

Competition Alert

28 January 2010

Criminalisation

Yesterday the Ministry of Economic Development released a Discussion Document on cartel criminalisation.

While few people would doubt that there is a category of "hard-core" cartelists, who knowingly and without justification collude to the detriment of consumers to raise prices, the real concern for New Zealand business is with defining the *boundaries* of any criminal liability. If a cartel offence is framed to have either very expansive boundaries, so as to capture potentially beneficial or unintentionally detrimental business activity, or very blurry boundaries, so that businesspeople cannot be clear whether any conduct will see them put in prison, this will be a matter of real concern.

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Either way, criminalisation is likely to be the most substantive reform to New Zealand's competition law since 1986. As well as adding criminal liability, any reform seems likely to involve a number of changes to the existing civil liability provisions of the Commerce Act 1986 (the "**Act**").

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The paper invites comment by Wednesday 31 March 2010. The Ministry also intends to hold workshops with interested parties commencing late February.

We comment specifically on the following aspects of the Ministry's proposal.

Whether to criminalise

The paper moves very quickly (in our view, too quickly) from the question of whether or not to criminalise to a discussion of exactly what the boundaries of criminal liability will be.

Significant planks in the Ministry's analysis are that:

- » there is currently significant under-detection and under-deterrence of cartels in New Zealand. This is based primarily (possibly exclusively) on a study that suggests that rates of detection increased on enactment of criminalisation in Australia;
- » individual civil penalties, even if increased beyond the current \$500,000 cap, are not sufficient to deter this conduct (this is apparently on the basis that there is a small group of individuals who are sufficiently wealthy as not to be deterred by any financial penalty);
- » it is important that the public considers cartels to be as deserving of moral condemnation as other conduct that is currently criminalised (it may be that the public does not currently think this: the Discussion Document elsewhere notes that conviction rates for cartel prosecutions before a jury in the United States are very low, even where there is strong evidence); and
- » it is beneficial to have New Zealand law as close as possible with Australia, both to reduce uncertainty and compliance costs, and to avoid New Zealand gaining a reputation as a "soft touch".

Suggested forms

The Discussion Document examines three possible methods of introducing criminalisation: (1) modifying the existing price fixing provision in s 30; (2) largely adopting the Australian offence; or (3) taking a "greenfields" approach and formulating a new criminal offence based on first principles, while retaining the existing s 30 for civil liability. Approach (3) appears to be the Ministry's preferred approach: the Discussion Document suggests a particular formulation of this new offence:

- » the cartel provision would make it an offence to *intentionally* form an agreement with competitors (or implement such an agreement), *knowing* that the agreement is to engage in one of the four OECD categories of hard-core cartel behaviour: price fixing, bid rigging, market allocation or output restriction;
- » defences would apply for (1) engaging in the conduct with a pro-competitive or sustainability-enhancing primary intention; or (2) legitimate, efficiency-enhancing joint ventures; and (3) joint buying. The Ministry also discusses a broader efficiency defence (to exempt, for example, franchise arrangements and network provisions that can show “non-trivial efficiency gains”), but there is concern about how practically this could be applied in a criminal (or civil) court;
- » a clearance regime would be instituted, and parties could avoid the criminal provisions through public notification; and
- » penalties of up to five to seven years imprisonment and an individual fine of up to \$5 million; maximum individual civil pecuniary penalties would also increase from the current \$500,000 to \$5 million.

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Joint ventures

In the Discussion Document the Ministry acknowledged that the current formulation of the joint venture provision in s 31 was flawed and did not provide a “model to follow in defining a joint venture exemption or defence.” Under its “greenfields” approach, the Ministry has suggested defining joint ventures on economic terms, with, for example, a requirement that the joint venture involve significant economic integration of activities and potentially enhance efficiency. This suggestion may prove difficult to apply in practice and may stifle some pro-competitive behaviour, since the extent to which a proposed joint venture reached these goals can, presumably, only be assessed after the event.

Knowledge and secrecy

Knowledge and secrecy are the Ministry’s suggested key critical factors distinguishing a criminal cartel from non-criminal (but still unlawful) price fixing.

- » For example, on a proposed formulation, a person would commit a cartel offence if that person (1) *intentionally* entered into an agreement with a competitor, and (2) *knew* that this agreement

would provide for “price fixing” (or the other elements of the offence). As the Court of Appeal decision in *NZ Bus*¹ demonstrated, the “knowledge of critical facts” test that this appears to import can be extremely difficult to apply on the boundaries. This is not just a matter of evidence-gathering: there will likely be real legal uncertainty, and a very blurry line, about what level of knowledge creates criminal liability.

- » The Discussion Document also proposes a defence for any arrangements formally “notified” to the Commission. This appears to rest on a theory that only covert conduct is deserving of moral condemnation, and that other conduct deserves to be considered only as price fixing. In our view, this proposal is helpful and certainty-enhancing, as is the proposal for a “clearance” process for potentially restrictive conduct (at present, there is no notification process and clearance is only available to business acquisitions).

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Jurisdiction

The Discussion Document contains a very brief discussion of jurisdiction. Broadly, it suggests moving to an “effects-based” test, whereby any cartel conduct, anywhere in the world, would be subject to criminal liability so long as it affects New Zealand. (There is some discussion that the existing safeguards found in criminal law conspiracy, such as the conduct being legal or necessary in another jurisdiction, would apply; however, these are not developed to any extent.)

If the jurisdiction test is to be wholly “effects-based” (the Discussion Document suggests, erroneously in our view, that this is “[t]he relevant factor”), there must be some risk of retaliation from other regimes, if cartels that enhance other countries’ interests (for example, OPEC) are attacked under the Act. It would also be important that this expanded jurisdiction apply only to the cartel offence, not to the more idiosyncratic provisions of New Zealand competition law that are unlikely to be known to people overseas, nor to civil claims by other parties that are not necessarily in the national interest.

Matters not addressed

The Discussion Document does not discuss:

- » *Retrospectivity*: whether the cartel offence could be applied retrospectively (It will be important that any cartel provisions take effect only prospectively);

- » *Limitation*: whether a limitation provision would apply to prosecutions. There will need to be some coherent limitation provision to prevent prosecutorial delay and otiose claims;
- » *Deemed purpose and effects*: some of the "definition" provisions of the Act have deeming effect (for example, s 2(5) relating to purpose, and s 2(8) deeming members of an association to be parties to agreements if their association makes a recommendation). These provisions will need to be carefully considered so that criminal liability does not become too broad; and
- » *Vicarious liability for individuals*: at present, s 90 of the Act holds an individual (or corporation) liable for intentional price fixing by an (actual or apparent) agent or employee of that individual (or corporation). There is no discussion about whether this form of vicarious liability would transfer into criminal provisions (although it appears to be at least contemplated for corporations).

Conclusion

As noted at the outset, this proposed initiative is of major importance to the development of competition law in New Zealand. It is essential to the initiative that any new legislative provisions are carefully considered and tightly drafted so as to avoid over-reaching and catching legitimate pro-competitive conduct. In this context, businesses should ensure that they take advantage of the opportunity to make submissions and help shape the new law.

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1. [2008] NZCA 159, [2008] 3 NZLR 433.

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