

Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Development Committee

Amending the Commerce Act to criminalise cartel conduct

Proposal

- 1 This paper seeks approval to:
 - 1.1 to introduce a new criminal offence for cartel conduct in the Commerce Act 1986, and
 - 1.2 introduce the Commerce (Criminalisation of Cartels) Amendment Bill ('the Bill') into the House.

Executive Summary

- 2 The previous government introduced legislation into parliament which criminalised cartel conduct. The then government reversed its position and removed the criminalisation provisions from the Bill during Committee of the Whole House.
- 3 I consider that the previous government was incorrect and I am proposing the introduction of a Bill to criminalise cartel conduct.
- 4 The criminal regime I am proposing will run parallel to the existing civil regime. The penalty for an individual would be a term of imprisonment of up to seven years or a fine up to \$500,000, or both. Bodies corporate would also be criminally liable. The existing exemptions and defences would apply with the addition of an "honest belief defence" meaning that it will be a defence where a defendant was mistaken in fact as to whether the exception for specified international shipping agreements applies. I am also proposing that the existing collaborative activity exemption should be extended to the circumstances where a defendant could be mistaken as to whether the exception for specified international shipping agreements applies.
- 5 I am seeking approval to introduce the Commerce (Criminalisation of Cartels) Amendment Bill on 15 February 2018. I am also seeking agreement to add this Bill to the Government's 2018 Legislative Programme [

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Background

Cartels cause harm

- 6 Cartels are formed when rival firms agree to not compete with each other by fixing prices, restricting outputs, or allocating markets. Cartels allow firms to raise their prices above the competitive level without fear of losing customers to rivals. This increases the profits of the participants but it does not create a countervailing benefit to consumers through more efficient business operations. Cartels are difficult to detect because they are generally conducted in secret and the participants often go to great lengths to hide their activity.

- 7 Currently cartel conduct is prohibited under section 30 of the Commerce Act 1986 ('the Act'). This prohibition was substantially amended in 2017 to apply to all three classes of cartel conduct, being price fixing, restricting output, or allocating markets. In addition, new or amended exceptions were introduced to exclude from this prohibition circumstances where collaboration between competitors may have benefits. These exceptions relate to collaborative activities (or joint ventures), vertical supply arrangements, joint buying and specified international shipping activities. In addition, a new clearance regime was introduced such that businesses could apply to the Commerce Commission for a ruling as to whether their collaborative activity arrangement complied with the new provisions.
- 8 The cartel prohibition in section 30 is a civil prohibition. That is, a contravention must be proven to the civil standard of a balance of probabilities. In addition, the main sanctions are pecuniary penalties as follows:
- 8.1 in the case of an individual, up to \$500,000, or
- 8.2 in any other case, up to the greater of \$10 million, or three times the illegal gain, or if the illegal gain is unknown, 10 per cent of turnover in each accounting period in which the contravention occurred.
- 9 In addition, the Commerce Commission may seek banning orders preventing any individual who has contravened the cartel prohibition from being a director or otherwise involved in the management of a business for a period up to five years.
- 10 The Commerce Commission has investigated numerous alleged domestic and international cartels, and successfully taken enforcement actions. These enforcement actions show that cartel misconduct is active in New Zealand to the detriment of competition, consumers and the wider economy.

International movement towards criminalising hard-core cartel behaviour

- 11 There has been growing international recognition of the extent of cartel activity, with many cartels operating in multiple countries. In response, a number of our key trading partners, such as Australia, the United States, the United Kingdom, Canada, Japan and Korea, have criminalised cartel conduct. All the developed common law countries have criminalised cartel conduct. The OECD recommends cartel criminalisation where this is consistent with social and legal norms.¹
- 12 In 2009, Australia criminalised hard-core cartel conduct and the first conviction was recently secured against Japanese shipping company Nippon Yusen Kabushiki Kaisha (NYK). NYK was ordered to pay AUD\$25 million in fines which was the second highest amount ever in an Australian cartel case.

The previous government removed the criminalisation of cartels

- 13 The previous government considered proposals to introduce a new criminal offence for cartels. The Commerce (Cartels and Other Matters) Amendment Bill ('the previous Bill') was introduced to the House in October 2011. This Bill included a new criminal cartel offence with sanctions for imprisonment of up to seven years.

¹ OECD, *Hard Core Cartels: Recent Progress and Challenges Ahead*, 2003

- 14 The previous Bill was reported back from the then Commerce Committee in May 2013 with unanimous support for the new criminal offence. In December 2015 the previous government agreed to remove the criminalisation provisions from that Bill [EGI-15-MIN-0167 refers]. The Cabinet paper which sought this decision outlined a concern that cartel criminalisation would have a chilling effect on pro-competitive behaviour. In particular, that criminalisation may unduly increase compliance cost on businesses and company directors as they seek to minimise risk.
- 15 The criminalisation provisions were removed from the previous Bill at Committee of the Whole House with the remaining provisions receiving the Royal Assent in August 2017 (as the Commerce (Cartels and Other Matters) Amendment Act 2017).

Proposal to criminalise cartel behaviour

- 16 I have reviewed the relative merits of criminalising cartel conduct and I consider that the introduction of a criminal cartel offence would be in the public interest.
- 17 A criminal offence would have the following benefits:
- 17.1 increased detection and deterrence of cartel conduct, and
 - 17.2 improved enforcement by the Commerce Commission.
- 18 In particular, the potential for imprisonment focuses deterrence directly on the individual decision-makers within the firm who are responsible for the cartel conduct. These sanctions are not able to be avoided in the same way as fines, which could be viewed as simply a cost of business for some firms. An example of this deterrence effect is the advice from the US Department of Justice that some global cartels did not operate in the United States because of the perceived risk of imprisonment.
- 19 The Commerce Commission also indicates that a criminal regime would provide important investigative and enforcement benefits such as:
- 19.1 it would enable the Commission to use extradition procedures to return to New Zealand any cartel offenders located overseas, and
 - 19.2 by virtue of New Zealand also having a criminal regime, overseas cartel enforcement agencies would be liberated to share information more freely with the Commerce Commission and to cooperate more extensively.
- 20 In addition, I consider that the concerns related to business uncertainty and a potential chilling effect may be addressed in the design of the offence and defences and the availability of clearance from the Commerce Commission. These matters were well-canvassed by the Commerce Committee in its consideration of the previous Bill. I discuss these matters in more detail in the remainder of this paper.

Key features of a cartel regime with criminal sanctions

- 21 There are three main elements of the proposed criminal regime, which have a number of safeguards built into them to promote certainty and confidence:
- 21.1 the criminal offence
 - 21.2 the defences and exceptions, and

21.3 a transitional period before commencement of the provisions.

Criminal offence provision

- 22 Clause 4 of the Bill introduces new section 82B in the Act which provides for criminal liability for breaches of section 30 of the Act, based upon the offence in the previous Bill.
- 23 The new criminal regime would operate in parallel to the existing civil regime. That is, the prohibited conduct would be the same as that outlined in section 30 of the Act relating to price fixing, restricting output, and allocating markets. However, the additional element of 'intention' would be needed to prove the offence and the criminal penalty regime. I am advised that this mental element of the offence will target the offence to those persons who meant to engage in cartel conduct or who would be aware that this result would occur in the ordinary course of events. The offence would need to be proved to a higher standard than the civil penalty - beyond reasonable doubt.
- 24 The offence would apply to individuals and bodies corporate. As to sanctions, for bodies corporate, the maximum penalty is the same as the maximum pecuniary penalty. For individuals, the maximum penalty is a term of imprisonment not exceeding seven years. Court.
- 25 Arguments in these criminal trials will be long and complex being based on detailed commercial and economic reasoning. Accordingly, I consider that these prosecutions are best suited to a High Court trial. Therefore, I propose that this will be a category 4 offence.

Defences and exceptions

- 26 The four exceptions in the Act that currently apply to civil prohibition would also be extended to apply to the new criminal offence. In particular, competitors that are involved in a collaborative activity or joint venture will not be subject to the criminal offence.
- 27 This exception has been well received by businesses and competition law specialists. In its submission during the last process BusinessNZ stated that "the breadth of the exemption should create greater certainty for businesses that are proposing to enter into collaborative efficiency-enhancing arrangements". Competition law specialists indicated that businesses should be able to satisfy themselves that contemplated conduct does not come within the prohibition. There was some concern over how the Commerce Commission and the courts will interpret and approach the collaborative activities exemption but I believe this has been addressed by the Commission issuing appropriate guidelines.
- 28 Given the seriousness of the criminal offence, as in the previous Bill, an additional defence is proposed to recognise that a defendant could be factually mistaken about the availability of one or more of exceptions (new section 82C in the Bill). It will be defence for a defendant involved in a collaborative activity if the defendant believed that the cartel provision was reasonably necessary for the purposes of the collaborative activity (including in relation to restraint of trade).
- 29 I also propose that a defence (similar to the one above) should extend to the circumstances where a defendant could be mistaken in fact as to whether the exception for specified international shipping agreements applies. The exception was added to the previous Bill at a late stage after criminalisation was removed. This exception allows for

specified international shipping agreements between ocean liner shippers, such as vessel sharing arrangements. It was inserted due to concerns on the effects of the removal of a previous wider exemption for ocean liner shipping which are vital to New Zealand's export economy.

Commencement

- 30 Section 2 of the Bill provides that criminal sanctions will commence two years after the date on which the Act receives the Royal Assent. This will allow the Commerce Commission and Crown Law to take the necessary implementation measures during this two year period. In addition, it will also allow businesses to ensure compliance with section 30 of the Act before criminal liability applies. The collaborative clearance regime is already available to businesses who wish to use it during this lead-in period.

Consultation

- 31 The Commerce Commission, the Treasury, Ministry of Justice, the Ministry of Foreign Affairs and Trade, Crown Law and the Department of Prime Minister and Cabinet (Policy Advisory Group) were consulted.
- 32 On balance, Treasury is supportive of the policy direction to criminalise cartels in line with the suggestions in this paper. However, there will be fiscal implications from the policy change which are currently unknown. [

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- 33 The Commerce Commission supports the introduction of criminal sanctions, provided that the Commission is appropriately resourced. The Commission has raised concerns about the breadth and complexity of the defences proposed. It will raise these concerns at Select Committee.

Financial implications

- 34 The Bill will have financial implications for the Commerce Commission and Crown Law. While I would expect criminal trials under these provisions to be relatively rare, the Commerce Commission will experience increased costs as all cartel investigations will need to be undertaken to a criminal standard, at least in the first instance.
- 35 I have asked my officials to work with The Treasury, the Commerce Commission and Crown Law to assess any need for increased funding. This will be progressed through the usual budgetary process.

Legislative implications

- 36 The proposals outlined in this paper are to be given effect in the Commerce (Criminalisation of Cartels) Amendment Bill.

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Regulatory impact analysis

- 38 A Regulatory Impact Statement (RIS) recommending criminalisation of cartels on balance was prepared for the original cabinet decision [CBC Min (11) 10/2; CAB Min (11) 39/1 refers]. A new or amended RIS is not required for this Bill as the option outlined in this paper was considered in that RIS (as option 3) and officials' advice is unchanged.
- 39 The Regulatory Impact Analysis Team (RIAT) at Treasury previously considered that the RIS met the quality assurance criteria, but noted that balancing costs and benefits was challenging due to the hidden nature of cartels and their impacts on the economy. Effectiveness of criminalisation as a deterrent is highly dependent on how the tool would be enforced by the regulator.

Compliance

- 40 The Bill complies with the:
- 40.1 the principles of the Treaty of Waitangi;
 - 40.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 40.3 disclosure statement requirements and a copy of that statement is attached to this paper;
 - 40.4 the principles and guidelines set out in the Privacy Act 1993;
 - 40.5 relevant international standards and obligations;
 - 40.6 the LAC Guidelines on the Process and Content of Legislation (2014 edition), which are maintained by the Legislation Design and Advisory Committee.
- 41 In considering whether to create a criminal offence, the Legislative Advisory Committee Guidelines suggests the following principle applies when determining if conduct should be criminalised:
- "Compelling reasons must exist to justify applying the criminal law to any conduct. The criminal law should be reserved only for conduct that society considers is sufficiently blameworthy to attract the consequences of a criminal conviction."*
- 42 I believe this principle has been met, as set out above, hard-core cartels cause harm, both to individuals and to the economy. It is impossible to know the size of the harm because cartels by their very nature are secret but there is no reason to think that cartels do not operate in New Zealand given that our markets are concentrated.
- 43 As the criminal regime will run parallel to the civil regime, the Commerce Commission and Crown Law will need to produce guidelines outlining where a criminal prosecution will be taken as opposed to a civil proceeding. I would anticipate this to occur in the two year lead in period.

Binding on the Crown

- 44 This Bill amends the Act, which currently applies to the Crown to the extent that it engages in trade. However section 5(4) of the Act provides that the Crown is not liable to be prosecuted for an offence under that Act. Instead, if it is alleged that the Crown has contravened an offence (such as the new offence against criminalisation of cartels in section 82B of the Bill), the Commerce Commission or any person directly affected by that contravention may apply to the court for a declaration to that effect, and if the court is satisfied beyond a reasonable doubt that the Crown has contravened the offence, it may make its declaration accordingly.

Allocation of decision-making powers

- 45 This Bill proposes that the criminal cartel offence shall be a category 4 offence under the Criminal Procedure Act 2011. Category 4 offences are heard by the High Court by jury trial. However, the court may order that the trial be conducted by judge without a jury if the proceedings are long and complex, which we anticipate may apply to many criminal cartel proceedings.

Associated regulations

- 46 Regulations are not required to implement the Bill.

Other instruments

- 47 The Bill does not contain any new provision empowering the making of other instruments that are deemed to be legislative and/or disallowable instruments.

Definition of Minister/department

- 48 This Bill does not create a new definition of Minister or Department.

Commencement of legislation

- 49 The Act will come into force two years after the Royal Assent.

Parliamentary stages

- 50 I intend to introduce the Bill on 15 February 2018 and, depending on availability of House time, I will move first reading during the week of 19 February 2018. The Bill should be passed by April 2019.
- 51 I will propose that the Bill be referred to the Economic Development, Science and Innovation Committee for consideration for a period of six months.

Publicity

- 52 I propose to issue a press release once the Bill has been introduced into the House.
- 53 This paper will be published on the Ministry of Business, Innovation and Employment's website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1 **note** [];

2 **note** [];

Policy proposal

3 **note** that I am proposing introduction of a new criminal offence and defences which are broadly the same as those reported back by the Commerce Committee on the Commerce (Cartels and Other Matters) Amendment Bill;

4 **agree** to the introduction of a criminal offence for cartels in the Commerce Act 1986;

5 **agree** to the following parameters for the criminal regime:

5.1 the criminal regime will be parallel to the civil regime and relate to arrangements between competitors to fix prices, restrict output or allocate markets;

5.2 the criminal offence will include the mental element of "intention" to engage in cartel conduct;

5.3 the current exceptions and exemptions from the cartel prohibition in the Commerce Act 1986 will apply to the new criminal offence;

5.4 a new defence will apply if the defendant was of the belief that certain facts relating to the exceptions for collaborative activities (including the exception for restraint of trade) or specified shipping activities applied;

5.5 bodies corporate will be criminally liable for cartel offences;

5.6 the maximum sanctions for the cartel offence will be the following:

5.6.1 for an individual will be a term of imprisonment of seven years or a fine up to \$500,000, or both;

5.6.2 in any other case, the fines will be the same as those applying under the civil regime, being a fine up to the greater of \$10 million or three times the illegal gain, or if the illegal gain is unknown, up to 10 times the annual turnover;

5.7 the offence will be a Category 4 offence under the Criminal Procedure Act 2011;

Approval of Bill

6 **agree** to the introduction of the Commerce (Criminalisation of Cartels) Amendment Bill on 15 February 2018;

7 **agree** that the government propose that the Commerce (Criminalisation of Cartels) Amendment Bill be:

7.1 referred to the Economic Development, Science and Innovation Committee;

7.2 enacted by April 2019;

8 **agree** to its inclusion in the Government's 2018 Legislation Programme [];

Communication

9 **approve** the Ministry of Business, Innovation and Employment to publish a copy of this paper on its website.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs