Cabinet Economic Growth and Infrastructure Committee

EGI (10) 235

Copy No: 31

Summary of Paper

15 October 2010

Criminalisation of Cartels

Portfolio Commerce

Purpose This paper reports back on the outcome of consultation on cartel criminalisation and seeks agreement to the development of an exposure draft Bill for further consultation.

Previous Consideration In November 2009, Cabinet agreed that there is a prima facie case for the introduction of a criminal penalty regime for hard-core cartel conduct, and agreed to the release of a discussion document on *Cartel Criminalisation* [CAB Min (09) 39/15].

Summary

Hard-core cartels are formed when rival firms agree to not compete with each other by fixing prices, restricting outputs, allocating markets, or rigging bids. Cartels allow firms to raise their prices above the competitive level without fear of losing customers to rivals.

Cartels are a global problem, and the OECD recommends cartel criminalisation where this is consistent with social and legal norms. A number of New Zealand's trading partners have criminalised cartel conduct, including Australia, the United States, Canada, the United Kingdom, Ireland, Japan and Korea.

Civil sanctions are available in New Zealand – the Commerce Act 1986 prohibits price fixing and other actions that substantially lessen competition. A proposal to introduce a criminal penalty regime has been the subject of a public consultation process. While submitters expressed a range of views on the merits of this proposal, there was a consistent message that the current price fixing prohibitions and joint venture exemptions in the Commerce Act are ill-suited to modern business practices. The clear message was the need for certainty for businesses.

Given the divided opinion and the uncertainty over whether submitters' concerns can be addressed, it is proposed that an exposure draft Bill be developed for further consultation. The draft Bill would include both civil and criminal offences for cartel conduct.

A summary of the proposed regime is in the Annex on page **31**.

Regulatory Impact Analysis A draft Regulatory Impact Statement will be included in the exposure draft Bill.

Baseline Implications	Financial implications will be considered after consultation on the exposure draft Bill.
Legislative Implications	The Commerce (Cartel Criminalisation and Other Matters) Amendment Bill has a category 5 priority (instructions to PCO in 2010) on the 2010 Legislation Programme.
Timing Issues	The Minister of Commerce will report back to EGI by 31 July 2011 on the outcome of the consultation on the exposure draft Bill.
Announcement	The Minister of Commerce will announce Cabinet's decisions. This paper will be posted on MED's website.
Consultation	Paper prepared by MED. The Commerce Commission, Treasury, Justice, Police, MFAT, Crown Law, Corrections and Transport were consulted. DPMC was informed. The Minister of Commerce indicates that the Prime Minister, Deputy Prime Minister, Minister for Economic Development and Minister of Transport were consulted, and that discussion is not required with the government caucus or with other parties represented in Parliament.

The Minister of Commerce recommends that the Committee:

Background

1 note that the Single Economic Market Outcomes Framework includes a medium-term objective that firms operating in both the Australian and New Zealand markets are faced with the same consequences for the same anti-competitive conduct;

2 note that Australia has recently criminalised cartel conduct;

3 note that in November 2009, Cabinet:

3.1 agreed that there is a prima facie case for the introduction of a criminal penalty regime for hardcore cartel conduct;

3.2 agreed to the release of a discussion document on *Cartel Criminalisation*;

[CAB Min (09) 39/15]

4 note that:

4.1 submitters on the discussion document on *Cartel Criminalisation* had mixed views on the merits of criminalisation in New Zealand;

4.2 a number of issues raised by submitters relate directly to the drafting of the legislation;

5 agree to the development of an exposure draft Bill on cartel criminalisation;

6 agree to make final policy decisions on cartel criminalisation after consultation on the draft exposure Bill;

The exposure draft Bill

7 agree to the following policy parameters for the exposure draft Bill:

7.1 parallel civil and criminal cartel prohibitions;

7.2 sections 30-33 of the Commerce Act 1986 will be repealed and replaced with new criminal and civil cartel prohibitions, drawing on the wording of the existing prohibitions along with Australian, Canadian and American laws;

7.3 the physical elements of the criminal offence and civil prohibition will be identical and should:

7.3.1 directly prohibit (without reference to purpose or effects on price) fixing price, restricting output, market allocation, and bid rigging;

7.3.2 prohibit entering into cartel provisions in contracts, arrangements or understandings;

7.3.3 include a separate prohibition on the implementation of cartel provisions;

7.3.4 specify that the alleged principal offenders are competitors;

7.4 for the mental element of the criminal offence:

7.4.1 intent will be required for forming and implementing a cartel agreement;

7.4.2 knowledge of the essential facts that would characterise it as a cartel agreement will also be required;

7.5 the civil prohibition will have a purpose element;

7.6 all existing exceptions to Part 2 of the Commerce Act will apply to the new cartel offence;

7.7 an ancillary restraints defence should apply;

7.8 a new joint venture exemption would replace the current joint venture exemption in section 31 of the Commerce Act, and the new exemption should:

7.8.1 define a joint venture in economic terms, requiring a substantial integration of the parties' resources, with the prospect of efficiency gains;

7.8.2 capture the full range of legitimate purposes of a joint venture, including the production or supply of goods or services, research and development, or the ownership of assets;

7.8.3 exempt prima facie cartel provisions from the cartel offence if they are reasonably necessary to achieve the lawful purposes of the joint venture;

7.8.4 provide that such a prima facie cartel provision can be in a contract, arrangement or understanding;

7.9 section 32 of the Commerce Act, which exempts agreements of more than 50 people from section 30 of that Act, should not be replaced as there is little justification for this exemption;

7.10 a new exemption for joint buying agreements should replace the current joint buying exemption in section 33 of the Commerce Act, with amendments to the current wording of section 33 to remove the uncertainty about the scope of "collectively acquired";

7.11 collaboration between bidders should be exempt from the cartel offence where this is made known to the person requesting bids;

7.12 the exceptions, exemptions and defences will apply to both the criminal and civil prohibitions;

7.13 a clearance regime, based on the merger clearance regime, should be available for the ancillary restraints and joint venture exemptions to the cartel offence and long term contracts;

7.14 the following two step process for clearance will apply:

7.14.1 the Commerce Commission considers whether a cartel provision is reasonably necessary to achieve the purposes of a wider agreement; and

7.14.2 if yes, the Commerce Commission considers whether the wider agreement is likely to substantially lessen competition;

7.15 the cost of a clearance regime would be covered through cost recovery via fees;

7.16 there should be a review provision for the clearance regime to assess its effects and ongoing need;

7.17 the maximum penalty for the cartel offence will be a term of imprisonment of seven years;

7.18 the maximum fine for a body corporate will be the same as the current maximum pecuniary penalties in section 80 of the Commerce Act;

7.19 the sentencing judge be provided with the discretion to impose any criminal penalties under the Sentencing Act 2002;

7.20 if a person is acquitted but the judge believes the charges were proved to a civil standard, the judge may impose a civil pecuniary penalty;

7.21 no civil pecuniary penalty proceedings may be brought against a person who has been criminally prosecuted, and any civil proceedings are stayed if criminal charges are brought;

7.22 corporations should be criminally liable for cartel offences;

7.23 prosecutions will be undertaken by members of a specialist panel, convened by the Solicitor-General, instead of the Crown Solicitors;

7.24 the Commerce Commission's existing investigation powers, which include compulsory production of documents and compulsory interviews, would apply to criminal investigations, with the existing protections on the use of self-incriminating statements;

7.25 the penalties in the Commerce Act for obstruction should be increased to:

7.25.1 a short term of imprisonment for individuals, with a maximum term of 18 months;

7.25.2 a maximum fine of $1,000,000 for bodies corporate;

7.26 the limitation period on obstruction will be extended to three years;

7.27 to enable effective enforcement:

7.27.1 the jurisdictional rules applying to criminal conspiracies should apply to a cartel offence and the civil prohibitions;

7.27.2 a minor amendment is required to section 90(4)(b) of the Commerce Act to attribute conduct carried out on behalf of a person, to that person, if the conduct is at the direction of that person;

8 note that in September 2008, the previous government agreed to amend the clearance and authorisation procedures in the Commerce Act, to:

8.1 extend the statutory time-frame for merger clearance determinations from 10 to 40 working days;

8.2 repeal the requirement that parties must halt conduct while the Commerce Commission is considering an authorisation application for that conduct and ensure that the Commerce Commission is able to apply to the Court to seek an injunction to halt the conduct in appropriate circumstances;

8.3 remove the right of an applicant and any third parties to require the Commerce Commission to call a conference;

8.4 allow the Commerce Commission to call a conference at any point in its proceedings, and not just following the release of a draft determination;

8.5 replace the current provisions granting standing to appeal for third parties against Commerce Commission determinations if they participated in a Commission conference, with the following:

8.5.1 in relation to merger clearance determinations, third parties shall not have the ability to initiate an appeal but in the case of those who participated in the Commission's proceedings, will be able to join an appeal;

8.5.2 in relation to authorisation determinations, third parties shall have standing to appeal if the person participated in the Commerce Commission's proceedings in relation to the determination and they have a significant interest in the determination (as determined by the High Court);

[CBC Min (08) 26/33]

9 agree to include the amendments referred to in paragraph 8 above in the exposure draft Bill;

10 note that the current territorial scope for mergers and acquisitions is overly broad;

11 agree to include in the exposure draft Bill changes to the merger jurisdiction that:

11.1 repeal section 4(3) of the Commerce Act;

11.2 adopt section 50(A) of the Australian Trade Practices Act 1974 (with appropriate adaptations);

12 authorise the Minister of Commerce to approve any minor and technical changes to the proposed amendments referred to in the above paragraphs that are consistent with the policy approach outlined in the paper under EGI (10) 235;

13 invite the Minister of Commerce to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs;

14 authorise the Minister of Commerce to publicly release a draft exposure Bill and supporting material, without further reference to Cabinet;

15 invite the Minister of Commerce to report back to EGI by 31 July 2011 on the consultation on the exposure draft Bill;

Leniency

16 note that leniency, whereby a cartel participant is granted immunity by the Commerce Commission in exchange for co-operation, is an essential tool in the detection of cartels;

17 note that ease of application and certainty for leniency applicants are essential for the success of the programme;

18 note that currently, only the Solicitor-General can grant immunity from criminal prosecutions;

19 invite the Solicitor-General, in consultation with the Commerce Commission, to develop draft guidelines and draft amendments to the Prosecution Guidelines by 31 January 2011;

Publicity

20 note that the Minister of Commerce intends to announce Cabinet's decisions in relation to the paper under EGI (10) 235;

21 note that Cabinet's decisions will be publicly released on the Ministry of Economic Development's website.

Janine Harvey
Committee Secretary

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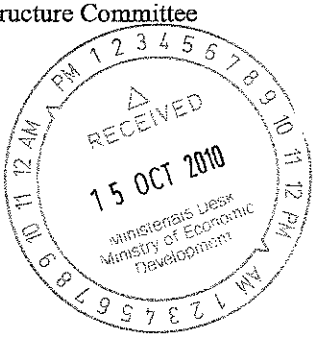

OFFICE OF THE MINISTER OF COMMERCE

The Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

CRIMINALISATION OF CARTELS

PROPOSAL

1 This paper reports back on the consultation on cartel criminalisation and recommends the development of an exposure draft bill for further consultation, before final policy decisions are made.

EXECUTIVE SUMMARY

2 Hard-core cartels are formed when rival firms agree to not compete with each other by fixing prices, restricting outputs, allocating markets or rigging bids. 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.

3 Cartels are a global problem with many cartels operating in multiple countries. Global deterrence and coordinated response efforts require cooperation between different jurisdictions. The OECD recommends cartel criminalisation where this is consistent with social and legal norms. All the developed common law countries have criminalised cartel conduct, as have a number of our trading partners, including Australia, the USA, Canada, UK, Ireland, Japan and Korea. The recently agreed Single Economic Market Outcomes Framework has a medium-term goal that firms operating in both the Australian and New Zealand markets are faced with the same consequences for the same anti-competitive conduct.

4 I released a discussion document on cartel criminalisation and written submissions were received. This was supplemented with workshops with competition law specialists and general counsel. A range of views were expressed on the merits of criminalisation.

5 Among those that support criminalisation, the likely increased detection and deterrence effects were cited as the main reason to introduce criminal sanctions. Supporters see criminalisation as a suitable punishment given the level of harm caused by cartels. Some also believe that there would be value in aligning with other jurisdictions in this area.

6 In general, those who oppose criminalisation argue that there is a lack of evidence of a problem to justify criminal penalties for cartels as well as a lack of evidence to suggest that criminalisation would improve either the detection or deterrence of cartels. They suggest that the current penalties are effective. Thus criminalisation would offer little benefit while imposing substantial costs on businesses (in terms of compliance costs and chilling pro-competitive activity) and the Commerce Commission.

7 One of the strongest messages expressed is the need for certainty for businesses. The risk that it will be difficult to express exactly what is and is not criminal cartel conduct in legislation is considered high and could result in significant uncertainty.

8 Given divided opinion and the uncertainty over whether submitters concerns can be addressed, I propose consulting on an exposure draft bill. Many of the issues raised will only be definitively resolved through the drafting process. After consultation on the draft bill, I propose reporting back to Cabinet with final policy recommendations. An outline of the parameters for the draft exposure bill is in the appendix.

BACKGROUND

What is a cartel?

9 Hard-core cartels are formed when rival firms agree to not compete with each other. The OECD defines four types of hard-core cartel behaviours: price fixing, bid rigging, market allocation and output restrictions. They 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. Joint ventures, franchises and similar cooperative business forms are not cartels.

10 Hard-core cartels are generally conducted in secret. The participants often go to great lengths to hide their activity. The cartel is not apparent to consumers. Cartels are difficult to identify and investigate because of their clandestine nature.

11 Cartels have such a pernicious effect on competition, without any countervailing benefit, that they can be definitively deemed as anti-competitive. The OECD has described hard-core cartels as the most egregious violation of competition law and should be a principle focus of competition policy and enforcement.

12 Cartel activity impedes New Zealand's economic performance in three ways:

a By raising the price above the competitive level, a cartel reduces demand for the good or service and hence production of the good or service. As a result, resources are not deployed where they will be of maximum benefit.

b A successful cartel also protects its participants from the risk that they will lose market share in response to competition from another firm. This protects inefficient firms and creates a drag on productivity improvements.

c The lack of competition creates less incentive for the cartel members to innovate by reducing costs or improving the quality of their product in order to retain their market share. Cartelised businesses may also attract greater levels of investment because they are more profitable than they would be in a competitive environment. This would create distortions in investment.

13 In addition to its economic harm, cartel conduct is an unjustified interference with market forces. The higher prices imposed by cartels result in a transfer wealth from consumers to the cartelists, on the basis of a secretive agreement that consumers are not aware of.

14 In order to deter cartel conduct, price fixing and other actions that substantially lessen competition are prohibited and unlawful under the Commerce Act 1986 and are subject to civil sanctions. These civil prohibitions have enabled the Commerce Commission [the Commission] to successfully prosecute cartel activities such as price fixing. New Zealand Courts have issued 13 price fixing judgements since the Commerce Act came into force, leading to civil pecuniary penalties (generally in the order of $100,000 to $500,000) for the businesses involved. Some of these cases involved domestic cartels (such as animal remedies[1] and the ophthalmologists). There are also two Trans-Tasman cartels: wood chemicals[2] and cardboard. The vitamins[3], air cargo[4] and gas insulated switch gear cartels are all international cartels which are likely to have had effects in New Zealand, though it is not yet legally settled if they were operating in New Zealand. These Trans-Tasman and international cartels appear to have affected larger markets in New Zealand than the cases of domestic price fixing. Where there is data, the size of the market is given in the footnotes, as well as an estimate of the total overcharge in nominal terms[5].

Criminal prohibitions

15 There has also been growing international recognition of the extent of cartel activity, with many cartels operating in multiple countries. In response, a number of our key trade and investment partners, such as the United States, the United Kingdom, Canada, Australia, 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, which would enhance both deterrence and the effectiveness of leniency programmes.[6]

16 This raises the question of whether the current legislation provides sufficient disincentives for cartel activity and sufficiently allows New Zealand to participate in co-ordinated international criminal action against hard-core cartels.

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[1] $2.5M turnover for one year – total overcharge $250,000
[2] $14m per annum rising to approximately $25 over 5 years – total overcharge $9.75M
[3] $6M per annum for 8 years – total overcharge $4.8M
[4] $400M per annum for 7 years – total overcharge $280M
[5] This estimate is based on an assumption of a 10% increase in price – less than the median overcharge in cartel cases, but the figure used in OFT evaluations of the effectiveness of enforcements against cartels.
[6] OECD 2003, *Hard Core Cartels: Recent Progress and Challenges Ahead.*

17 In order to reduce barriers to trans-Tasman trade, the Government has committed to a high-level outcome under the Single Economic Market agenda of ensuring that those who engage in anti-competitive behaviour in Australia or New Zealand face the same penalties [ERD Min (09) 10/1].

18 Cabinet subsequently agreed that there was a prima facie case for the introduction of a criminal penalty regime for hard core cartel conduct and authorised the release of a discussion document on cartel criminalisation [CAB Min (09) 39/15].

COMMENT

19 Twenty five written submissions were received on the discussion document. In addition, officials held three workshops with competition law specialists and two forums with the General Counsels of businesses. A range of views were expressed on the merits of criminalisation.

20 Among those that support criminalisation, the likely increased detection and deterrence effects were cited as the main reason to introduce criminal sanctions. Supporters see criminalisation as a suitable punishment given the level of harm cartels can cause and that sanctions for this type of behaviour should be brought into line with other white collar crimes. Some also believe that there would be value in aligning with other jurisdictions in this area.

21 In general, those who oppose criminalisation argue that there is a lack of evidence of a problem to justify criminal penalties for cartels as well as a lack of evidence to suggest that criminalisation would improve either the detection or deterrence of cartels. They suggest that the current penalties are effective. Thus criminalisation would offer little benefit while imposing substantial costs on businesses (in terms of compliance costs and chilling pro-competitive activity) and the Commerce Commission.

22 One of the strongest messages expressed is the need for certainty for businesses. The risk that it will be difficult to express exactly what is and is not criminal cartel conduct in legislation is considered high and could result in significant uncertainty. How the defence is defined and the exemptions and defences that will apply will be very important to mitigate this. There was also a consistent message that the current price fixing prohibitions and joint venture exemptions in the Commerce Act are ill-suited to modern business practices and there is already considerable uncertainty in their application.

23 Given divided opinion and the uncertainty over whether submitters concerns can be addressed, I propose consulting on an exposure draft bill. Many of the issues raised will only be definitively resolved through the drafting process. After consultation on the draft bill, I propose reporting back to Cabinet with final policy recommendations.

Approach to the exposure bill

24 The current prohibitions regarding hard-core conduct are set out in Part 2 of the Commerce Act. The heart of Part 2 is section 27, which prohibits the entering into, and giving effect to, contracts, arrangements or understandings that have the purpose, effect or likely effect of substantially lessening competition.

25 The main provisions in the Act regarding hard-core cartel conduct are:

- **Section 30**, which deems price fixing agreements between competitors to contravene section 27. These contracts, arrangements or understandings must have the purpose, effect or likely effect of fixing, controlling or maintaining the prices of goods or services supplied or acquired by the parties, in competition with each other;

- **Sections 31-33**, which exempt certain joint ventures, recommended pricing by industry associations, and joint buying and promotion arrangements from the application of section 30.

26 Three options to introduce criminal cartel provisions to the Commerce Act have been considered – adapting the current section 30, adopting the Australian regime, or creating new provisions while providing enhanced certainty.

27 An advantage of adapting the current section 30 is that people are familiar with the language and concepts of the provision and there is existing case law to guide interpretation. However, it is currently too broad and some change would be required to clarify hard-core cartel behaviour. It is also unclear whether section 30 would cover all elements of the OECD definition of cartel conduct. In addition, section 31 – the joint venture exemption – is too narrow in its application. It currently has a chilling effect on pro-competitive joint venture activity. Regardless of whether cartels are criminalised, it is widely considered that the joint venture provisions need reform.

28 Adopting the Australian criminal regime would have potential benefits including harmonisation, reduced compliance costs for trans-Tasman businesses and greater development of case law. However, this option received little support. Notably, all the Australian submitters on the discussion paper put forward reasons why New Zealand should not replicate the Australian provisions. It was criticised as suffering from overreach, duplication, unnecessary provisions and an unsatisfactory joint venture exemption. It was not recommended as an example to follow.

29 I propose that the draft bill develop the third option of creating new provisions while providing enhanced certainty. This would involve repealing sections 30-33 of the Commerce Act and replacing them with a new civil and criminal regime. This approach will draw on the existing section 30 to the extent possible, along with Australian, Canadian and American laws. It involves the greatest degree of change.

30 The main benefit of this option is that it would provide an opportunity to address the issues identified with section 30, allowing for tighter drafting to ensure that only hard core cartels are caught. It would also provide more flexibility to tailor an approach which is suitable to New Zealand. This option has also been designed with a clearance mechanism to give business ex ante certainty about the operation of the cartel provisions. While there is scope for unintended consequences, drawing on law from other jurisdictions should reduce these risks.

31 Note that section 27 will be unaffected by the proposed changes.

Policy Parameters for the Exposure Draft Bill

32 It is important to note at the outset that the proposed regime below should be considered as a whole as the different elements have been designed to complement each other. For example, if criminal prohibitions were adopted but certainty was not given to the Commission's leniency program, it would undermine the effectiveness of the Commission's cartel enforcement. The proposals below should be considered as a package. They have been designed with the principles of certainty, simplicity, fairness, proportionality, and reasonable enforcement, litigation and compliance costs in mind.

33 A summary of the parameters is set out on a single page in the appendix.

Civil and criminal prohibitions

34 I propose that the draft bill include both civil and criminal per se offences for cartel conduct. This would allow the Commission to criminally prosecute only cases of serious cartel conduct while retaining a civil prohibition to allow for private actions for damages and cover situations where only corporate liability can be established, or situations where a lower level of enforcement action is justified.

35 The civil prohibition would be identical to the criminal, with the exception of the mental element (discussed below). This is the approach taken in other jurisdictions, including Australia, and will thus contribute to greater harmonisation. It is also the approach in a number of other areas of law, such as the Securities Markets Act. The creation of a dual civil/criminal system was supported by a number of submitters.

36 It is expected that like Australia, guidelines will be developed by the Commerce Commission to give more guidance on the circumstances where the Commission would refer cartels for criminal prosecution, and when they will be prosecuted civilly. These guidelines would make the "public interest" test of the general Prosecution Guidelines more tangible. In Australia, under the ACCC prosecution guidelines, cartels are only criminally prosecuted if:

a they are longstanding;

b they caused or had the potential to cause a significant impact on the market or damage to consumers;

c participants were previously involved in cartels; and/or

d the value of affected commerce exceeds $1million in a year.

Other factors could include deliberateness or secrecy. In Australia the list is non-exhaustive and the factors are considered holistically – no single factor is determinative.

37 It is not appropriate to include factors such as those above in legislation to further distinguish between conduct subject to criminal or civil sanction. They are more appropriately considered in prosecution decisions (and may be similar to factors potentially considered in sentencing). Otherwise, it may create strong incentives for parties to dispute the scale of the harm caused or the size of the relevant market. This would require detailed economic evidence and only serve to increase costs and delay trial without any gain in certainty for the accused.

38 It is important to create a bright line between conduct which is legal and illegal – this is a strong consideration in the design of the offence to give certainty to business. There is not such a pressing need to clearly distinguish between conduct subject to criminal or civil sanction as it is not critical for those engaging in illegal activity to know with any degree of precision the exact penalty if they are successfully prosecuted.

39 Note that civil proceedings will be stayed if criminal proceedings are started, to avoid any possibility of a form of double jeopardy. If a defendant is acquitted in criminal proceedings, but the judge believes that the offence has been proved to a civil standard, the judge should be able to impose civil penalties, without the need for further Court proceedings. If criminal proceedings are brought against a defendant, they cannot later have proceedings brought against them for a civil pecuniary penalty.

Physical elements

40 An offence requires both physical elements and mental elements. I propose the following physical elements for the draft bill:

- Entering into an agreement (contract, arrangement or understanding)/with a competitor/to engage in cartel behaviour; and
- implementing an agreement/with a competitor/to engage in cartel behaviour.

An agreement

41 In New Zealand, as in Australia, the terms "contract, arrangement and understanding" are used for an agreement. Each of these concepts requires that there be two or more parties. The term "contract" has its normal common law meaning. "Arrangements" and "understandings" are terms that describe something less than a formal contract. The essential elements of these are: communication giving rise to a meeting of minds among the parties that embodies an expectation as to the future conduct of at least one of the parties, and that such party or parties be under some type of moral obligation to conduct themselves in the way that their communication has indicated.

42 Given the reasonably high degree of certainty and understanding around the scope of "contracts, arrangements and understandings" and strong stakeholder support for this formulation, it should be retained in the cartel offence. The offence should also utilise the current Commerce Act structure of prohibiting *provisions* in contracts, arrangements or understandings.

With a competitor

43 It is essential that cartel provisions are only applied to agreements between competitors (or people who, but for the agreement, would be competitors). This ensures that the offence covers horizontal conduct rather than vertical conduct (between entities in different parts of the supply chain). Vertical arrangements can be pro-competitive and without an exclusion, common business practices such as franchise agreements could be criminalised. The offence should specify that the alleged principal offenders are competitors in a way that excludes vertical arrangements.

To engage in cartel behaviour

44 The OECD recommends criminalising four categories of conduct: price fixing, bid rigging, output restrictions and market allocation. Section 30 in the Commerce Act covers price fixing and has also been used in a bid rigging case. It most likely prohibits output restrictions because of the economic interrelationship between price and output, but it is an open question whether section 30 covers market allocation.

45 Some jurisdictions have chosen to criminalise all four of the OECD categories of cartel offence. In some jurisdictions, bid rigging and output restrictions are regarded as subsets of price fixing and/or market allocation, as the impact is to affect pricing or divide certain customers between competitors. Some jurisdictions have only criminalised bid rigging or made it a separate offence.

46 There are two approaches to defining cartel behaviour – either by reference to its effects on price, or by reference to the specific behaviours (i.e. the OECD definition).

47 I recommend that the offence specifically targets the actions in the OECD definition, rather than the effect on price. With an "effects" definition, economic evidence would likely be required, making trials considerably more complex. It is also difficult to prove any economic question beyond reasonable doubt. The second-round and unforeseeable effects of cartels may also be captured, which would lead to extended liability.[7] Specifying the actions which are prohibited is more conventional because it focuses the prohibition on the behaviour rather than the foreseeable effects. It also gives greater certainty as to the type of conducted which is prohibited but does place greater reliance on exceptions and defences to exclude pro-competitive conduct.

Implementing a cartel agreement

48 It is desirable to have a separate offence for implementing agreements because it allows for prosecutions for implementing cartel agreements formed before the law is changed, providing stronger incentive for cartels to disband when criminal provisions come into effect. Parties to an agreement can also change over time, additional parties can join at a later date, and an agreement can be suspended and subsequently "re-implemented". An offence for implementing agreements would cover these situations.

Mental elements

49 The principal distinction between civil prohibitions and criminal offences is that criminal offences generally require a mental element or state of mind ("mens rea"). This helps to distinguish hard-core cartel conduct from less egregious violations, ensuring the criminal law only captures those acts for which there is fault in the sense of culpability, not effects.

50 I propose that the standard approach to defining the mental element of a criminal offence is adopted: identifying the physical elements and then assigning appropriate mental elements to them. For a cartel offence there are the conduct elements of "entering into an agreement" and "implementing and agreement" and the circumstance element of "an agreement to engage in cartel behaviour".

51 Intention (meaning deliberateness) is generally required for inchoate liability. This means that the mental element for "entering an agreement" should be intention, given its conspiracy-like nature. Given the deliberate nature of cartel conduct, intention is also the requisite mental element in relation to the implementation of the agreement.

52 Knowledge of essential facts is most apt in relation to the circumstances existing when a person acts. Knowledge that the agreement is "an agreement to engage in cartel behaviour" is the appropriate mental element for the circumstances of both offences (forming and implementing an agreement).[8]

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[7] For example, a cartel in an automotive component could have an effect on the price of the finished automobile. The component may not be sold directly in New Zealand, but the automobile is, leading to extended liability based on an effects test.

[8] Note that this knowledge refers to the facts that can be drawn on to establish that the agreement is one to engage in cartel behaviour – not knowledge of their legal characterisation as cartel behaviour.

The civil prohibition

53 A civil prohibition generally does not include a mental element. The current civil prohibitions use "purpose/effect" to enquire into either the rationale for entering into an agreement, or the likely effects. "Purpose" does not require an inquiry into mental states or moral blameworthiness but can be read as a reasonable foreseeability test. In the cartel context, having an effects test on the per se prohibition introduces an unnecessary degree of uncertainty for parties entering into an agreement. It also means that if market circumstances change so that a previously harmless agreement now has an anti-competitive effect, it becomes prohibited. The effects test can also bring in to play effects in downstream markets, even if the primary market is not cartelised. I recommend that the new civil prohibition have a purpose element.

Exceptions, exemptions and defences

54 Not every agreement which literally fixes prices has an anti-competitive effect. Some cartel behaviours can also be related to the lawful realisation of cost-reducing or output-enhancing efficiencies, particularly price fixing and market allocation (e.g. in joint ventures, franchises or networks). Some activity that has useful public benefits (such as activity that is critical for environmental or health and safety reasons) can also fall within the categories of hard-core cartel activity. For example, doctors frequently develop rosters for after hours' service, to ensure that they are not all on call 24 hours a day. These agreements can be considered market allocation schemes because they divide up a market, depending on the time of day.

55 It is not the intention to prohibit conduct that has desirable economic effects or is clearly in the public interest. As well as having a clearly defined offence, having the right exceptions, exemptions and defences is important to ensure these types of activities are not caught by the cartel prohibitions (both criminal and civil).

Existing exceptions

56 The Commerce Act contains a number of exceptions to Part 2 (sections 43-46). These include things such as export cartels, terms and conditions of employment and the carriage of goods by sea to or from New Zealand.

57 I recommend that all existing exceptions to Part 2 of the Act are applied to the cartel offence. While some submitters commented on the scope and/or the need for some of the exceptions, most supported retaining all of them.

Ancillary restraints

58 Joint venture agreements often include restraints of competition between the parties and the joint venture, or between the parties. They may also include restraints on pricing, output or market allocations. The US and Canada have developed an ancillary restraint defence to exempt those restraints which are ancillary to a lawful purpose and reasonably necessary to accomplish that purpose. Ancillary restraints exclude per se liability but liability can be imposed under a competition test.

59 The Canadians have included this defence in their legislation. It states:

"No person shall be convicted of an offence under subsection (1) in respect of a conspiracy, agreement or arrangement that would otherwise contravene that subsection if:

a That person establishes, on a balance of probabilities, that

i it is ancillary to a broader or separate agreement or arrangement that includes the same parties; and

ii it is directly related to, and reasonably necessary for giving effect to, the objective of that broader or separate agreement or arrangement; and

b the broader or separate agreement or arrangement, considered alone, does not contravene that subsection."

60 The main purpose of the agreement that the ancillary restraint is designed to achieve is first considered. If this purpose is legitimate, then the restraint is looked at to determine whether it is reasonably necessary to achieve that purpose. If the purpose of the broader agreement is not legitimate, the ancillary restraint deserves per se condemnation.

61 An ancillary restraint defence would help to ensure that only hard core cartel conduct is targeted and not those restraints which seek to achieve efficient collaboration between competitors. Furthermore, it is not prescriptive in the structure of agreements that would be exempt from the cartel offence. Thus it would not just cover joint venture situations but all types of arrangements, including franchises and network businesses. It would not chill pro-competitive activity and would also be relatively easy for businesses to assess whether they come within its scope as it should be clear whether the broader, separate agreement is a cartel. The trickier question may be if the restraint is no broader than necessary to achieve the broader agreement's purpose.

Joint ventures

62 A joint venture is an association of persons formed to pursue a particular business objective together for mutual profit. They sit on a continuum between cartels and fully integrated mergers, and can come in a variety of structures, durations, forms and scopes. They may also be entered into for a variety of reasons e.g. 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.

63 Joint ventures are a legitimate form of business activity that can have pro-competitive, efficiency-enhancing effects and should be exempt from per se cartel offences. However, the current joint venture exemption in the Commerce Act (section 31) is inadequate, preventing potential beneficial collaboration between competitors, and needs reform. There is widespread consensus that it needs to be changed.

64 Joint ventures can enhance efficiency through spreading costs and risks, creating economies of scale, eliminating duplication of facilities, accessing complementary resources and pooling know-how. They can facilitate the market entry of a new entity that would not otherwise exist, or the development of new products. In order to function, a genuine joint venture may need to set prices, which because of its cooperative nature, may be seen as a form of price fixing.

65 They can also have anti-competitive effects through the suspension of rivalry between partners or by facilitating collusion between partners in areas outside the joint venture. There are two main ways of using a joint venture to cover up cartel activity. One is to call the cartel a joint venture, being one for the purpose of camouflaging cartel activity. The other is to have a legitimate joint venture with some degree of integration of business functions, but to add restraints that effectively form a cartel. These restraints will be broader than necessary for the legitimate joint venture activity.

66 Genuine joint ventures do not deserve per se condemnation. They should be individually assessed for their competitive effects and excluded from the scope of a cartel offence.

67 Section 31 provides an exemption for joint venture pricing. It defines a joint venture broadly as an activity in trade, carried on by two or more persons, whether or not in partnership, or carried on by a body corporate. It then restricts the exemption to the pricing of supply to the joint venture, in proportion to the respective interests of the parties, or in the case of a body corporate to the supply of goods or services by it. The exemption is widely seen as inadequate. It is appropriate for some mining and manufacturing situations but is not suited to most other sectors, or to more innovative technology based arrangements. The narrow exemption chills pro-competitive activity and leads to a favouring of incorporated joint ventures, even though they may not always be the most optimal structure.

68 In redefining a joint venture exemption, it is important to make it flexible enough to capture the full range of legitimate joint ventures so that parties are not forced into using less optimal or efficient structures. However, it must also exclude joint ventures used as a guise for cartel activity.

69 A way to do this is to define a joint venture in economic terms, requiring some integration of functions. In the US, a joint venture is defined as an integration of resources in a way that "holds the promise of increasing a firm's efficiency and enabling it to compete more effectively."[9] Another proposal, in the Australasian context is:

a "A reference to a joint venture is a reference to an activity in trade or commerce carried on between two or more parties whether carried on in partnership or by a body corporate formed by them; and

b The activity carried on is one in which there is a substantial integration of the parties production, management, distribution, finance or other resources, or a significant number of these resources, with the objective of producing goods or services by way of joint activity between them using in common the resources contributed by each of them."[10]

70 The key elements in these approaches are an integration of resources and the prospect of efficiency gains. They avoid a prescriptive structural definition of a joint venture while excluding "cartels in disguise", whose primary purpose is to avoid the application of cartel prohibitions. A necessary limb will be assessing whether a provision is reasonably necessary to operate or achieve the purposes of the joint venture.

71 Another advantage of having a joint venture exemption is that it would achieve some alignment with the Australian regime which also has a joint venture exception, although this has been criticised in a number of respects:

a For the exemption to apply, the cartel provision can only be in a contract (and not in an arrangement or understanding) which is considered impractical;

b It only applies to joint ventures for the production and/or supply of goods or services; and

c The wording "for the purposes of the joint venture" is seen as obscure. Must the cartel provision be *only* for the purposes of the joint venture, *predominantly* for its purposes, or *substantially*?

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[9] *Copperweld Corp v Independence Tube Corp* 467 IS 752 (1984)

[10] W Pengilley, "Thirty years of the Trade Practices Act: Some Thematic Conclusion", 2004 Annual Competition Law Conference, Sydney May 2004.

These issues will be taken into account when drafting the joint venture defence for the New Zealand regime.

72 It could be argued that a joint venture exemption is unnecessary if an ancillary restraint defence is included in the regime, as this would capture joint ventures. The term ancillary restraint is used in two slightly different ways in the US. In one sense, an ancillary restraint is contrasted with a naked restraint. A naked restraint has no purpose other than stifling competition but an ancillary restraint is ancillary to some efficiency-enhancing cooperation. In this sense an ancillary restraint is a *component* of a joint venture. In the second sense, "ancillary restraint" is applied to restraints which are *collateral* to a joint venture, such as restraints between the parents to the joint venture. A joint venture exemption would give greater certainty as to what can constitute a "broader, legitimate agreement", and the ancillary restraints defence would provide some protection for collateral restraints. Having both exceptions means that there is no need to dispute where the line is drawn between the "core" of the joint venture and any collateral arrangements.

Agreements of more than 50 people

73 Section 32 exempts agreements of more than 50 people from section 30. It is intended to allow trade associations to make price recommendations. There is little economic justification for this exemption and the OECD has specifically recommended it be repealed.[11] Australia repealed a similar provision in the Trade Practices Act in 1995. Submitters who commented on this exemption agreed that it is unnecessary. I recommend that this is not applied to the new cartel offence.

Joint buying

74 Sections 33 exempts joint buying agreements from section 30. This can have beneficial effects if the savings achieved through joint buying are passed on to consumers. It can also promote competition by permitting small traders to combine their purchases and advertising and thereby to compete more effectively against larger competitors. It is an important exemption in relation to franchising.

75 However, there is some uncertainty around what is meant by "collectively acquired". Section 33 states that goods or services can be acquired "directly or indirectly" indicating that it is intended that a wide variety of group purchasing schemes should enjoy section 33 protection. However, an early Australian case[12] found that an indirect acquisition was one through an agent, and that where an intermediary took title to the goods and sold them in his or her own right there was no indirect supply by the original supplier to the ultimate acquirer. To limit the section in this way may downplay the role of "directly or indirectly".

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[11] OECD, *Product Market Competition and Economic Performance in New Zealand,* Economics Department working Papers No. 437, Annabelle Mourougane and Michael Wise ECO/WKP (2005)24.
[12] *TPC v Legion Cabs (Trading) Co-op Soc Ltd* (1978) ATPR 40-092

76 I propose that a joint buying exemption apply to the new cartel prohibitions, but that it is amended to remove the uncertainty about the scope of "collectively acquired".

Notified arrangements between bidders

77 There can be pro-competitive collaboration between bidders in a bidding process. Vendors with complementary assets can form consortia to bid, or offer each other mutual discounts for the purposes of separate tenders. Bid rigging is an area where secrecy can be a useful dividing line between pro and anti-competitive behaviour. Both Canada and the UK exempt agreements between competitors where they are made known to the person requesting bids. I recommend that a similar exemption apply in New Zealand.

Clearance

78 When a law is changed, there is a period of uncertainty as to how it will be applied by an enforcement agency and interpreted by the Courts. In areas that are infrequently litigated (such as cartels), the uncertainty can linger for a considerable period. This uncertainty can have a chilling effect on commercial activity.

79 To promote predictability and mitigate this chilling effect, I recommend that a clearance process be introduced for restrictive trade practices (RTPs), based on the proposed exemptions. A clearance process received strong support in consultation.

80 In the merger context, where a potential acquirer wishes to protect a merger from legal challenge under the Commerce Act, either from the Commission or from other parties in the market, it may apply to the Commission for clearance under section 66 of the Act. The Commission may grant clearance where it is satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening of competition in a market. This provides ex ante commercial certainty to the applicant.

81 Clearance processes have been considered for RTPs but have been rejected on the grounds that they would be too costly and administratively burdensome. There is also a view that the onus should be on businesses to comply with the law on an ongoing basis. Businesses should take Commerce Act risk into account in determining their conduct. Transferring the burden of assessing this risk to the Commission could be viewed as an inefficient use of public resources. There are implications for the effectiveness of the Commission in devoting time to assessing clearance applications.

82 However, the benefits of a clearance regime arise from the certainty it provides and relate directly to the scope of the clearance regime. The costs of a clearance regime will increase in proportion to the number of applications, which will also depend largely on the scope of RTPs available for clearance.

83 The cost of the clearance regime can be reduced by limiting the availability to obtain clearance to certain practices. I propose that the clearance regime is aligned with the exemptions to the cartel offence, and also long term contracts. Long term contracts can be economically similar to (and may be substitutes for) an acquisition or merger, and have obvious potential pro-competitive effects.

84 The Commission will conduct a two-step process in assessing clearance applications. The first will be to consider whether the cartel provision is reasonably necessary to achieve the purposes of a wider agreement. If it is, the Commission will then consider whether the wider agreement will, or is likely to, substantially lessen competition. If the answer is no, the Commission can issue a clearance, giving immunity to the agreement from legal challenge under the cartel prohibitions and section 27.

85 If clearance is limited to conduct which would be caught by the exemptions, the Commission's initial decisions will require it to consider the meaning of the exemption provisions. The Courts may also be called to interpret these provisions (if, for example, the Commission declined clearance on the grounds that the conduct did not fall within the exemption involved). This would provide greater certainty to all parties without having to wait until prosecutions are brought. The demand for, or complexity of, clearances would be expected to lessen over time as greater clarity is obtained over those provisions.

86 It is difficult to estimate the number of clearances that would be filed, and it could be significant in the short and medium term. Given this risk, I propose that the Commission is given the ability to manage excess applications by having the discretion not to accept an application in certain circumstances such as if it considers the application does not raise new or novel issues or if it has too many clearances on hand. I also propose that the legislation include a review provision to assess the effectiveness of the clearance process and its ongoing need.

Penalties and Procedure

Penalties

87 Overseas, the maximum term of imprisonment for cartel conduct ranges from five years (UK), to 10 years (Australia and the US), through to 14 years (Canada). Penalties for comparable offences in New Zealand range from five years (tax offences, insider trading, market manipulation, false statement in financial report), to seven years (money laundering, dishonestly using a document, obtaining by deception) through to 10 years (false statement by a promoter).

88 A longer statutory maximum will lead to longer sentences being imposed and a marginally greater deterrent effect. Cartels should be considered a serious criminal violation. With a shorter statutory maximum, there is a greater likelihood that defendants will receive an alternative sentence and the deterrent effect of criminalisation could be undermined. Therefore, I propose that a maximum sentence of seven years be adopted.

89 I also propose that the maximum fine for corporations be set at the same level as the maximum pecuniary penalty for corporations. Large fines that jeopardise a defendant firm's solvency have the potential to weaken or remove competition, and so cannot be relied upon as a complete solution. For this reason the maximum fine for corporations should not be higher than the existing maximum pecuniary penalty.

90 The current maximum pecuniary penalty for cartel conduct (and any breach of Part 2 of the Act) is the greater of $10,000,000; or either 3 times the value of any commercial gain resulting from the contravention, or 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

91 I also recommend that the sentencing judge be provided with the discretion to impose any criminal penalties under the Sentencing Act 2002 (e.g. home detention, community detention, supervision, community work and reparation) along with civil orders available under the Commerce Act as part of the sentence. This will provide the Court with greater flexibility in sentencing.

Limitation

92 Some submitters suggested that it is important to have a limitation provision to provide commercial certainty and guard against the unfairness of a trial being conducted after the relevant documentation has been destroyed. The current limitation period in the Commerce Act is three years after the conduct was discovered and no more than 10 years after the conduct occurred.

93 However, comparable regulatory offences do not have limitation periods.[13] There is no reason why the cartel offence should be subject to a limitation period not imposed on other regulatory offences. Further, all criminal offences are subject to the jurisdiction of a Court to stay the proceedings, including where there has been an abuse of process, or where due to the length of time since the alleged offending the defendant will not be able to obtain a fair trial. This is sufficient to deal with any potential abuse or unfairness.

[13] For example, the Companies Act, Securities Act, Securities Market Act and the Tax Administration Act do not provide any limitation in respect of indictable offences (although they do provide for limitation periods between three and 10 years for summary offences).

Corporate criminal liability

94 Submitters supported the extension of criminal liability to corporations. While corporations cannot be imprisoned, there is a stigma associated with conviction. Practical difficulties could also arise if corporations were only civilly liable e.g. if there is no corporate criminal liability, two proceedings may be required – one criminal, for the individuals, and one civil, for the company. Further, the civil proceeding may need to be stayed so that it did not interfere with the criminal proceedings, causing delays in resolving the claims against the company. I recommend that corporations should be criminally liable for cartel offences.

Self-incrimination

95 Section 23(4) of the Bill of Rights Act gives every person who is arrested, or detained under any enactment, for any offence or suspected offence the right to refrain from making any statement and to be informed of that right. Everyone who is charged with an offence has the right not to be compelled to be a witness or to confess guilt under section 25(d). These together are frequently referred to as a "right to silence" or a "privilege against self incrimination". This privilege may be restricted where this can be justified in a free and democratic society.

96 The right to silence is limited in the Commerce Act. The Commission has the ability to compel evidence during its investigation, but cannot use that information against that person. In particular:

- Section 98 of the Commerce Act provides that the Commission may require a person to provide information, produce documents, or give evidence;
- Section 106(4) provides that a person is not excused from providing information, producing documents, or giving evidence on the ground that to do so might tend to incriminate that person; and
- Section 106(5) provides that a statement made by a person in answer to a question put by or before the Commission may not be used in proceedings for a pecuniary penalty or (with a few exceptions) in criminal proceedings.

97 The ability to compel evidence is important for the Commission. The complexity of cartel conduct, coupled with secrecy and the frequent lack of physical evidence, justifies restrictions on the right to silence for investigatory purposes. Frequently, in the business context, a person will owe an obligation of confidence to their employer and may not be able to cooperate with an investigation without a compulsion that overrides existing duties and obligations of confidence.

98 A limit on the right to silence can be justified in the business law context, as opposed to other areas of law, because people voluntarily enter into the business environment and can refrain from entering this environment if they do not agree with the underlying rules.

99 In the UK, Canada and Australia, the competition authorities are able to compel self-incriminating statements in the course of their criminal investigations into cartel activity, though these statements cannot be used against the person in criminal proceedings for cartel offences.

100 I recommend that the existing protections on the use of self-incriminating statements in the Commerce Act apply to the new cartel prohibitions.

Obstruction

101 Section 103 of the Commerce Act sets out offences for failing to comply with section 98 information or interview orders, providing misleading information, obstructing a warranted search, and misleading or deceiving the Commission. The maximum fine is $10,000 for individuals and $30,000 for bodies corporate.

102 Comparable legislation in New Zealand provides for substantially greater fines and/or imprisonment. For example, the maximum penalty for destroying or altering records under the Serious Fraud Office Act 1990 is two years' imprisonment or a fine of $50,000. The equivalent provision in the Australian Trade Practices Act provides for a penalty of up to 12 months imprisonment.

103 The threat of imprisonment would be a real deterrent for those who may attempt to mislead or deceive the Commission, or who refused to comply with a notice under section 98. If a sentence of imprisonment is available in respect of cartel conduct, but not in respect of obstruction, then compliance with Commission investigations could fall. Persons under investigation might weigh up the risks and available penalties and opt to take the risk of obstruction proceedings rather than cartel proceedings.

104 To help effective investigation and enforcement by the Commission, I propose that the penalty for obstruction be a short term of imprisonment, with a maximum term of 18 months. For a body corporate, I propose that the maximum fine is $1,000,000.

Independence in Cartel Prosecutions

105 Under the current civil regime, the Commerce Commission is responsible for investigating and prosecuting cartel conduct. The criminal cartel prohibition will be an indictable offence or a category 4 offence under the criminal procedure simplification proposals. This means that it would be triable in the High Court only. The Solicitor-General is responsible for prosecuting criminal jury trials. Only the Solicitor-General can grant immunity, however the Solicitor-General does not generally initiate or conduct the prosecution of offences or crimes. In cases of indictable crimes, the prosecution is initiated by an investigating agency and conducted by Crown Solicitors.

106 In this process, informations are laid by an investigating agency, which has responsibility for the initial charging decisions. A Crown Solicitor takes control of indictable prosecutions after the committal for trial, although they often assist investigating agencies prior to that. After committal, the Crown Solicitor determines whether to proceed, and on what charges, and is not subject to instructions from the investigating agency. The Crown Solicitor often consults with the prosecuting agency in exercising its discretion in respect of the conduct of the prosecution.

107 The Serious Fraud Office (SFO) is an exception to this regime. It is explicitly independent of the Attorney-General. The Director of the SFO determines whether or not a prosecution should be taken and on what charges, and lays an information accordingly. However, prosecutions must be conducted by a member of the Serious Fraud Prosecution Panel (which may include Crown Solicitors).

108 There was strong support among submitters for the involvement of a prosecution panel (like the Serious Fraud Office) or the Crown Solicitor network (as in the case of indictable prosecutions) to provide independence in cartel prosecution decisions.

109 There are clear public policy reasons that the conduct of indictable prosecutions should be carried out independently of the investigating agency. In 2000, the Law Commission considered and rejected the idea of investigating agencies conducting indictable prosecutions. There has been no suggestion that cartel prosecutions require any different treatment from other indictable matters. However the decision to prosecute, and consequential laying of informations, is routinely conducted by the investigatory agency, most commonly the Police. The Law Commission concluded that the filing of informations by investigating agencies remained appropriate.

110 However, cartel prosecutions can be highly complex and it is unlikely that all Crown Solicitors would have the requisite skills and expertise to conduct prosecutions. Thus I recommend that a specialist prosecution panel is formed of suitably qualified barristers and solicitors, convened by the Solicitor-General, and independent from the Commerce Commission. The Commission would commence by laying an information. The case would then be referred to a member of the Solicitor-General's cartel prosecution panel, for prosecution in accordance with the Prosecution Guidelines. Commission staff would be able to support the prosecutor in this process. The Commission may consult a member of the panel in the preparation of a case.

Leniency

111 Criminal immunity is granted to secure prosecutions in New Zealand. In some jurisdictions it is also used for investigatory purposes to investigate general criminal offending. Leniency and immunity are tools used in a number of jurisdictions to detect cartel activity with significant success. Under leniency, conditional immunity from civil and criminal prosecution is offered to the first member of a cartel who tells the enforcement agency about its operation and provides evidence.

112 The Commission's leniency program is an essential tool in its detection of cartels. It encourages cartelists to confess and provide first-hand, direct "insider" evidence of conduct that other parties to the cartel want to conceal. Leniency helps to uncover cartels, destabilise existing cartels and acts as a deterrent to those contemplating entering into cartel arrangements. Evidence can be obtained more quickly and at a lower direct cost, leading to prompt and efficient resolution of cases. An effective leniency policy is considered international best practice.

113 Submitters were generally supportive of leniency. A number of submitters noted that with criminalisation, leniency applicants will need certainty that they can obtain both civil and criminal immunity. Without this certainty, the effectiveness of the leniency policy would be undermined. This would diminish the Commission's ability to detect and investigate cartels and would be counterproductive.

114 Some jurisdictions have provided this certainty in legislation, with the investigating agency granting civil and criminal immunity. In New Zealand, the Solicitor-General has the power to grant immunity from criminal prosecution. The "automatic" nature of cartel leniency – leniency is given to the first in the door – is different to the grounds on which immunity is generally offered in criminal cases. Given the success of the cartel leniency programme, which depends on the certainty that leniency is available to the first applicant, the current criminal immunity policy ought to be amended to accommodate cartel leniency.

115 In both Canada and Australia, a leniency applicant approaches the enforcement agency (the ACCC or Competition Bureau) seeking leniency. The enforcement agency then refers the case to the equivalent of the Solicitor-General for criminal leniency. Once civil and criminal immunity have been confirmed, this is communicated back to the applicant. The leniency applicant only has to deal with the enforcement agency, even though the decision on criminal immunity is made elsewhere.

116 I propose that the Solicitor-General be invited to produce draft guidelines, in consultation with the Commerce Commission, on how immunity from criminal prosecution would be granted in the cartel context. I propose that these draft guidelines should be released by January 2011 so that they can be considered along with the Bill, to give a full picture of how the regime will work.

Jury Trial

117 Trial by jury is a longstanding feature of the criminal law in common law jurisdictions. However, section 361D of the Crimes Act confers on the Court the power to order trial by a judge alone in appropriate cases – those that are likely to be lengthy and/or complex. The majority of cartel trials are likely to meet the requirements for a judge alone trial under section 361D. Most are likely to take longer than 20 days and so will be "lengthy". It is likely that even relatively simple price fixing conspiracies are likely to be "complex".

118 Although section 361D was enacted relatively recently, the provision has been considered by the Court of Appeal, and a number of complex and lengthy cases have been heard by a judge alone under the provision. There appears no reason why the Courts would not apply section 361D in appropriate cartel cases, even if this meant that most cases were heard without jury trials. Note that sections 361B(6) and 361D(5) provide that separate applications and orders are required in respect of all accused for an order for a judge alone trial.

Territorial application

119 Cartels are often global in nature – a consequence of the globalisation of international commerce. An overseas cartel can have significant harmful economic effects in New Zealand irrespective of where the agreement is reached. It is appropriate that the Commerce Act provide jurisdiction for the Commission to prevent and deter conduct which has an effect in New Zealand, and for affected parties to be able to seek damages for the harm caused to them. That is the position in the Canadian and American law.

120 As a result of a recent Supreme Court decision[14] and submitter comment on effects based jurisdiction, section 4 of the Commerce Act has been reviewed, which applies the Act to some conduct outside New Zealand. This section also applies an effects test to mergers and acquisitions.

121 The current cartel provisions in the Act have a narrower jurisdictional reach than common law or statutory conspiracy offences. At present the jurisdiction is limited to:

- Conduct in New Zealand, including conduct by a person who is not resident or carrying on business in New Zealand.[15]
- Conduct outside of New Zealand, which has an effect in New Zealand, if it is carried on by persons who are resident or carrying on business in New Zealand.

122 This creates loopholes in the Act. Individuals or corporate entities may enter into anticompetitive arrangements overseas directed at a New Zealand market, and can avoid the jurisdiction of the Commerce Act by operating through local entities and taking care not to hold meetings in, or to send communications to, New Zealand.

[14] *Poynter v Commerce Commission*, [2010] NZSC 38.
[15] Under the Act a corporation outside of New Zealand may be attributed the conduct of its directors, servants or agents in New Zealand.

123 The conspiracy and jurisdiction provisions of the Crimes Act (sections 6, 7 and 310) allow for the prosecution of conspiracies formed outside New Zealand where they are, at least in part, implemented in New Zealand. There are strong analogies between the formation of cartels and criminal conspiracies. This approach would enable effective cartel enforcement without over-extending the reach of the Commerce Act. The normal powers of extradition will be available to bring individuals before the New Zealand Courts in appropriate cases. These territorial application rules will be extended to the civil provisions to enable appropriate private damages actions.

124 To make this territorial application effective, a minor amendment is also required to section 90(4)(b) to attribute conduct carried out on behalf of a person, to that person, if the conduct is at the direction of that person.

125 Section 4(3) provides for a very wide-ranging extraterritorial application of the Commerce Act in respect of mergers and acquisitions. It provides that "section 47 of this Act extends to the acquisition outside New Zealand by a person (whether or not the person is resident or carries on business in New Zealand) of the assets of a business or shares to the extent that the acquisition affects a market in New Zealand". This territorial scope is overly broad. The Act does not however provide any means for imposing remedies upon the local subsidiaries of the merging overseas entities, if the merger results in a substantial lessening of competition in New Zealand.

126 Each year a number of multinationals voluntarily seek clearance for their mergers from the Commerce Commission, even though the Commission would have no recourse against them if their merger resulted in a substantial lessening of competition in New Zealand. A legislative amendment to reduce the scope of jurisdiction for mergers but ensure the application of appropriate remedies would ensure that the Commerce Act is effective in preventing harmful mergers in New Zealand.

127 To remedy this deficiency, I propose the adoption of section 50(A) of the Trade Practices Act, with appropriate adaptation to take into account slight differences between the clearance and authorisation processes in New Zealand. Section 50(A) applies where an international merger takes place, which results in a party obtaining a controlling interest in a body corporate carrying on business in Australia. If the acquisition occurs outside Australia and it is likely to result in a substantial lessening of competition in a market in Australia, application can be made for a declaration to that effect. The party then has six months to remedy the situation and if it is not remedied, the parties are not permitted to continue to carry on business in Australia. Adoption of section 50(A) will enable the repeal of section 4(3) of the Commerce Act.

CONSULTATION

128 The Commerce Commission, Treasury, Ministry of Justice, Police, Ministry of Foreign Affairs and Trade, Crown Law, and the Ministry of Transport were consulted on the proposals in this paper. The Department of Prime Minister and Cabinet was informed.

FISCAL IMPLICATIONS

129 More detailed costings for criminalisation will be developed after consultation on the draft exposure bill. I anticipate that there may be some one-off set-up costs to enable the Commission to develop appropriate guidelines and adjust its procedures and make any necessary capital investments to undertake criminal investigations. It may be possible to meet these costs from reprioritisation within the Vote, if not within the existing appropriation. There will be some ongoing costs associated with increased investigation costs.

130 Any ongoing costs from clearances should be met through fees, which will be set at a level roughly commensurate with costs.

131 The cost of prosecutions could be met by the Commerce Commission's litigation fund. There may be a need for ad hoc transfers to Vote Attorney-General to cover the costs of prosecution, if these are funded by the Attorney-General.

132 It is uncertain if cartel prosecutions will impose higher costs on Vote Courts than civil cartel proceedings. At this stage I am assuming the costs are similar, or not so different as to warrant funding changes.

133 Based on US imprisonment rates for cartel offences, I would anticipate the imprisonment of no more than 5 people in New Zealand for cartel offences, over a period of 10 years. This number is too low to have any direct impact on Vote Corrections.

HUMAN RIGHTS

134 There may be a prima facie breach of the right to silence, if the Commission uses its compulsory interview powers for investigations of criminal activities. However, this may be justified because of the seriousness and complexity of cartel conduct, coupled with secrecy and the frequent lack of physical evidence. However, investigated parties may owe conflicting duties of confidentiality to their employer and be unable to cooperate with investigations without a compulsory order which overrides their other duties and obligations.

LEGISLATIVE IMPLICATIONS

135 This paper seeks permission to develop an exposure draft bill which would amend the Commerce Act. I seek Cabinet agreement for me to issue drafting instructions to Parliamentary Counsel Office to draft the Bill. The Bill will be consulted on and then Cabinet will make a decision whether or not to proceed with the legislation.

136 Cabinet has also previously agreed to four changes to the merger and acquisition processes in Part 5 of the Act [CBC Min (08) 26/33 refers]. I propose that these are included in the draft Bill.

REGULATORY IMPACT ANALYSIS

137 As this paper does not seek substantive policy decisions, a final Regulatory Impact Analysis is not required. A draft RIS has been prepared. It was circulated with the Cabinet paper for departmental consultation purposes and is attached to this paper. The draft RIS will be included in the exposure Bill and will also be the subject of consultation.

PUBLICITY

138 I intend to publicly announce the decisions in this paper and propose that it is posted to the Ministry of Economic Development's website.

RECOMMENDATIONS

139 It is recommended that the Committee:

1 Note that the Single Economic Market Outcomes Framework includes a medium-term objective that firms operating in both the Australia and New Zealand markets are faced with the same consequences for the same anti-competitive conduct;

2 Note that Australia has recently criminalised cartel conduct;

3 Note that submitters on the discussion document had mixed views on the merits of criminalisation in New Zealand;

4 Note that a number of issues raised by submitters relate directly to the drafting of the legislation;

5 Agree to the development of an exposure draft bill;

6 Agree to make final policy decisions on cartel criminalisation after consultation on the draft exposure bill;

The exposure draft bill

7 Agree to the following policy parameters for the exposure draft bill:

7.1 Parallel civil and criminal cartel prohibitions;

7.2 Sections 30-33 of the Act be repealed and replaced with new criminal and civil cartel prohibitions, drawing on the wording of the existing prohibitions along with Australian, Canadian and American laws;

7.3 The physical elements of the criminal offence and civil prohibition will be identical and should:

7.3.1 Directly prohibit (without reference to purpose or effects on price): fixing price, restricting output, market allocation, and bid rigging;

7.3.2 Prohibit entering into cartel provisions in contracts, arrangements or understandings;

7.3.3 Include a separate prohibition on the implementation of cartel provisions;

7.3.4 Specify that the alleged principal offenders are competitors;

7.4 For the mental element of the criminal offence:

7.4.1 Intent is required for forming and implementing a cartel agreement; and

7.4.2 Knowledge of the essential facts that would characterise it as a cartel agreement is also required;

7.5 The civil prohibition have a purpose element;

7.6 All existing exceptions to Part 2 of the Commerce Act apply to the new cartel offence;

7.7 An ancillary restraints defence should apply;

7.8 A new joint venture exemption would replace the current joint venture exemption in section 31 of the Act and that the new exemption should:

7.8.1 Define a joint venture in economic terms, requiring a substantial integration of the parties' resources, with the prospect of efficiency gains;

7.8.2 Capture the full range of legitimate purposes of a joint venture including the production or supply of goods or services, research and development, or the ownership of assets;

7.8.3 Exempt prima facie cartel provisions from the cartel offence if they are reasonably necessary to achieve the lawful purposes of the joint venture; and

7.8.4 Provide that such a prima facie cartel provision can be in a contract, arrangement or understanding;

7.9 Section 32, which exempts agreements of more than 50 people from section 30, should not be replaced as there is little justification for this exemption;

7.10 A new exemption for joint buying agreements should replace the current joint buying exemption in section 33, with amendments to the current wording of section 33 to remove the uncertainty about the scope of "collectively acquired";

7.11 Collaboration between bidders should be exempt from the cartel offence where this is made known to the person requesting bids;

7.12 The exceptions, exemptions and defences apply to both the criminal and civil prohibitions;

7.13 A clearance regime, based on the merger clearance regime, should be available for the ancillary restraints and joint venture exemptions to the cartel offence and long term contracts;

7.14 A two step process for clearance will apply:

7.14.1 The Commission considers whether a cartel provision is reasonably necessary to achieve the purposes of a wider agreement; and

7.14.2 If yes, whether the wider agreement is likely to substantially lessen competition.

7.15 The cost of a clearance regime would be covered through cost recovery via fees;

7.16 There should be a review provision for the clearance regime to assess its effects and ongoing need;

7.17 The maximum penalty for the cartel offence be a term of imprisonment of seven years;

7.18 The maximum fine for a body corporate be the same as the current maximum pecuniary penalties in section 80 of the Commerce Act;

7.19 The sentencing judge be provided with the discretion to impose any criminal penalties under the Sentencing Act 2002.

7.20 If a person is acquitted but the judge believes the charges were proved to a civil standard, the judge may impose a civil pecuniary penalty;

7.21 No civil pecuniary penalty proceedings may be brought against a person who had been criminal prosecuted and any civil proceedings are stayed if criminal charges are brought;

7.22 Corporations should be criminally liable for cartel offences;

7.23 Prosecutions will be undertaken by members of a specialist panel, convened by the Solicitor-General, instead of the Crown Solicitors;

7.24 The Commission's existing investigation powers, which include compulsory production of documents and compulsory interviews, would apply to criminal investigations, with the existing protections on the use of self-incriminating statements;

7.25 The penalties in the Commerce Act for obstruction should be increased to:

7.25.1 A short term of imprisonment for individuals, with a maximum term of 18 months; and

7.25.2 A maximum fine of $1,000,000 for bodies corporate;

7.26 The limitation period on obstruction be extended to three years;

7.27 To enable effective enforcement:

7.27.1 The jurisdictional rules applying to criminal conspiracies should apply to a cartel offence and the civil prohibitions;

7.27.2 A minor amendment is required to section 90(4)(b) to attribute conduct carried out on behalf of a person, to that person, if the conduct is at the direction of that person;

8 Note that Cabinet has previously agreed to changes to Part 5 of the Commerce Act on clearance and authorisation procedures [CBC Min (08) 26/33 refers];

9 Agree to include these amendments in the exposure draft bill

10 Note that the current territorial scope for mergers and acquisitions is overly broad;

11 Agree to include in the exposure draft bill changes to the merger jurisdiction that:

11.1 repeal section 4(3) of the Commerce Act; and

11.2 adopt section 50(A) of the Australian Trade Practices Act 1974 (with appropriate adaptations);

12 Authorise the Minister of Commerce to approve any minor and technical changes to the proposed amendments that are consistent with the policy approach outlined in this paper;

13 Invite the Minister of Commerce to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations;

14 Invite the Minister of Commerce to release a draft exposure Bill to enable further consultation without further reference to Cabinet;

15 Authorise the Minister of Commerce to publicly release a draft exposure Bill and supporting material without further reference to Cabinet.

16 Invite the Minister of Commerce to report back to Cabinet by 31 July 2011 on the consultation on the exposure draft bill.

Leniency

17 Note that leniency, whereby a cartel participant is granted immunity by the Commerce Commission in exchange for cooperation, is an essential tool in the detection of cartels;

18 Note that ease of application and certainty for leniency applicants are essential for the success of the progamme;

19 Note that currently, only the Solicitor-General can grant immunity from criminal prosecutions;

20 Invite the Solicitor-General, in consultation with the Commerce Commission, to develop draft guidelines and draft amendments to the Prosecution Guidelines by 31 January 2011;

Publicity

21 Invite the Minister of Commerce to announce the decisions in this paper;

22 Agree that the decisions in this paper may be publicly released on the Ministry of Economic Development's website.

Hon Simon Power
Minister of Commerce

Date signed: 12/10/10

Summary of Proposed Regime

Defining the offence

- Parallel civil and criminal prohibitions for cartel conduct
- The offence formulated as forming an agreement (contract, arrangement or understanding)/with a competitor/to engage in cartel behaviour
- A separate offence for implementing a cartel agreement
- The behaviours of price fixing, market allocation, output restriction and bid rigging to be directly prohibited
- Mental element requiring "intent" to enter into or implement a cartel agreement, and "knowledge" that it is a cartel agreement
- A "purpose" element for the civil prohibition

Exceptions, exemptions and defences

- All current exceptions to Part 2 of the Commerce Act to apply
- An ancillary restraint defence
- A joint venture exemption
- Repealing the current exemption for agreements of more than 50 people
- The current joint buying exemption to apply, but amended to clarify meaning of "collectively acquired"
- An exemption for notified arrangements between bidders

Clearance

- A clearance process based on the exemptions to the cartel offence, and for long term contracts
- Cost recovery through fees

Prosecution

- A specialist prosecution panel to be formed, convened by the Solicitor-General but independent from the Commerce Commission
- Solicitor-General to produce draft guidelines on granting immunity
- Rules for jury trials to apply, including s 361D of the Crimes Act

Penalties

- Maximum of seven years imprisonment
- Maximum fines for companies set at the same level as current pecuniary penalties
- Other orders to be imposed
- Bodies corporate to be subject to criminal liability
- The penalty for obstruction to increase to up to 18 months imprisonment for an individual and $1 million for a company
- The current provisions in the Commerce Act regarding self-incrimination to apply
- No limitation period
- Territorial application similar to that of criminal conspiracy to apply

Consultation on Cabinet and Cabinet Committee Submissions

Certification by Department:

Guidance on consultation requirements for Cabinet/Cabinet committee papers is provided in the CabGuide (see Procedures: Consultation): http://www.cabguide.cabinetoffice.govt.nz/procedures/consultation

Departments/agencies consulted: The attached submission has implications for the following departments/agencies whose views have been sought and are accurately reflected in the submission:

Commerce Commission, Treasury, Ministry of Justice, Police, Ministry of Foreign Affairs and Trade, Crown Law, Department of Corrections and the Ministry of Transport

Departments/agencies informed: In addition to those listed above, the following departments/agencies have an interest in the submission and have been informed:

DPMC

Others consulted: Other interested groups have been consulted as follows:

Name, Title, Department: Philippa Yasbek, Acting Manager, Ministry of Economic Development

Date: 25/08/2010	**Signature**

Certification by Minister:

Ministers should be prepared to update and amplify the advice below when the submission is discussed at Cabinet/Cabinet committee.

The attached proposal:

Consultation at Ministerial level	☐ **has been** consulted with the Minister of Finance *[required for all submissions seeking new funding]* ☑ **has been** consulted with the following portfolio Ministers: PM, DPM, T/Part, MED ☐ **did not need** consultation with other Ministers
Discussion with National caucus	☐ **has been** or ☐ **will be** discussed with the government caucus ☑ **does not need** discussion with the government caucus
Discussion with other parties	☐ **has been** discussed with the following other parties represented in Parliament: ☐ Act Party ☐ Maori Party ☐ United Future Party ☐ Other [specify] ☐ **will be** discussed with the following other parties represented in Parliament: ☐ Act Party ☐ Maori Party ☐ United Future Party ☐ Other [specify] ☑ **does not need** discussion with other parties represented in Parliament

Portfolio	**Date**	**Signature**
Commerce	12/10/10	