious. If the latter escapes the per se criminal provision it can still be assessed in the civil context. However, conversely, if pro-competitive conduct is inadvertently criminalised, then in the absence of any exemption or defence, that is the end of the story.

The physical elements of the offence

3.15 In adopting a greenfields approach to the drafting of a new tightly worded criminal sanction, we are of the view that there will be benefits in retaining the existing section 27 to leave the civil avenue open for allowing third party actions or penalising conduct at the margins, which may still be harmful to competition.

3.16 Although parallel criminal and civil provisions (like the Australian provisions) may create some issues, such as the inability to know at the outset of an investigation which track the Commission will pursue, so long as the criminal provision can be drafted narrowly

[10] Australian and New Zealand Trade Practices Law Bulletin, 2010, Vol 25, No. 8, p189, "The new cartel laws: what they mean for joint bids", Armitage and Cohen, Blake Dawson.

and precisely enough to create a clear line of what is or is not hard core cartel conduct, then it should be relatively easy to predict the Commission's approach.

3.17 Furthermore, the availability of a civil alternative to the criminal offence may also assist in the implementation of the Commission's co-operation policy if it has the discretion to take criminal penalties off the table in settlement discussions. The scenarios contemplated would be for less egregious price fixing, such as that which could have had the potential to substantially lessen competition and therefore ought to be a per se breach, but through other reasons, did not in fact have the intended detrimental effect on competition in New Zealand.

3.18 To maintain consistency with the existing developed case law on its interpretation, we are broadly comfortable with retaining the "contract, arrangement or understanding" formulation and other actus reus elements proposed with regards to the additional criminal section 30.

3.19 Adding the term "conspiracy" to the offence exacerbates the potential for confusion in the basic prohibition. Even a superficial review of the case law on criminal conspiracy reveals its convoluted complexity. In our view, such a term adds nothing to the clarity of expression of a properly formulated cartel prohibition and its addition would likely cause significant confusion for little or no gain.

3.20 However, we consider that greater clarity can be gained by drafting the new criminal provision to:

(a) include the requirement for secrecy or covertness; and

(b) restrict the 'fixing of the price' to the level of the supply chain in which the parties are said to be competitors. In other words, the parties must genuinely be actual or real potential competitors in a demonstrable way in the **same** horizontal market that the price fixing is said to occur. This approach would avoid many of the difficulties with attempting to criminalise alleged technical input/output price fixing conduct or other potential network or franchise arrangements, which shall remain subject to the section 27 prohibition.

The mental elements of the offence

3.21 We agree with the views set out in the Discussion Document and consider that the addition of 'dishonesty' as an element of the offence will complicate further a hard line approach towards identifying criminal conduct and introduce a *mens rea* requirement that may be difficult to prove beyond a reasonable doubt.

3.22 Although a dishonesty test may set too high a standard to achieve the MED's policy objectives, the mere requirement of 'intention' to fix price is in our view too broad, and captures the MED's price fixing that is not morally reprehensible. For example, in May 2005, the Commission issued warnings to six Manawatu-based funeral directors who agreed prices for the supply of services as part of a joint tender put forward to the New Zealand Police in 2003 for a contract to transfer deceased persons, which put them at risk of breaching the price fixing provisions of the Commerce Act. From our perspective, the funeral directors' conduct was not sufficiently morally reprehensible to be subject to criminal penalties because although there was no legitimate joint venture, they openly advised the customer of what they had done which was to fix a price between them.

3.23 If the MED takes the view that dishonesty sets too high a threshold, we strongly believe that some guidance needs to be provided in the statutory language to distinguish morally reprehensible behaviour from price fixing that a customer might be aware of and potentially unconcerned by. This should not be left to prosecutorial discretion. For this reason we have recommended the addition of the requirement the conduct be "covert",

in our wording of the draft provision. While we agree that intention is a useful addition, we are not convinced it picks up the difficulties that the Manawatu funeral directors' arrangements demonstrated.

3.24 To illustrate the difficulties in using the 'intention' standard to capture the moral reprehensibility factor, we note that the Court of Appeal has recently considered related issues in respect of accessional liability under the Commerce Act. The Court's dictum in *New Zealand Bus v Commerce Commission*[11] on the nature of intention required for accessional liability indicates the difficulties in finding certainty in analyses of intention. Hammond J stated the test as whether conduct in question was 'commercially unacceptable', (arguably a form of moral reprehensibility). Arnold J, on the other hand, preferred the incumbent test of 'objective dishonesty', though conceded it, too, was fraught with the uncertainty that he saw in Hammond J's proposed test. Wilson J agreed with both.

3.25 We are of the view that if there is any ambiguity about the moral reprehensibility of the conduct or what their intentions were, then the civil track should be used.

3.26 In our view, a combination of:

(a) a requirement of intention, coupled with:

(b) a requirement of knowledge, and

(c) that the conduct be covert, with,

(d) the added protection of a clearance process for potentially problematic conduct as is proposed in the Discussion Document;

should cumulatively ensure only the type of hard core cartel conduct that is contemplated in the quotes set out at paragraph 3.4, will be prosecuted criminally.

3.27 Moreover, the inclusion of subsection (4) in our draft wording (described at paragraph 3.29 below) will assist in ensuring that competitors at the same functional level ought not to be entering into any discussions fixing price among them.

Defining the cartel offence

3.28 We are of the view that the types of conduct caught by the criminal provision should be clearly defined to specify exactly what is considered to be hard core cartel conduct. For example, there is an issue about whether hard core cartel behaviour extends to bid rigging, market allocation and output restrictions as well as price fixing. In our experience, conduct that might be described as output restriction, for example, is common in legitimate business contexts.

3.29 In seeking to introduce a criminal test, one of the principal questions is deciding which conduct should fall within the regime, and how the test should be framed. A useful starting point for discussion drawing on our comments above, and the drafting of the Canadian provision, would be that recommended by Brent Fisse in his paper entitled "*Cartel Offences Under the Trade Practices Act 1974 (Cth): Definitional Issues*" presented at the Federal Criminal Law Conference on 5 September 2008 (subject to minor amendments underlined in the wording below):

(1) *<u>No person shall</u>:*

[11] [2007] NZCA 502 (CA).

(a) intentionally make a covert contract or arrangement or arrive at a covert understanding with a competitor in the knowledge or belief that the contract, arrangement or understanding contains a cartel provision; or

(b) intentionally give effect to a covert cartel provision in the knowledge or belief that the provision is a cartel provision contained in a contract or arrangement made, or an understanding arrived at, by the person and a competitor.

(2) A cartel provision is a provision that is contained in a covert contract, arrangement or understanding between a person and a competitor, and:

(a) is intended by the person and the competitor to fix, control or maintain the price for, or a discount, allowance, rebate or credit in relation to, goods or services supplied or acquired or to be supplied or acquired by the person or the competitor, or by any body corporate that is related to either of them; or

(b) is intended by the person and the competitor, or between the person or the competitor and a third party competitor, to restrict or prevent the supply or acquisition of goods or services by the person or the competitor, either generally or in particular circumstances or on particular conditions, and

(c) is not a provision described in subsections (5) to (7) below.

(3) A person has intention:

(a) with respect to conduct if he or she means to engage in that conduct;

(b) with respect to a circumstance if he or she believes that it exists or will exist;

(c) with respect to a result if he or she means to bring it about or is aware that it will occur in the ordinary course of events.

(4) The alleged principal offenders must be competitors at the same level of the supply, production or distribution chain to which the contract, arrangement or understanding and the cartel provision relates.

3.30 We consider the criminal accessory liability provisions as set out in section 66 of the Crimes Act 1961 ("**Crimes Act**") are the extent of appropriate party liability. To the extent the MED considers the separate offences of attempts and conspiracies (Crimes Act sections 310 and 311) ought to be replicated in respect of the cartel offence, then these ought to be contained in separate offences as they are in the Crimes Act.

3.31 We are not convinced of the benefit of having an additional conspiracy offence because it is notoriously difficult to distinguish between the primary offence and the anterior conspiracy where both are effectively different forms of agreement. This problem was accurately identified by the MED by the reference to *Allied Mills* (at paragraph 200 of the Discussion Document) where the conspiracy allegations were struck out as the allegation merged with the substantive breach. This problem is particularly acute where the Commission alleges both an overarching understanding as a cartel agreement and customer specific understandings as further cartel agreements in and of themselves as well as being a "giving effect" to the overarching understanding.

3.32 At criminal law, it is clear that there are limits on when conspiracy can be charged, for example, it cannot be charged when each of the acts alleged to give rise to the conspiracy are themselves substantive offences. These acts must be charged as the substantive offences and not a conspiracy. A conspiracy can only be alleged when there is an anterior agreement to commit a substantive offence that is more than a series of substantive offences itself. Keeping the conspiracy offence separate from the accessory liability provisions will assist in importing these basic rules concerning prosecution of conspiracies, which will add clarity to the circumstances in which a conspiracy may be charged in respect of a criminal cartel.

3.33 Finally, we agree with the MED that it is useful to have a parallel civil standard for price fixing offences, which does not replicate the intention and knowledge requirements of the criminal offence. Recommended wording as a starting point for discussion for a parallel civil test is accordingly as follows:

(1) No person shall:

(a) make a contract or arrangement or arrive at an understanding with a competitor that contains a cartel provision; or

(b) give effect to a cartel provision contained in a contract or arrangement made, or an understanding arrived at, by the person and a competitor.

(2) A cartel provision is a provision that is contained in a contract, arrangement or understanding between a person and a competitor, and:

(a) which fixes, controls or maintains the price for, or a discount, allowance, rebate or credit in relation to, goods or services supplied or acquired or to be supplied or acquired by the person or the competitor, or by any body corporate that is related to either of them; or

(b) restricts or prevents the supply or acquisition of goods or services by the person or the competitor, either generally or in particular circumstances or on particular conditions.

(3) The alleged principal offenders must be competitors at the same level of the supply, production or distribution chain to which the contract, arrangement or understanding and the cartel provision relate.

4. EXEMPTIONS, EXCEPTIONS AND DEFENCES

4.1 We agree with the MED that all exceptions and defences set out in Part II of the Commerce Act should apply equally in both the civil and criminal contexts.

Certainty – public notification, authorisation/clearances

4.2 We agree with the MED that the availability of authorisations and clearances for practices that substantially lessen competition or long term contracts based on a overall impact test would be sensible and indeed very helpful in going some way to achieving commercial certainty. There would be benefits to be gained from developing a precedents base as a helpful indication of acceptable commercial options.

4.3 The Discussion Document suggests a clearance regime that would be instituted, for parties to avoid the criminal provisions through public notification. We agree with a public notification process to avoid criminal sanctions. The ACCC allows for a similar

process for exclusive dealing conduct (e.g. third line forcing) and there is similarly the benefit of some precedent in this area.

4.4 This would propose a defence for any parties that had used the public notification process. This proposal is consistent with the foundation for an ancillary restraints defence and enhances certainty as the proposal for notification or authorisation/clearance for potentially restrictive conduct on the basis that only covert conduct requires to be considered as criminal cartel conduct.

4.5 Although the introduction of a public notification process might give rise to issues of adequate disclosure, we are of the view that the benefits to be gained by providing this as an alternative to authorisation/clearance, including a reduction in both costs and the time it takes for an authorisation/clearance to be considered outweigh the potential for such disputes.

Defences

Defence of ancillary restraint

4.6 We agree with the MED that a further protection against stifling pro-competitive conduct, such as that in franchise or network arrangements, would be to introduce a defence of ancillary restraints. The defence will become particularly relevant where a public notification has been made with regard to the same conduct.

4.7 The availability of the defence would further support the MED's approach in targeting hard core conduct, by ensuring the criminal prohibition is reserved only for agreements between competitors to fix prices, allocate markets or restrict output that constitute "naked" restraints on competition without pro-competitive benefits, and not for restraints in furtherance of a legitimate collaboration, strategic alliance or joint venture.

4.8 We agree that the Canadian legislation provides the most appropriate starting point (subject to minor amendments underlined in the wording below):

(5) ***A cartel provision does not include:***

(a) *a provision that:*

(i) *is ancillary to a broader or separate contract, arrangement or understanding that includes the same parties; and*

(ii) *is directly related to, and reasonably necessary for giving effect to, the objective of that broader or separate contract, arrangement or understanding; and*

(b) *the broader or separate contract, arrangement or understanding, is not a cartel provision.*

Legitimate primary intention

4.9 We agree with the MED's view on the benefits of a defence of legitimate primary intention set out in paragraph 279 of the Discussion Document.

Joint ventures

4.10 When one is considering traditional type joint ventures involving shared production and the creation of a co-owned entity, the current section 31 appears relatively clear. However, as the Discussion Document acknowledges, section 31 is less suited to some of the more innovative technology based arrangements which have been developed in

recent years such as computer and financial networks. Untested also is the extent to which concepts of ancillary restraint can or should be incorporated under section 31. If we are going to take a strict black letter law approach to section 30 in such a way as to capture large amounts of seemingly innocuous conduct then an equally broad approach should be taken to section 31.

4.11 Joint ventures may be entered into for a number of reasons, including for example, to enable the joint venture companies to produce or supply goods or services; for research and development; or for the sole purpose of ownership of assets. Any joint venture defence or exemption should be broad enough to capture the full range of legitimate joint ventures, so that parties are not forced by a poorly formulated joint venture exception to use less optimal or less efficient structures.

4.12 We are therefore of the view that there is a need for a clearly articulated joint venture defence or exemption, which avoids the introduction of a 'but for' test. Legitimate commercial conduct, such as more cost effective, efficiency-enhancing joint ventures, should not be prohibited by provisions prohibiting cartel conduct.

4.13 A useful starting point for discussion would be as follows:

(6) A cartel provision does not include a provision that is for the purposes of a [genuine] joint venture.

(7) A joint venture means a collaboration between two or more persons entered into with the purpose of undertaking an efficiency enhancing activity in trade, including expanding output, reducing price, or enhancing quality, service or innovation.

Joint buying

4.14 We agree the current joint buying exception should remain broad as it applies to the new cartel offence. To this end we recommend the current wording in section 33 of the Commerce Act should be replicated (with the addition of 'services' to the current wording of section 33(b)):

(8) A cartel provision does not include a joint buying arrangement.

(9) A joint buying arrangement is a provision of a contract, arrangement, or understanding that:

(a) relates to the price for goods or services to be collectively acquired, whether directly or indirectly, by parties to the contract, arrangement, or understanding; or

(b) provides for the joint advertising of the price for the resupply of goods or services so acquired.

5. CRIMINAL LIABILITY

5.1 In this area the MED's approach in endorsing criminal liability for corporations in the extended circumstances provided for in section 90 of the Commerce Act constitutes a departure from the well established principles of criminal law (i.e. liability only attaches where the actor is the 'mind' and 'will' of the company). By allowing section 90 style liability, the New Zealand regime will be prone to inappropriate over-reach.

5.2 The possibility of a defence of reasonable precaution for companies whose employees have engaged in cartel conduct has been mooted in Australia. This defence builds on

the current regime wherein penalties may be reduced if companies can show evidence of effective compliance programmes being in place, recognising that an unethical employee may still engage in cartel conduct irrespective of robust compliance measures taken by his or her employer. However, the availability of this defence, while sensible, risks disguising the fundamental issue here - that it is entirely inappropriate to introduce concepts of extended or deemed liability contained in section 90 of the Commerce Act to criminal liability at all.

6. INVESTIGATION AND PROSECUTION

Investigations

Search powers

6.1 Given the different standards of evidence required in civil and criminal prosecutions and different protections required where a person's liberty is at stake, it is fundamental to reassess whether any of the current evidence gathering provisions of the Commerce Act should apply to a criminal regime.

6.2 Our starting point is that all relevant protections normally applicable in the criminal context should apply to the new cartel offence.

Self incrimination

6.3 The Law Commission identified that the privilege against self incrimination is necessary for the principles of natural justice to be observed for the following reasons:

(a) avoidance of the cruel tri-lemma (requiring a person who is forced to provide self-incriminating information to choose between self-incrimination, perjury, or, punishment for contempt if they fail to answer);

(b) preference for an accusatorial system (rather than a wide ranging inquisition);

(c) striking a fair state-individual balance;

(d) protection of human dignity and individual privacy;

(e) unreliability of self-deprecatory statements; and

(f) protection of the innocent.

6.4 Established authorities favour an interpretation of legislation that retains the privilege against self incrimination when the abrogation of the privilege by statute is not completely clear. For example in *New Zealand Apple and Pear Marketing Board v Master & Sons Ltd* [1986] 1 NZLR 191, the Court of Appeal stated:

> Whether in any enactment it demonstrates an intention to take away that privilege is a matter of construction. The common law favours the liberty of the subject and, if a Court is not satisfied that a statutory power of questioning was meant to exclude the privilege, it is in accordance with the spirit of the common law to allow it: *Taylor v New Zealand Poultry Board* [1984] 1 NZLR 394, 402, 406. The question must be whether Parliament has disclosed an express and direct intention in the statute itself to take away the right to silence...

6.5 The Court of Appeal in *Taylor v New Zealand Poultry Board* also quoted the High Court of Australia in *Pyneboard Pty Ltd v Trade Practices Commission* (1983) 152 CLR 382 in relation to the privilege against self-incrimination:

> In consideration of that question it is necessary to bear in mind the general principle that a statute will not be construed to take away a common law right unless the legislative intent to do so clearly emerges, whether by express words or by necessary implication.

6.6 We are concerned that the Commission's compulsory interview powers under section 98 of the Commerce Act coupled with the abrogation of the right to silence would be inconsistent with the BORA and a person's privilege against self-incrimination, and are of the view that the extent of the Commission's compulsory information gathering and interview powers must be narrowed in this respect in the criminal context.

6.7 The issue is not just with ensuring that information provided to the Commission properly obtained in the context of a civil proceeding is not then improperly used to initiate a criminal investigation, but also to prevent abrogation of the fundamental criminal law protections, and avoid 'fishing expeditions' leading to a depravation of a person's liberty.

6.8 One alternative may be to limit the Commission's ability to require production of information and its ability to compulsorily interview where it intends to proceed criminally (which latter limitation would be consistent with its current powers in the summary criminal context of the Fair Trading Act 1986).

Other powers

6.9 Other options are canvassed in the Discussion Document. We are particularly concerned with the suggested addition of surveillance powers under the Search and Surveillance Bill 2009. We have seen no evidence produced by the Commission or otherwise demonstrating that these are powers that the Commission needs. To add them to a criminal regime without such evidence is particularly problematic. Otherwise, we do not see as problematic initiatives such as an improved leniency programme and remedies like management banning orders and adverse publicity orders.

Evidentiary standards

6.10 We agree with the Discussion Paper that the standard of proof should be beyond reasonable doubt, and the standard applying to the defences (such as joint venture defence) should be consistent with, for example, the defence of self defence or colour of right (i.e. the defendant must only raise a factual foundation for the defence and the prosecution must then prove beyond a reasonable doubt that the defence does not apply).

Prosecutions (Prosecutors Panel)

6.11 Under a criminal regime it seems obvious that the Commission would continue to undertake the investigatory role in New Zealand, in respect of all cartel investigations. In terms of prosecuting cartels, it would seem sensible that the Crown Prosecutor, who already prosecutes on behalf of the Commission in the Fair Trading Act context (including criminal proceedings) and in respect of civil proceedings for cartel conduct, would continue in this role. Under the current system, the Commission ultimately decides, often on the advice of the Crown Prosecutor, whether or not to prosecute parties subject to a Commission investigation. From an administrative point of view, we consider this approach to be sufficiently workable to continue, along with the development of a panel of prosecutors, similar to the SFO panel, as suggested in the MED Discussion Document.

Deemed purpose and effects

6.12 Some of the definition provisions of the Commerce Act have a deeming effect (for example, section 2(5) relating to purpose, and section 2(8) deeming members of an association to be parties to agreements if their association makes a recommendation).

6.13 We are of the view that these provisions will need to be carefully considered so that criminal liability does not become too broad.

7. JURISDICTION

7.1 The appeal in *Harris* illustrates the problem with any possible ambiguity leading inevitably to attempted jurisdictional over reach. In that matter, the Commission argues that notwithstanding section 4 (which deals with the type of overseas conduct that is caught by the Commerce Act) the addition of 'conspiracy' to section 80 (which deals with party liability for the Part II breaches) extends the scope of what conduct is to be regarded as 'conduct within New Zealand' to capture overseas actions pursuant to an alleged conspiracy by analogy with sections 310 and 7 of the Crimes Act and the common law crime of conspiracy (which does not exist in New Zealand).

7.2 This is precisely the type of uncertainty that must be avoided in a criminal liability context. The Crimes Act, in accordance with established legal principles that support a country exercising criminal jurisdiction over foreign nationals, expressly excludes extraterritorial reach, save for express exceptions codified in sections 6 and 7. If the Commission were to claim such extraterritorial reach in the criminal context, then surely it ought to derive this from an express act of Parliament, which includes those protections.

7.3 We are therefore of the opinion that clarity around the jurisdictional reach of the criminal provisions is necessary, bearing in mind that an "effects-based" test may result in retaliation from other regimes if the conduct is pro-competitive in another country. It is also important that the expanded jurisdiction apply only to the cartel offence and not to other more idiosyncratic provisions of New Zealand competition law.

7.4 In this respect, we consider that the following factors ought to be considered:

(a) any prohibitions that will have extra-territorial reach should be no broader than hard core cartel conduct in other jurisdictions, so that overseas parties can be expected to know what the New Zealand law is;

(b) extraterritorial prohibitions should reflect principles of international comity, for example, allowing an exception for foreign sovereign compulsion or legality of the conduct in the place in which it occurred; and

(c) the substantive rules applying to private antitrust claims should be generally consistent with (or no broader than) foreign rules, in order to avoid forum-shopping by third parties and nuisance suits by interest groups.

7.5 Our preference is that, the criminal cartel prohibition be confined to conduct within New Zealand in the circumstances described in section 4(1) of the Commerce Act, which are demonstrably justifiable in an international law context. If the Commission can demonstrate a requirement for a broader jurisdictional reach, then it may be appropriate for the criminal cartel offence to replicate sections 4(2) and 4(3), i.e. it could extend to:

(a) any person resident or carrying on business in Australia, to the extent that person's conduct or business affects a market in New Zealand; and

(b) conduct by any person outside New Zealand, whether or not that person is resident or carries on business in New Zealand, to the extent that conduct would affect a market in New Zealand.

7.6 If a foundation for such an extension could be established, then it would be important to replicate other protections contained in the Crimes Act, for example, it should be a defence if the conduct in question is legal in the jurisdiction in which it was undertaken, the standard of proof applying to that defence being the same as described at paragraph 6.10.

7.7 If New Zealand is to follow Australia's lead and introduce a criminal offence for cartel participation, the question of the jurisdiction to pursue offenders in each others' country becomes relevant. Such a discussion is especially pertinent given the current position in New Zealand which in effect allows the Commission to bring proceedings against persons neither resident nor carrying on business in New Zealand so long as the conduct in question has a sufficient connection within New Zealand.

8. RETROSPECTIVITY

8.1 The issue of retrospectivity and when a cartel offence can be applied is not addressed in the Discussion Document. It is important to ensure that any cartel provisions will only take effect prospectively.

9. LIMITATION PROVISIONS

9.1 There is a question as to whether a limitation provision would apply to prosecutions.

9.2 We are of the view that the current limitation provision under section 80(5) of the Commerce Act (i.e. that action be taken within three years after the matter giving rise to the contravention was discovered or ought reasonably to have been discovered, but no more than ten years after the matter giving rise to the contravention) should continue to apply to criminal proceedings in the criminal context.

9.3 The discretion of the Court to stay proceedings for want of a fair trial is not a sufficient and certain protection against prosecutorial delay and otiose claims.

10. SHOULD CARTELS BE CRIMINALISED IN NEW ZEALAND?

10.1 We are not convinced of the strength of the case for criminalisation.

10.2 There are already substantial disincentives for companies to engage in cartel activity in New Zealand. Cartel conduct is already illegal and subject to significant financial penalties, reputational damage and potential loss of employment. For a company, these repercussions are in addition to the financial and opportunity costs it faces when subject to a lengthy investigation process. Commission investigations (whether or not they result in a prosecution) are inherently destabilizing and result in a deadweight loss of commercial momentum and focus, management time and internal resources, and potentially hundreds of thousands of dollars in legal fees that cannot be recouped. Indeed, there has been a corresponding increase in the number of companies putting in place internal compliance programmes.

10.3 During the last decade there has been a steady increase in the detection of domestic cartels, especially in light of the Commission’s leniency programme. As the Commission’s latest annual report notes: “The leniency programme has gained momentum with an increasing number of cases being brought to the Commission. The

Commission now has a considerable programme of cartel cases in both the litigation and investigation phases." Of note is the fact, moreover, that all 'hard core' cartels currently before the Commission are extremely historical and most were initiated prior to the increase in financial penalties. As yet, the effectiveness of this increase in penalties (coupled with the introduction of the leniency programme) on the incidence of new cartels has not yet been fully tested.

10.4 It is not clear from the experience of overseas jurisdictions that have criminalised cartel conduct whether the incentives for establishing cartels have been reduced by criminalisation. Aside from the United States, the number of prosecutions in any of the jurisdictions that have criminalised cartel conduct has been very small and, of course, those jurisdictions continue to experience cartel conduct.

10.5 It is often debatable whether cartel conduct (essentially an economic crime) is suited for criminal penalties. In a complex area of law, it is critical that the law is certain and clear as defining the offence too broadly or if there is uncertainty about whether conduct is legal or illegal risks deterring pro-competitive activity. In declining to adopt the criminal approach to accessory liability under the Commerce Act in the *NZ Bus* case,[12] Miller J in the High Court made it clear that it questioned whether criminal liability was appropriate in circumstances where one cannot tell in advance with any degree of predictability whether or not the conduct in question is lawful or not (at paragraph 220):

> I accept that there is a risk of over-deterrence. It does not arise in the criminal law, from which s83 is drawn, because offences attach to conduct that is normatively wrong. Accessories to a criminal offence are likely to know, or ought to know, that what the principal is doing is wrong even if they do not realise that it is illegal. The same is not true of s47. Participation in markets for corporate control is regarded as a good thing, up to a point. The question whether that point has been reached is answered by examining the economic effect of the transaction in the market as a whole. That exercise requires predictions about the economic effect of future behaviour of the merged firm and other existing or potential market participants. The vendor may be in a poor position to know the essential facts, let alone to appreciate its legal risk.

10.6 The criminalisation of cartel conduct will inevitably involve considerable additional prosecutorial cost. For the Commission to conduct criminal investigations as proposed, it would need additional staff, resources, and training to collect the evidence necessary to prove offences beyond reasonable doubt, without encroaching on the rights of those subject to serious criminal investigation. At a time when the Commission already carries heavy responsibilities for telecommunications, energy, airports and dairy regulation and enforcement (among other areas) and Government entities face strict budget constraints, it is difficult to see why priority will or should be given to the funding necessary for cartel criminalisation (especially when greater economic benefit can be obtained by advancing reform in other areas such as electricity pricing and security of supply and telecommunications).

11. ADDITIONAL OPTIONS

11.1 Considering the difficulties set out above, it may be worthwhile to consider the value in utilising alternative actions aimed at addressing any perceived deficiencies in our current competition law.

11.2 For example, the MED suggests that increased financial penalties may need to be as high as $5 million. Interestingly, while the MED does not consider fines to provide the full answer, it notes that "increasing the level of individual pecuniary penalties will have

[12] *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679.

the benefit of providing a disincentive to the small number of people for whom the current maximum is insufficient to deter cartel behaviour."

Russell McVeagh

31 March 2010

APPENDIX 1

QUESTIONS FOR SUBMITTERS

Detecting and deterring cartels

1. Do you consider cartels to be harmful?

2. Are the current penalties for cartel activity sufficient to deter and detect cartels? Is there any evidence to support this judgement?

3. What do you consider would be the most effective means of increasing the deterrence and detection of cartels?

4. What are the costs and benefits of the options outlined for increasing deterrence and detection?

5. Are there any other options that should be considered?

6. Should New Zealand introduce criminal penalties for "hard core" cartel conduct?

See observations at paragraph 10.

Defining the offence

7. Are there any categories of cartel conduct, not included in the OECD recommendations that should be criminalised in New Zealand?

   No.

8. Should the cartel offence be a per se prohibition or a rule of reason approach?

   Per se to reflect seriousness of the offence. We have seen no evidence that per se offences improve certainty from a business perspective however. Our suggestion in the drafting proposed in this submission to include the exclusions within the definition of "cartel provision" (as opposed to creating separate defences) would do significantly more to enhance business certainty because our proposed approach places the onus on the prosecutor to have considered the application of those defences before any prosecutorial decision can be made.

9. What should the physical elements of the cartel offence be?

   Contract, arrangement or understanding.

10. Should "conspiracy" be brought into the offence?

    No

11. Should there be a competition element, and if so, how should it apply?

    Not in the criminal offence.

12. Should there be a separate offence of implementing a cartel agreement?

    Yes.

13. Should there be a descriptive or basic approach to defining the mental elements of the offence? What should the specific mental elements of the offence be?

Intention and knowledge or belief as set out above.

14. Which of the OECD categories of hard core cartel (price fixing, market allocation, output restriction and bid rigging) should be explicitly covered by a cartel offence? Should they be included directly or only indirectly by reference to effects on price?

See proposed wording.

15. Are there any existing exceptions to Part 2 that should be applied to the cartel offence (or more broadly)? Are there any exemptions from the Commerce Act in other legislation that should not be applied to the cartel offence?

No. Although section 44(d) and section 45 wording may require reform in this context.

16. How can we achieve greater ex-ante predictability in the application of the cartel offence?

See drafting and comments in section 8.

17. Should there be a notification scheme, which provides for immunity from criminal prosecution?

Yes

18. Should there be a clearance regime for joint ventures?

Yes.

19. Should there be a clearance regime for other potentially restrictive trade practices?

Yes.

20. What are the appropriate defences and exceptions to the cartel offence? In particular, how should joint ventures, franchises and networks be treated?

See drafting. Section 33(b) should also be amended to include services.

21. Should there be a specific legislative exemption for agreements of more than 50 people?

22. Should there be a legislative exemption for joint buying arrangements?

Yes.

23. Should a new civil prohibition mirror the physical elements of the new criminal offence?

Yes, except as to "knowledge" and "belief", the "intention" requirement should also be replaced with the accepted test of "purpose or effect", and the civil prohibition need not meet the "covert" requirement.

24. Should the defences and exceptions for the new civil prohibition be the same as those for the criminal offence?

Yes.

Choice of options

25. Which of the three approaches - adaption of section 30, adopting Australian legislation, or greenfields - should be adopted?

    Starter for 10.

Criminal procedures and penalties

26. Should corporations be criminally liable for cartel offences?

    Yes.

27. Should the existing protections on the use of self-incriminating statements in the Commerce Act stand?

    No they should be different for a criminal regime (same as the Securities Act).

28. Should the existing provisions on self-incrimination be amended to allow the use of self-incriminating statements when a defendant contradicts those statements in evidence, or the defence proffers other contradictory evidence?

    No.

29. What should the maximum fine for the obstruction offences be under section 103? Should imprisonment be a possible penalty?

    No.

30. Should provision be made for the appointment of a panel of expert prosecutors to conduct cartel prosecutions?

    Yes.

31. Should the right of a cartelist to trial by jury be restricted?

    No, the same standard as set out under the Crimes Act should sufficiently deal with this issue.

32. What should be the appropriate maximum term of imprisonment for a cartel offence?

    5 years.

33. Should there be a maximum fine and, if so, at what level should it be set?

    No change is required.

34. Should the sentencing judge have discretion to impose civil orders (i.e.damages, management exclusions and/or adverse publicity orders) as part of the sentence?

    Yes.

35. Do you agree that the jurisdictional rules for the cartel offence should be the same as those for conspiracies?

    No. As with the Crimes Act, there should be a separate conspiracy offence, and that offence should be subject to the same jurisdictional rules as the Crimes Act conspiracy offence.

"Starter for 10" summary

The physical and mental elements of the cartel offences are:

- internationally forming an agreement (contract, arrangement or understanding) or conspiring/with a competitor/to engage in cartel behaviour; with knowledge that the agreement is one to engage in cartel behaviour; and

- intentionally implementing an agreement/with a competitor/to engage in cartel behaviour; with knowledge that the agreement is one to engage in cartel behaviour.

- "Cartel behaviour" directly includes all four OECD categories of hard core cartel behaviour: price fixing, market allocation, output restriction and bid rigging. The behaviours would not be defined by reference to their effects on price.

- All existing exceptions to Part 2 would apply to the offence.

- Authorisations will apply to cartel-like activity. A notification scheme would provide for immunity from criminal prosecution and a clearance regime would apply to long-term contracts.

- Exceptions to Part 2 (sections 43-46) will also apply to the cartel offence.

- A defence of legitimate primary intention will apply to the cartel offence. A specific joint venture defence would apply, based on an economic definition of a joint venture.

- There should be no exemption based on the number of parties to the agreement. There should be an exemption for joint buying arrangements.

- The accused relying on any defence would have an evidentiary but not persuasive burden of proof.

- The new civil prohibition would mirror the physical elements of new criminal offence with the same defences and exceptions.

- Corporations would be criminally liable for cartel offences.

APPENDIX 2

Rosalind Donald

International Competition Network 2009
'The recipe for a successful criminal cartel system'

Countries preparing to introduce a cartel offence should carry out a thorough systemic review and secure the support of stakeholders, enforcers said today at the ICN's cartel working group plenary session. Panellists also discussed coordinating criminal and civil cartel investigations when DG Comp and member state inquiries converge.

A country's entire system must be primed, by creating dedicated prosecutors, allocating the required resources and giving appropriate training "down to the level of the police academy", said Ana Paula Martinez, director at Brazil's Secretariat of Economic Law, recounting Brazil's preparations for a criminal system.

Authorities should also invest heavily in increasing awareness to foster stakeholder support, she said. Authorities must give examples of "concrete cases" to persuade both their governments and the public that cartel activity is a serious crime that warrants criminal sanctions.

Graeme Samuel, chairman of the Australian Competition and Consumer Commission agreed - it is essential to change the public perception that "white-collar crime does not deserve jail," he said. Samuel also emphasised the need for consensus with the judiciary. In Australia's preparations for criminal sanctions it has been essential to create "cultural trust between the public prosecutor's office and the ACCC", he said.

Samuel said this was especially important when agreeing on the prosecutor's approach to leniency. "Regulating and prosecuting authorities must have convergence," he said, so that whistleblowers have concrete assurances that their immunity is respected. He added that the Australian authority has set out the relationship between it and the public prosecutor in a memorandum of understanding.

Scott Hammond, deputy assistant attorney general at the US Department of Justice's antitrust division, who moderated the session, said ensuring that leniency programmes are accepted by public prosecutors is essential so that "with the adoption of sanctions there is no disincentive to report."

In addition to ensuring the judiciary is on board, countries should consider creating specialist judges, said Bruno Lasserre, head of France's Competition Authority, commenting on the country's recent efforts to activate criminal provisions in its cartel law. "To build case law you need a critical mass," he said. On the efficacy of criminal sanctions, Lasserre said that beyond acting as a deterrent, they open up prospects for increased cartel enforcement.

According to the session's second panel, when criminal and civil investigations converge, authorities must strike a balance between maintaining independence and sharing essential information.

Clear "dividing lines" are essential in interagency work if cases are being investigated simultaneously by DG Comp and member states, said Kirtikumar Mehta, principal adviser at DG Comp. Agencies must coordinate at the information-gathering stage. "Jurisdictions conducting criminal investigations may have additional means [of investigation], so DG comp may have to defer to the jurisdiction's needs."

Simon Williams, senior director at the UK's Office of Fair trading used the marine hose cartel case as an example of coordination between two agencies. When two agencies are raiding the same address it takes "thought and imagination" to organise, he said, and alternative methods such as subpoenas may be preferable. He noted that the OFT would not conduct a civil investigation on top of a criminal one if the commission was simultaneously conducting a civil procedure.

Mehta argued that it is vital to ensure that parties under criminal investigation elsewhere can still apply to DG Comp for leniency. This is "crucial for gathering evidence," he said, confirming that the different authorities' investigations are kept separate after the initial phase.

Thursday, 04 June 2009