Ministry of Economic Development
Manatū Ōhanga

CARTEL CRIMINALISATION

Discussion Document

January 2010

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Ministerial foreword

Competition is critical to our economic success. Competitive pressures force firms to innovate and become more efficient and ultimately more productive. Cartels are recognised as the most harmful form of anti-competitive behaviour, because they suppress and eliminate competition. Cartels protect inefficient producers, creating a drag on the economy and a burden on the businesses that, and consumers who buy their products.

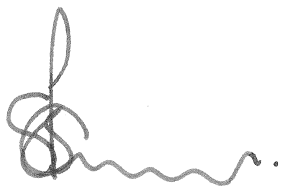
Cartels are illegal but this has not stopped them operating in either New Zealand or around the world. This raises the question of whether the current legislation provides sufficient disincentives for cartel activity. Criminal sanctions are already in place for other activities that distort markets, such as insider trading, market manipulation and making false statements in financial reports.

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. Under the Single Economic Market agenda, we have committed to a high-level outcome of ensuring that those who engage in anti-competitive behaviour in Australia or New Zealand face the same penalties.

This discussion document explores what can be done to deter and detect cartels better. It comes to the preliminary conclusion that there is a case for criminalisation. The paper goes on to discuss the different factors that would need to be considered to define a criminal offence. It also covers some of the generic elements of criminal law that would apply to investigations, proceedings, trials and penalties. This detailed consideration of a criminal regime is necessary to assess fully the costs and benefits of criminalisation.

Cartels are relatively easily recognised – we know them when we see them. However, defining cartel activity in legislation is more difficult. If the definition is too broad it can have a chilling effect on pro-competitive business practices. A badly defined criminal offence can also create uncertainty, which can stifle business activity.

I invite submissions on the discussion document by 31 March 2010, to the Ministry of Economic Development. The Government will carefully consider these submissions in deciding on cartel criminalisation.



Hon Simon Power
Minister of Commerce

Information for submitters

Written submissions on the issues raised by the discussion paper are invited from all interested parties. The closing date for submissions is 5pm Wednesday, 31 March 2010.

Submissions should be sent to:

Cartel Criminalisation
Ministry of Economic Development
PO Box 1473
Wellington 6140
New Zealand
Delivery address: Level 8, 33 Bowen Street, Wellington
Fax: +64-4-499-1791
Email: cartels@med.govt.nz

It would be useful if submissions sent in hard copy or faxed were also provided in electronic form (Adobe Acrobat, Microsoft Word 2000 or compatible format).

Submissions will be considered by officials in the preparation of advice to Ministers on the criminalisation of cartels.

Specific questions have been posed to submitters in boxes at the end of some sections. The full set of questions appears after the executive summary. Broader comment on the issues will also be welcomed.

Any queries should be directed to Philippa Yasbek, either at the above email address or by telephone at +64-4-474-2753.

Official Information Act and Privacy Act

Posting and release of submissions

The Ministry generally posts all written submissions received in the course of a review on its website at www.med.govt.nz. The Ministry will consider you to have consented to posting by making a submission, unless you clearly specify otherwise in your submission.

In any case, submissions provided to the Ministry are likely to be subject to public release under the Official Information Act 1982 following requests to the Ministry. Please state if you have any objection to the release of any information contained in a submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. The Ministry will take into account all such objections when responding to requests for copies and information on submissions to the document under the Official Information Act.

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Regulatory impact assessment

The substantive regulatory impact assessment elements (problem, options and impacts of those options) have been included in the text of the discussion document.

Executive summary

Chapter 1

Hard-core cartels are formed when rival firms agree to not compete with each other. Cartels allow firms to raise their prices above the competitive level without fear of losing customers to their rivals. The Organisation for Economic Co-operation and Development (OECD) defines four types of hard-core cartel: price fixing, bid rigging, market allocation and output restrictions. In general, hard-core cartels allow the participants to increase their profits by limiting or removing competition to provide products at competitive prices.

Cartels cause harm by:

- reducing economic output;
- undermining competition as the mechanism that sets prices;
- undermining trust in markets;
- causing losses in allocative, productive and dynamic efficiency;
- slowing productivity growth; and
- distorting investment signals by making cartel businesses appear more profitable than they would be in an undistorted market.

Hard-core cartels are currently prohibited and are unlawful under the Commerce Act 1986 and subject to civil sanctions. There are some concerns regarding whether or not our current civil penalty regime is effective at deterring cartel behaviour. Australia has recently introduced criminal penalties for cartels, and the Australian Competition and Consumer Commission has reported an increase in leniency applications since the new law came into force. As Australia's cartel penalties were similar to ours prior to criminalisation, this tends to suggest that our penalties may not be optimal.

There are a number of ways to increase the deterrence of cartel activity. Deterrence theory suggests that this can be done by increasing the probability of detection, increasing the costs to the firm/individual of detection and/or changing the firm's/individual's risk preferences. This generates a number of options, many of which are not mutually exclusive:

- increasing funding for the Commerce Commission's public awareness and enforcement activity;
- improving the operation of the leniency programme;
- rewarding whistleblowers;
- granting investigators covert surveillance powers;
- improving cooperation with enforcement agencies in other jurisdictions;
- increasing the level of financial penalties;
- using other forms of penalty; and/or

- increasing the probability of private enforcement.

There are more effective means for achieving increased deterrence of cartel conduct than the current civil financial penalties. The Commerce Commission's current level of funding for enforcement is probably not impeding cartel deterrence, although an increase may see some small gains. The leniency programme, improved cooperation with other jurisdictions and improving private enforcement are all areas where work is currently underway. This should lead to some improvements, but these will not be large (the costs of the interventions are not large either). Rewarding whistleblowers, increasing the level of financial penalties for individuals, extending the possible length of management banning orders and introducing adverse publicity orders are all options worth considering further, although again their cumulative impacts (and costs) are likely to be relatively small.

The single intervention most likely to have a significant impact on deterrence and detection is the possibility of imprisonment. This requires criminalisation, which brings with it a number of costs and benefits. A greater deterrence of the most serious forms of cartel behaviour will have significant benefits for the effective operation of markets. Criminalisation, and particularly the possibility of imprisonment, provides strong disincentives for executives of corporations to engage in cartel behaviour.

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. The OECD recommends cartel criminalisation where this is consistent with social and legal norms.

There are difficulties in defining a criminal offence that covers only hard-core cartel conduct. The definition of the conduct would need to be considered carefully to avoid legislative over-reach and the deterrence of pro-competitive, competitively neutral or efficiency-enhancing conduct.

The higher standard of proof required in criminal prosecutions – proof beyond reasonable doubt – may make it difficult to obtain convictions. The cost of administering criminal penalties, such as jail terms, needs to be considered. Criminal investigations may be more costly to undertake than civil investigations because of the higher standard of proof required and the rules of evidence that require better documentation of the chain of custody.

The magnitude of the costs and benefits of criminalisation will depend to a large degree on the legislative design and implementation of the criminal penalty regime. The objective is to design an offence and penalty regime that deters hard-core cartels, while not deterring efficiency-enhancing cooperation arrangements. Any reform must also be consistent with: certainty; simplicity; fairness; proportionality; and reasonable enforcement, litigation and compliance costs.

Chapter 2

The consideration of options will need to take into account different types of decision error:

- type 1: false positive (i.e. deterring welfare-enhancing conduct or over-reach);
- type 2: false negative (i.e. allowing welfare-reducing conduct or under-reach); and
- type 3: excessive uncertainty and costs for regulators and business.

Chapter 3

The OECD recommendations on cartels emphasise that "the hard-core cartel category does not include agreements, concerted practices, or arrangements that are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies". This caveat is included because some behaviours associated with hard-core cartels (particularly price fixing and market allocation) are also associated with activities that reduce costs or enhance outputs. This type of activity is most commonly seen in joint ventures, franchises and networks.

Chapter 4

Three possible approaches to criminalising cartel conduct are discussed.

Option 1: Create an offence based upon the existing civil prohibitions in the Commerce Act

Criminalising the existing civil prohibition on price fixing would have a number of advantages. It would give businesses certainty that if their conduct does not breach the existing law, they will not breach the new criminal provisions. The language and concepts are familiar and there is existing case law (both New Zealand and Australian) to support the statute. The joint venture provisions would probably need to be changed but this could potentially stimulate more pro-competitive activity.

The disadvantage of this approach is that there is still some uncertainty on whether the prohibition on controlling price includes market allocation schemes; this would introduce under-reach. This approach would also suffer from over-reach (type 1 error) as franchises and networks not structured as joint ventures could be subject to criminal penalties. This could be rectified by introducing further exemptions or defences.

Option 2: Adopt the Australian offence provisions

The Australian legislation contains both cartel offences and a new set of parallel civil per se prohibitions. The new offences and civil per se prohibitions address four types of anti-competitive behaviour: price fixing, output restriction, market allocation and bid rigging. These types of cartel behaviour are defined in terms of the core concept of a "cartel provision". It is an offence (subject to proof of fault/mental elements) or a civil per se violation to make a contract, arrangement or understanding that contains a cartel provision or to give effect to a cartel provision contained in a contract, arrangement or understanding.

The main driver for adopting the Australian cartel law would be harmonisation. Ideally, Australian and New Zealand business law should converge on global best practice. There are significant harmonisation benefits in New Zealand criminalising cartel behaviour. Whether there are significant benefits in adopting the same law needs to be considered as well.

The advantage of adopting the Australian approach is that it would reduce compliance costs for trans-Tasman businesses that have to comply with competition law in both jurisdictions. The Commerce Act differs significantly from the Australian Trade Practices Act 1974 in other areas of competition law. To gain significant compliance cost reductions from harmonisation, we would need to harmonise more than just the cartel provisions. There would be greater development of the case law if we can rely on Australian judgments as well as domestic ones.

There have been criticisms of the Australian legislation, and adopting it would mean that we could not address any of those critiques in our own legislation.

Option 3: Take a greenfields approach and develop new offences based on first principles.

The section on the greenfields approach provides an in-depth discussion of all the options for each element of an offence. A "Starter for 10"[1] is developed to aid comparison with the Australian law and the existing law.

"Starter for 10" summary

The physical and mental elements of the cartel offences are:

- intentionally forming an agreement (contract, arrangement or understanding) or conspiring/with a competitor/to engage in cartel behaviour; with knowledge that the agreement is one to engage in cartel behaviour; and
- intentionally implementing an agreement/with a competitor/to engage in cartel behaviour; with knowledge that the agreement is one to engage in cartel behaviour.
- "Cartel behaviour" directly includes all four OECD categories of hard-core cartel behaviour: price fixing, market allocation, output restriction and bid rigging. The behaviours would not be defined by reference to their effects on price.
- All existing exceptions to Part 2 would apply to the offence.
- Authorisations will apply to cartel-like activity. A notification scheme would provide for immunity from criminal prosecution and a clearance regime would apply to long-term contracts.
- Exceptions to Part 2 (sections 43-46) will also apply to the cartel offence.
- A defence of legitimate primary intention will apply to the cartel offence. A specific joint venture defence would apply, based on an economic definition of a joint venture.
- There should be no exemption based on the number of parties to the agreement. There should be an exemption for joint buying arrangements.
- The accused relying on any defence would have an evidentiary but not persuasive burden of proof.
- The new civil prohibition would mirror the physical elements of new criminal offence with the same defences and exceptions.
- Corporations would be criminally liable for cartel offences.

Option 3 potentially addresses most of the concerns relating to the other two approaches. It would, however, have the disadvantage of being new and untested, with little ability to draw on case law from other jurisdictions.

[1] A "Starter for 10" is an initial proposition, a starting point, which can be modified. All the elements making up the "Starter for 10" are open for debate and discussion.

Chapter 5

Hard-core cartels are already prohibited civilly and those found liable (individuals and corporations) are subject to pecuniary penalties. One of the main drivers behind criminalisation is the increased deterrent impact of a jail sentence in comparison with that of a monetary penalty. Obviously, corporations cannot be imprisoned.

New Zealand already has corporate criminal liability in many other areas of the law. Section 90 of the Commerce Act already attributes the actions and states of mind of directors, servants and agents to the body corporate. It is proposed that bodies corporate also be criminally liable for the cartel offence.

Chapter 6

The purpose of this chapter is to describe the key differences between the criminal and the civil law that would impact on cartel cases. Unless a specific legislative exception is made, standard criminal law will apply to the cartel offence.

The Commerce Commission's current investigatory powers allow the Commission to interview people compulsorily, require the furnishing of information or the production of documents and search under a warrant[2]. The New Zealand Bill of Rights Act 1990 (NZBORA) 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. Any restriction on these rights would need to be considered for compliance with the NZBORA. This entails an assessment of whether the restriction can be justified in a free and democratic society.

The current level of fines for obstruction offences in the Commerce Act is inadequate. Consideration should be given to increasing the level of fines, possibly to bring them in line with the Securities Act 1978.

The Serious Fraud Office has a Serious Fraud Prosecutors Panel. When the Director of the Serious Fraud Office has determined that a prosecution should commence, the actual prosecution is carried out by a senior barrister in private practice. The Solicitor-General, in consultation with the Director of the Serious Fraud Office, appoints these barristers to the Prosecution Panel. The Panel members are independent of the Serious Fraud Office and the intention is that they bring an objective approach and judgement to the prosecution. A similar arrangement could be introduced for the prosecution of cartel offences after investigation by the Commerce Commission.

Trial by jury is a longstanding feature of the criminal law and is protected by section 24 of the NZBORA. There are existing limitations on this right. It has most recently been constrained by section 361D of the Crimes Act 1961. This section confers on the Court the power to deny an accused their normal right to jury trial on the basis that the jurors would not be able to perform their duties effectively given the length and complexity of the trial. It is likely that most cartel trials would meet the "complex" requirement of section 361D. The majority of cartel trials are likely to take longer than 20 days, so will meet the "long" requirement of section 361D.

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[2] In the criminal context, the Serious Fraud Office and Securities Commission have similar powers to the Commerce Commission to interview compulsorily and require the furnishing of information or documents.

Given that the majority of cartel trials will be judge only, should specific provision be made to ensure that all cartel trials will be judge only? In the United States, conviction rates for cartels are much lower than for other crimes. There are a number of ways that defence counsel can manipulate the natural emotional responses of a jury to secure acquittals in cartel trials, even in the face of strong evidence of guilt. This factor, combined with the technical nature of offending, means that more just outcomes might be achieved if all cartel trials were conducted by a judge alone.

An indicative comparison of offences, such as insider trading, tax evasion, market manipulation and dishonestly using a document, suggests that a maximum sentence of between five and seven years is probably appropriate for the cartel offence.

Questions for submitters

Detecting and deterring cartels

1. Do you consider cartels to be harmful?
2. Are the current penalties for cartel activity sufficient to deter and detect cartels? Is there any evidence to support this judgement?
3. What do you consider would be the most effective means of increasing the deterrence and detection of cartels?
4. What are the costs and benefits of the options outlined for increasing deterrence and detection?
5. Are there any other options that should be considered?
6. Should New Zealand introduce criminal penalties for "hard-core" cartel conduct?

Defining the offence

7. Are there any categories of cartel conduct, not included in the OECD recommendations that should be criminalised in New Zealand?
8. Should the cartel offence be a per se prohibition or a rule of reason approach?
9. What should the physical elements of the cartel offence be?
10. Should "conspiracy" be brought into the offence?
11. Should there be a competition element, and if so, how should it apply?
12. Should there be a separate offence of implementing a cartel agreement?
13. Should there be a descriptive or basic approach to defining the mental elements of the offence? What should the specific mental elements of the offence be?
14. Which of the OECD categories of hard-core cartel (price fixing, market allocation, output restriction and bid rigging) should be explicitly covered by a cartel offence? Should they be included directly or only indirectly by reference to effects on price?
15. Are there any existing exceptions to Part 2 that should not be applied to the cartel offence (or more broadly)? Are there any exemptions from the Commerce Act in other legislation that should not be applied to the cartel offence?
16. How can we achieve greater ex-ante predictability in the application of the cartel offence?
17. Should there be a notification scheme, which provides for immunity from criminal prosecution?
18. Should there be a clearance regime for joint ventures?
19. Should there be a clearance regime for other potentially restrictive trade practices?
20. What are the appropriate defences and exceptions to the cartel offence? In particular, how should joint ventures, franchises and networks be treated?
21. Should there be a specific legislative exemption for agreements of more than 50 people?

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

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

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

Choice of options

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

Criminal procedures and penalties

26. Should corporations be criminally liable for cartel offences?

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

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

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

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

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

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

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

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

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

Chapter 1: Should we criminalise hard-core cartel conduct?

1.1 What is a "hard-core" cartel?

1. Hard-core cartels are formed when rival firms agree to not compete with each other. The clearest example of cartel conduct is where all the competitors in a market agree the prices they will charge for certain products. This allows the firms to raise their prices above the competitive level without fear of losing customers to their rivals. Other forms of cartel conduct, such as bid-rigging, market allocation and output restrictions, all have the effect of avoiding competitive pressures and raising prices above competitive levels. In general, hard-core cartels allow the participants to increase their profits by limiting or removing competition to provide products at competitive prices in order to win customers.

2. 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 the buyers of their products. Cartels are difficult to identify and investigate because of their clandestine nature.

3. Hard-core cartels only serve to increase the profits of the participants and do not create a countervailing benefit to consumers through more efficient business operations. A key distinction between hard-core cartel conduct and legitimate cooperation between competitors is that cartel agreements involve the coordination of core business decisions but not the integration of business functions that would be reasonably expected to generate efficiencies, such as joint ventures. Joint ventures, franchises and similar cooperative business forms are not cartels. More specific discussion on what is and is not a hard-core cartel is set out in chapter 3.

4. Hard-core cartels have such a pernicious effect on competition, without any countervailing benefit, that they can be definitively deemed as anti-competitive. The Organisation for Economic Co-operation and Development (OECD) Competition Committee has described hard-core cartels as the most egregious violation of competition law, and hence they should be a principal focus of competition policy and enforcement. The OECD recommends "introducing criminal sanctions in cartel cases in countries where it would be consistent with social and legal norms, which would enhance both deterrence and the effectiveness of leniency programmes"3.

1.2 What harm do cartels cause?

5. Hard-core cartel conduct causes detriment to the economy and to consumers. The term "consumer" is used generically. Sometimes the consumers of a cartelised product are other businesses or industries, whose competitiveness can be impaired by the increased costs. For example, the Australian cardboard box cartel raised packaging prices for a number of industries.

[3] OECD 2003, *Hard Core Cartels: Recent Progress and Challenges Ahead*.

6. Cartels create a loss of economic efficiency because their operation mutes or eliminates the effects of market forces. In a competitive market, goods and services are priced so that resources are allocated to the production of goods and services with the most value to consumers. A successful cartel raises the price above this level and reduces the demand and hence production of the good or service. As a result, resources are not deployed where they will be of maximum benefit. In economic terms this is a loss of allocative efficiency. A cartel also protects its participants from the risk that they will lose sales in response to competition from another firm(s), thus creating less incentive for them to innovate by reducing costs or improving the quality of their product in order to retain their market share. Cartels protect inefficient firms and create a drag on productivity improvements. This is a loss of productive efficiency.

7. 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. In economic terms this is a loss of dynamic efficiency.

8. Hard-core cartels cause direct harm to consumers as they result in a transfer of wealth to cartelists. If a consumer purchases a good or service from a cartel, they pay more than would have been necessary if the market had been competitive. If the consumer had known that the price of the transaction had been set by a cartel rather than by market forces, they might not have been willing to pay that price. However, as the consumer has operated under the pretence of a competitive market, they will have unknowingly supported the higher profits achieved by the cartelists at their own expense.

9. Overall, a cartel causes economic distortions and deprives consumers and the other market participants of the benefits of a competitive business environment. Even if the transfer of wealth from consumers to cartelists is considered to be neutral, the operation of a hard-core cartel still causes harm through the loss of economic efficiency. As such, hard-core cartel conduct in any form should be prohibited.

10. The economists' assumption that wealth transfers are neutral does not necessarily accord with popular assumptions of fairness. There are some who view the wealth transfer as theft. This idea has considerable popular appeal – in a non-cartel context, some consumers viewed an exercise of market power in the electricity market and the resultant overcharge as theft[4]. However, economists argue that the exchange between a buyer and seller is voluntary. The exchange is voluntary but the degree of "voluntariness" depends on the elasticity of demand for the good[5]. Elasticity may not even indicate "voluntariness" because of its marginal nature. Some goods are so essential to our functioning in a modern society that we cannot completely go without them, even if we respond at the margins to changes in price. For example, consumers may respond to electricity price increases by conserving electricity and reducing their overall demand. They do not generally respond by disconnecting from the grid and boycotting the suppliers. The act of buying and selling, with the

[4] "Power overcharges leave Grey Power feeling cold", Monday 25 May 2009, 2:59 pm, press release, Grey Power New Zealand, www.scoop.co.nz/stories/PO0905/S00335.htm

[5] Elasticity may also measure other determinants of demand. Price elasticity might be low, for example, if prices are low relative to income and the utility provided by consumption.

relatively voluntary nature of the transaction, does not make theft a useful basis for moral condemnation, even if it does have popular appeal.

11. Fraud may be a better analogy than theft, as cartel victims are generally unaware of their loss. Some people describe cartels as a victimless crime. This is a mischaracterisation. Cartels do cause genuine harm. Victims may, however, be difficult to identify individually and the exact extent of their loss can be hard to calculate.

12. Hard-core cartel conduct is a deliberate, deceptive and generally secretive attempt to manipulate prices and markets to gain at the expense of consumers. This makes it similar to fraud, or more specifically the crime of obtaining by deception or causing loss by deception. Buyers assume that the prices of goods purchased are determined by market forces. The cartel does not alert them to the fact that prices are set by the cartel, so misleads them. This type of deception may not meet the current legal definition of deception, but it is not dissimilar in nature.

13. Another school of thought regards the moral harm of cartels as stemming from an unjustified interference with market forces. This interference is independent of the level of harm caused by the cartel. This makes cartel conduct similar to other crimes that interfere with or subvert essential social systems, such as market manipulation and insider trading (distortions of the share market), tax evasion (distortion of revenue-gathering systems) and offences against the justice system, such as obstruction.

14. It is exceedingly difficult to identify the volume of commerce affected by hard-core cartels or the level of overcharges, as such behaviour is usually undertaken in secret. An OECD survey of detected cartels suggests that the 16 largest global cartels affected more than US$55 billion of commerce[6]. Empirical studies have placed the average cartel "mark-up" – the price a cartel achieves above the competitive level – at around 25%[7]. There is some contention as to the ability of cartels to operate over a period of time long enough to cause significant damage. Cartels are most likely to be sustained in markets with high levels of seller concentration, substantial product homogeneity, high transaction frequency and high barriers to entry[8]. Empirical studies have shown a median duration for cartels of five to six years[9]. This suggests that there is a fair prospect that cartels can create a consistent distortion of market prices over a period of time, and that they can generate a meaningful transfer of wealth from consumers to cartelists during their operation.

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[6] OECD 2006, Hard Core Cartels – Third Report on the Implementation of the 1998 OECD Recommendation, in *OECD Journal of Competition Law and Policy*, Vol 8 no 1.

[7] The median of 770 estimates of the average price effect of particular cartels, sourced from court decisions, economic literature and historical accounts.

[8] DW Carlton and JM Perloff *Modern Industrial Organisation* (1990), pp 216-223, quoted by Paul Scott 1999, "Price Fixing and the Doctrine of Ancillary Restraints", *Canterbury Law Review* Vol 7.

[9] Levenstein and Suslow's review of a wide variety of empirical studies (2006).

15. In summary, cartels cause harm by:

- reducing economic output;
- undermining competition as the mechanism that sets prices;
- undermining trust in markets;
- causing losses in allocative, productive and dynamic efficiency;
- slowing productivity growth; and
- distorting investment signals by making cartel businesses appear more profitable than they would be in an undistorted market.

1.2.1 The current provisions

16. Hard-core cartels are currently prohibited and are unlawful under the Commerce Act 1986 and subject to civil sanctions. The prohibitions regarding hard-core conduct are set out in Part 2 of the Act. The heart of Part 2 is section 27, which prohibits the entering into of, and giving effect to, contracts, arrangements or understandings that have the purpose, effect or likely effect of substantially lessening competition.

17. The main provisions in the Commerce 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 the following practices from the application of section 30:
    - certain joint ventures;
    - recommended pricing by industry associations; and
    - joint buying and promotion arrangements.

18. Those found in breach of these provisions face pecuniary penalties of:

a. in the case of an individual, $500,000; or

b. in the case of a body corporate, the greater of—

1. $10,000,000; or

2. either—

a. if it can be readily ascertained and if the Court is satisfied that the contravention occurred in the course of producing a commercial gain, three times the value of any commercial gain resulting from the contravention; or

b. if the commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

19. Cartelists are also liable for damages and the Courts may order the payment of exemplary damages, although this needs to take into account the existence or level of any prior pecuniary penalties. Exemplary damages have not been awarded to date.

20. In addition, individuals can be barred from holding any management position in a company for a period of five years. A company cannot indemnify its directors or employees for any pecuniary penalties.

1.3 Are the current penalties optimal?

21. There are some concerns regarding whether or not our current civil penalty regime is effective at deterring cartel behaviour. The secret nature of cartels means that we can never know the overall level of cartel activity in the economy. We can, however, look for other indicators. The lack of detection of domestic cartels may be an indicator of insufficient deterrence. The international cartels detected in New Zealand come off the back of enforcement activity or leniency applications in other jurisdictions, and it would appear that jurisdictions with greater penalties than New Zealand are more successful at detecting cartels, particularly through attracting leniency applications.

22. It is theoretically possible that New Zealand has a lower incidence of cartels than larger economies. The size and structure of New Zealand markets could mean that many markets can only sustain one or two competitors who may not need expressly to form a cartel to exercise market power. But even in a possible environment of cosy duopolies, with a lower incidence of cartel activity, the lack of detection of any serious domestic cartels would tend to indicate a lack of incentive (fear of detection and the consequent penalties) for cartelists to apply for leniency.

23. Australia has recently introduced criminal penalties for cartels and the Australian Competition and Consumer Commission (ACCC) has reported an increase in leniency applications since the new law came into force[10]. As Australia's cartel penalties were similar to ours prior to criminalisation, this tends to suggest that our penalties may not be optimal.

24. The preceding analysis suggests that the marginal social costs of cartel behaviour in New Zealand exceed the marginal social benefits of current deterrence measures. To address this, we need to consider how to adjust the current offence and penalty regime to further deter hard-core cartels, while not deterring efficiency-enhancing cooperation arrangements. Any reform must also be consistent with: certainty; simplicity; fairness; proportionality; and reasonable enforcement, litigation and compliance costs.

[10] "Cartel crackdown sparks whistleblowers' chorus", *Australian Financial Review*, 1-2 August 2009.

1.4 Options for increasing deterrence

25. There are a number of ways to increase the deterrence of cartel activity. Deterrence theory suggests that this can be done by increasing the probability of detection, increasing the costs to the firm/individual of detection and/or changing the firm's/individual's risk preferences. The following sections consider options for increasing the probability of detection and increasing the costs to the firm of detection. We do not consider changing risk preferences, as we assume these are fixed, even if some preferences (such as those around imprisonment) are untested by the current regime. The options are not mutually exclusive and there are initiatives in relation to some of these options already underway.

1.4.1 Options for increasing the probability of detection:

- increasing funding for the Commerce Commission's awareness and enforcement activity;
- improving the operation of the leniency programme;
- rewarding whistleblowers;
- granting investigators covert surveillance powers; and/or
- improving cooperation with enforcement agencies in other jurisdictions.

1.4.1.1 Increasing funding for the Commerce Commission's awareness and enforcement activity

26. The Commerce Commission this year received funding of $13,935,000 (GST exclusive) for enforcement of general market regulation. This is to cover competition, consumer law and consumer credit. Within this funding the Commission makes its own decisions about the allocation between different priorities. Cartel investigations are a priority for the Commission in its competition work. In the Commission's 2009/10 budget, $2,952,000 is allocated to "coordinated behaviour cases", and most of this would be used for cartel investigations. An additional litigation fund covers litigation costs.

27. The Commission investigates credible leads on cartel activity. A substantial proportion of anti-cartel resources is directed toward investigations that arise as a result of the Commission's leniency policy, as these are based on direct evidence from a cartel participant. Cases arising through leniency have a greater chance of resulting in penalty judgments and cessation of the offending activities. If more resources were available, the Commission would have the ability to be more proactive in endeavouring to detect cartels by following up a larger number of non-leniency-based leads and adopting methods used by other agencies to detect cartel behaviour.

28. The Commission could also undertake increased awareness programmes to raise awareness of the harm from cartels and the penalties. An awareness campaign in industries prone to cartel activity might stimulate leniency applications or increase detection through other means, e.g. procurers being more alert to suspicious bidding patterns.

29. Increasing funding obviously has direct fiscal costs, or at least an opportunity cost if increased funding comes through reprioritisation of other Government spending. The magnitude of the detection and deterrence effect of increased funding is uncertain as cartel enforcement is already a Commission priority. Increased funding is likely to exhibit diminishing marginal returns, as the strongest cases (those arising from leniency applications) are already being investigated.

1.4.1.2 Improving the operation of the leniency programme

30. An effective leniency programme is seen as the single most effective tool to detect cartels. The Commerce Commission's leniency programme allows a participant in a cartel (who is not the instigator) to disclose their participation to the Commission. In return for full cooperation, the firm receives immediate automatic immunity from the Commission. Amnesty is only given to the first person through the door. The design of a leniency programme is critical to its success. Leniency requires a high degree of trust and transparency to operate successfully. A leniency programme can be improved and the Commerce Commission is currently consulting on changes to its leniency policy, with the aims of increasing incentives for cartel participants to apply for leniency and of improving certainty for businesses applying for immunity. This is not, strictly speaking, an option in the present consultation, as the work is already underway.

31. Improvements to the leniency programme should have some positive benefits at relatively low cost. These benefits would include greater certainty for potential applicants and possibly an increase in applications.

1.4.1.3 Rewarding whistleblowers

32. Cartelists can be rewarded with immunity or reduced penalties if they cooperate with the competition agency. In the United Kingdom, whistleblowers (people not directly involved in the cartel) can receive rewards of up to £100,000 for specific information that leads to the investigation and prosecution of a cartel. This is an experimental programme and the UK Office of Fair Trading is currently considering whether or not to continue with it. Rewarding whistleblowers builds on the concept of leniency programmes. However, whistleblowers, as opposed to leniency applicants, have not directly participated in the cartel.

33. It may be worth further investigating the UK experience with financial incentives.

34. Rewarding whistleblowers is unlikely to have a large impact on overall deterrence, because the secret nature of cartels means that the pool of potential whistleblowers is small. There are obviously direct financial costs associated with rewards, but as these would only be paid where the information is of value, the benefits should exceed the direct costs. If the cartel is particularly damaging, the benefit-cost ratio may be very high from a reward. There would be indirect costs associated with negotiating with whistleblowers and assessing the usefulness of their information.

1.4.1.4 Granting investigators covert surveillance powers

35. The Commerce Commission currently uses compulsory interviews, production orders and search warrants to undertake its investigations. Some competition authorities, such as in the United States and Australia, can use covert surveillance to gather evidence about cartel activity (often in cooperation with law enforcement agencies). The New Zealand Bill of Rights Act 1990 (NZBORA) provides a right to everyone to be secure against unreasonable search and seizure. Covert surveillance is only used for the investigation of criminal offences.

36. Covert surveillance requires reasonable suspicion of illegal activity and a warrant as well. Covert surveillance would probably assist more in the investigation of cartels than their initial detection, because of the need for reasonable suspicion. The knowledge that covert surveillance can be used for investigation may, however, alter cartelists' assessments of the risks of prosecution, and so enhance deterrence. In the US, people given amnesty have been "wired" and sent to subsequent cartel meetings to gather evidence against other cartel participants.

37. The Search and Surveillance Bill, if enacted, will make it possible to obtain a surveillance device warrant to investigate any criminal offence, where a search warrant can be obtained.

38. Covert surveillance may improve the rates of successful cartel prosecution. Reasonable suspicion is required for the granting of a warrant, so it is unlikely to improve detection directly. Cartelists may, however, be concerned by the increased ability to gather evidence and be more likely to seek leniency. The Commerce Commission does not currently have the specialised technical skills to undertake surveillance and would probably have to rely on the Police for assistance. This obviously leads to a trade-off with other Police priorities.

1.4.1.5 Improving cooperation with enforcement agencies in other jurisdictions

39. The Commerce Commission has cooperation agreements with competition authorities in Australia, Canada, the UK and Taiwan, which enable the sharing of information with other authorities and informal cooperation. The Commission is currently constrained from providing investigative assistance and compulsorily acquired information it holds to overseas enforcement agencies, which are similarly constrained. The Commission's statutory powers of compulsion can only be used in relation to enforcement and adjudication within New Zealand. This in turn limits the ability of overseas regulators to provide assistance to the Commission, as cross-jurisdictional assistance tends to be based on mutual assistance.

40. The Commerce Commission (International Co-operation, and Fees) Bill, if passed, will allow the Commission to provide investigative assistance and information compulsorily acquired to overseas regulators, if there is an applicable governmental cooperation arrangement in place. It is hoped that the Bill will become law in mid-2010. The Regulatory Impact Statement for the Bill outlines the costs and benefits of this intervention. This is not strictly speaking an option for the current consultation as a Bill is already in the House, but it is included to provide a full picture of all efforts.

41. Criminalisation would allow the invocation of mutual criminal assistance treaties in the absence of governmental competition cooperation agreements. A lack of criminal penalties is a barrier to developing cooperation agreements with some jurisdictions.

1.4.2 Options for increasing the costs to the cartelist if detected:

- increasing the level of financial penalties;
- using other forms of penalty; and/or
- increasing the probability of private enforcement.

42. Financial penalties and damages impose financial costs on cartelists. However, from a social point of view, penalties can be used to both deter and address harm. A penalty such as a sentence of imprisonment is strictly punitive. It serves only as a deterrent and has no remedial effect. At the other extreme, damages' awards have a restorative effect and are generally not punitive, although there is provision for exemplary damages. A pecuniary penalty straddles the line – it is intended as a punishment but it is related to the harm caused. However, the money does not go directly to the victims, although the Crown accounts may be a proxy for general harm to the economy. The different effects of penalties may affect the assessment of impacts, costs and benefits.

1.4.2.1 Increasing the level of financial penalties

43. The very small number of competition law cases in New Zealand means that we do not have any statistically meaningful data on the level of financial penalties imposed in cartel cases. Larger jurisdictions have more information available to support changes in their competition law. We tend to rely on evidence in other jurisdictions and theory in order to develop our law. If we do nothing, we risk our law being ill-suited to modern business practices on the few occasions when it is tested.

44. The penalties for bodies corporate, as set out above, are substantial and have a degree of scaling (in the gain or turnover calculations), which enables each penalty to be tailored to the size of the entity and the scale of the illegal gain. While the maximum penalties are set on the basis of deterrence theory, the actual penalties imposed appear to be below the optimal level when the probability of detection is taken into account. In New Zealand, there are no cases that have imposed the maximum level of penalty on bodies corporate. The maximum level may, however, be enough to make some firms bankrupt, which is undesirable from a competition perspective. There is unlikely to be much further scope to increase the statutory maxima for penalties on firms.

45. The penalties for individuals are set at a maximum of $500,000. This has been the level of penalty since 1990. While this is a large sum, it may not be a sufficient disincentive for well compensated executives. The punishment or deterrent effect of a fine or penalty set at a specific monetary level varies enormously depending on the wealth and personal circumstances of the person on whom it is imposed. Fines and financial penalties are generally adjusted downwards if someone cannot afford to pay them, but cannot be adjusted above the maximum to have an effect on the very wealthy. Courts will always consider the severity of the infringement and are never likely to award the maximum penalty, even for the most serious contraventions of the law.

46. In the Australian Visy cartel case, Visy was ordered to pay AU$36 million in penalties, but no pecuniary penalties were awarded against Mr Pratt, a director, in his personal capacity, as his ownership of Visy meant that he would bear the burden of the penalty[11]. It is not clear whether a penalty of AU$36 million would have a specific or general deterrence effect for somebody with a personal fortune of AU$5.5 billion. The Commerce Commission's proceedings in New Zealand against Mr Pratt were withdrawn on his death.

47. The size of the New Zealand economy and the scale of our businesses mean that there are fewer wealthy individuals or highly compensated executives for whom a $500,000 financial penalty is trivial. From a *New Zealand Herald* survey regarding the pay of chief executives in 49 NZX-50, state-owned and private companies[6], the average salary of the surveyed CEOs was $1.29 million, with the highest just over $4.5 million. The salaries of the second tier of executives in a business will generally not lag too far behind the CEO's. Sometimes the participants in cartels affecting New Zealand are overseas-based individuals with much higher salaries than their New Zealand counterparts.

48. Individuals considering engaging in cartel behaviour face quite a complex set of incentives. Unless they have a significant ownership stake in a firm, they do not directly profit from the cartel. They will generally, however, have sales or revenue targets that can be much easier to reach if they participate in a cartel (whether or not their superiors are aware of this activity). Reaching or exceeding targets leads to rewards such as further career advancement or the payment of bonuses for reaching targets. There may also be pressure from the organisational culture to go along with cartel behaviour. The individual will be weighing up the prospect of relatively immediate, and sometimes intangible, rewards of participation (career advancement, bonuses, fitting in) with the probability of detection, successful litigation and a possible fine.

49. Given that there are some individuals for whom a $500,000 pecuniary penalty is not a strong disincentive, that this amount has not been adjusted for inflation since 1990, and that penalties can be reduced in accordance with an individual's ability to pay, there is a strong argument for increasing the maximum level of pecuniary penalty for individuals. To have a strong deterrent effect, the level may need to be as high as $5 million. This change needs to be considered in the context of other possible penalties.

50. Increasing the level of individual pecuniary penalties will have the benefit of providing a disincentive to the small number of people for whom the current maximum is insufficient to deter cartel behaviour. The pecuniary penalty is a straightforward transfer between the individual and the Crown, and as such counts as neither a cost nor a benefit. The only marginal benefit is the increased deterrence from a higher fine, which we cannot quantify. The marginal cost of an increase in penalty is probably zero, as the costs of investigation and prosecution are unrelated to the size of the penalty.

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[11] *Australian Competition and Consumer Commission v Visy Industries Holdings Pty Limited* (No 3) [2007] FCA 1617 (2 November 2007).

[6] "CEOs feel the freeze as bonuses criticised", Tamsyn Parker, *New Zealand Herald*, Saturday 11 April 2009.

1.4.2.2 Using other forms of penalty

Management banning orders

51. The Commerce Act currently has provisions for management banning orders – court orders that exclude a person from being a director or involved in the management of a body corporate for up to five years. These provisions have not yet been used but may be a stronger disincentive for some executives than a penalty because they deprive them of their livelihoods. There is a question of whether a maximum of five years is too low. In cases of the most egregious offending, there may be an argument that longer banning orders are warranted. It may be worth extending the maximum length of a banning order to a lifetime and giving the Courts the discretion to determine the appropriate penalty in each case. Banning orders are probably quite effective in preventing recidivism[12].

52. Extending the term on banning orders would have the benefit of increasing their deterrent effect. It would also prevent recidivism. The cost would be if those individuals had useful management skills; these would not be available to businesses, even with safeguards.

Adverse publicity orders

53. The Australian Trade Practices Act 1974 allows the courts to impose adverse publicity orders. These require a body corporate to communicate information specified by the court to specified people or the public, either directly or through advertisement. These orders can, for example, require publicity around admissions of wrongdoing by the corporation. While there is generally adverse media publicity anyway around a court case, a communication directly by the company may be more effective.

54. Adverse publicity orders have the benefit of increasing publicity about cartels and their harm. The effect on deterrence and detection is not known, particularly as adverse publicity orders are generally used in conjunction with other penalties or orders.

Imprisonment

55. Imprisonment is used as a penalty in some other jurisdictions. Obviously this requires criminalisation and much of the rest of this paper is devoted to that issue.

[12] UK legislation provides that a company director can be disqualified from acting as a director for up to 15 years.

56. Imprisonment has a general deterrence effect. People who do not offend may be dissuaded from doing so by the knowledge that imprisonment could result. Unlike that of pecuniary penalties, the general deterrent effect of imprisonment is not particularly dependent on an individual's wealth. The general deterrent effect of imprisonment may be higher for white collar offenders because of the social stigma and the greater opportunity cost (through lost income), the reduced opportunities for future employment and the possibility of travel restrictions to some destinations. Individuals may also have different risk preferences if imprisonment is a possible consequence. Some people may so abhor the prospect of prison that they are unwilling to undertake any activity where there is a risk of imprisonment. There are global cartels that have specifically excluded the US from their operations because of the substantial risk of imprisonment.

57. Imprisonment has not been shown to have a specific deterrence effect. That is, it does not deter those already convicted from committing further crimes when they are released from jail. A Canadian meta-study of 50 studies of the deterrent effect of imprisonment, which together observed more than 300,000 offenders, found that imprisonment did not reduce re-offending after release. The control groups were those who had received community sentences, rather than imprisonment[13]. This was a study covering all types of crime.

58. The costs and benefits of criminalisation are considered further in the next section.

1.4.2.3 Increasing the probability of private enforcement

59. Private actions for damages can significantly increase the cost of participating in a cartel. Private actions are most common in the US, which allows for treble damages to be awarded against cartelists. In New Zealand, private litigants can receive exemplary damages, over and above ordinary damages. The potential quantum of exemplary damages is uncertain as there have been no such awards under the Commerce Act to date. Given the costs of Commerce Act proceedings, and the relatively diffuse nature of harm from cartels, the most significant impediment in New Zealand to private litigation is the absence of class actions. Private actions may be preferable to fines or pecuniary penalties because damages' awards directly compensate victims.

60. Since 2006, the High Court Rules Committee has been examining legislative proposals for a class actions' procedure. The Committee has closely examined the Australian and UK legislation, and has sought to adapt relevant features for the New Zealand situation. Consultation papers and draft legislation were released in April 2007, and in October 2008. The Committee has recently concluded its work and submitted a proposal to the Secretary for Justice, for Government consideration. Costs and benefits will be considered as that work is progressed.

1.4.3 Conclusions

61. There are more effective means for achieving an increased deterrence of cartel conduct than the current civil financial penalties.

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[13] Gendreau, Paul, Claire Goggin and Francis T. Cullen 1999, *The Effects of Prison Sentences on Recidivism.* Ottawa, ON: Correctional Service of Canada, Solicitor General Canada.

62. The Commerce Commission's current level of funding for enforcement is probably not impeding cartel deterrence, although an increase may see some small gains. The leniency programme, improved cooperation with other jurisdictions and improving private enforcement are all areas where work is currently underway. This should lead to some improvements, but these will not be large (the costs of the interventions are not large either). Rewarding whistleblowers, increasing the level of financial penalties for individuals, extending the possible length of management banning orders and introducing adverse publicity orders are all options worth considering further, although again their cumulative impacts (and costs) are likely to be relatively small.

63. The single intervention most likely to have a significant impact on deterrence and detection is the possibility of imprisonment. This requires criminalisation, which brings with it a number of costs and benefits. The next section will consider those costs and benefits in greater detail.

1.5 Costs and benefits of criminalisation

64. The magnitude of the costs and benefits of criminalisation will depend to a large degree on the legislative design and implementation of the criminal penalty regime.

1.5.1 Benefits

1.5.1.1 Deterrence

65. In a strict economic cost-benefit sense, the benefit of criminalisation would be the incremental reduction in deadweight losses from cartels, caused by the incremental change in cartel behaviour. As we cannot directly observe the deadweight losses or the change in behaviour, we use the level of deterrence as a proxy.

66. Greater deterrence of the most serious forms of cartel behaviour will have significant benefits for the effective operation of markets and would contribute to improving productivity. Criminalisation, and particularly the possibility of imprisonment, provide strong disincentives for executives of corporations to engage in cartel behaviour. The introduction of criminal sanctions would create the threat of a highly personal penalty for any infringement. Criminal culpability, and the associated social stigma from a conviction, presents a greater risk to the individual's reputation and stature than financial penalties. Where the penalty is a management ban or a term of imprisonment, the risks associated with infringement increase significantly in a way that the risk from larger financial penalties cannot.

67. The introduction of criminal sanctions would also complement the Commission's leniency programme. The detection of cartels is difficult, and the threat of criminal penalties will provide a greater incentive to induce whistleblowing and cooperation through the provision of leniency in any resulting cartel proceedings. In the US, an increase in the detection of cartels and successful prosecutions in recent years has been attributed to a new, clear leniency policy backed up by the consistent and determined threat and use of criminal sanctions[14].

[14] United States Department of Justice Antitrust Division's corporate and individual leniency policies in OECD 2002, *Fighting Hard-Core Cartels*, Annex A.

1.5.1.2 Moral condemnation

68. Regardless of the theory of the harm of cartel behaviour, it is important that a social consensus develops around the moral condemnation of cartels. A cartelist deliberately engages in deceptive conduct to cheat consumers out of more than they would earn in a competitive market. Cartelists subvert competitive processes for some form of personal gain. Cartel behaviour is not just aggressive business behaviour; it is outside the bounds of morally acceptable conduct.

69. Moral attitudes change over time. Some conduct that was previously acceptable has become immoral. Other conduct was previously criminalised and viewed as immoral but is no longer criminal or generally considered immoral. The law can play a useful function in leading moral attitudes. Criminalisation signals moral condemnation, and cartel criminalisation could assist in developing stronger community norms against cartel conduct. Widespread moral norms on cartel behaviour could help to reduce its incidence or at least encourage detection.

1.5.1.3 Trans-Tasman harmonisation

70. The recently agreed Single Economic Market (SEM) 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.

71. The Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Coordination of Business Law also acknowledges that further coordination of significant areas of business law can facilitate deeper economic ties. The governments recognise that coordination is multifaceted and does not necessarily mean the adoption of identical laws, but rather finding a way to deal with any differences so they do not create barriers to trade and investment.

72. The Australian Government has recently criminalised cartels. Criminalising cartel conduct in New Zealand would improve the harmonisation of trans-Tasman competition law. The specific question of whether or not New Zealand should adopt the same cartel law is considered in more detail in the chapter on definitions of the legal offence.

73. The ACCC has had an increase in leniency applications since the cartel legislation came into effect. If New Zealand does not criminalise cartel behaviour, we risk being seen as a soft touch compared with Australia. Australasian cartels may scale back their activities solely to target New Zealand because of the lower penalties here.

74. Criminalisation would also facilitate cooperation between Australia and New Zealand in investigation and prosecution. Cooperation is greatly facilitated if the alleged offending is criminal in both jurisdictions. Extradition, for example, requires dual criminality. Until the Commerce Commission (International Co-operation, and Fees) Bill is passed, criminalisation will enable a greater reliance on generic criminal international cooperation agreements for investigation and other assistance.

1.5.1.4 International cooperation

75. The availability of criminal sanctions may also help New Zealand when involved in cross-jurisdictional proceedings against international cartels. Criminalisation is particularly prevalent in large English speaking countries: countries which are our major trading partners and sources of investment capital[15]. As a general rule, competition laws only allow for the prosecution of individuals who have caused harm in their own jurisdictions. In the absence of formal bilateral cooperation agreements on competition law, cooperation between the Commerce Commission and overseas enforcement agencies is largely informal or limited to non-confidential information. Criminalisation allows for the invocation of multilateral and bilateral criminal cooperation agreements that can provide for overseas competition authorities to undertake formal investigations. Dual criminality (criminality in both jurisdictions) is required for procedures such as extradition.

76. The OECD regards criminalisation as best practice. It is perceived as a signal of commitment to competition law. In an environment where some other common law countries have criminalised, we may be perceived as a softer touch if we do not follow suit. Perceptions about the degree of our commitment to competition law could also affect the willingness of other competition authorities to cooperate with the Commerce Commission.

1.5.2 Costs of criminalisation

1.5.2.1 Chilling pro-competitive activity

77. There are undeniable difficulties in defining a criminal offence that covers only ”hard-core” cartel conduct. The definition of the conduct would need to be carefully considered to avoid legislative over-reach and the deterrence of pro-competitive, competitively neutral or efficiency-enhancing conduct. The current civil prohibitions are framed in a broad manner, but the possibility of authorisation is intended to prevent any over-reach or chilling effects. This is an acceptable approach in the civil context, but undesirable in the criminal.

78. The statutory definition of hard-core cartel conduct would also need to provide a clear distinction between what is prohibited and what is not. Given the significant penalties available under a criminal regime, any uncertainty in the law could stifle legitimate, competitively neutral activity, and deter activity that may be of benefit to competition or efficiency.

79. The next section of the discussion document canvasses various options for defining the criminal offence so that this chilling effect is mitigated.

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[15] According to a survey of the OECD’s 30 member countries, nine countries provided for terms of imprisonment for some form of hard-core cartel conduct. – OECD 2002, *Report on the Nature and Impact of Hard Core Cartels and Sanctions Against Cartels Under National Competition Laws*, OECD Directorate for Financial, Fiscal and Enterprise Affairs, Competition Committee, Report Number 7. Since then a number of other jurisdictions have criminalised, including the UK and Australia.

1.5.2.2 Difficulties in obtaining convictions

80. The higher standard of proof required in criminal prosecutions – proof beyond reasonable doubt – may make it difficult, particularly in complex cases involving economic analysis, to obtain convictions. Jury trials could be especially hard given the complex nature of most cartel cases. During criminal trials there are additional restrictions on prosecutors that do not exist in civil proceedings, and these will need to be considered in the investigation process. For example, in criminal trials (as in proceedings for pecuniary penalties) the prosecutor cannot admit evidence that infringes on the right against self-incrimination for the accused. If the difficulty in achieving convictions is too great, the Commerce Commission might not undertake criminal prosecutions and credibility in the criminal regime will be lost. This would represent a significant risk to the Commission's enforcement function, and would result in a failure to increase the deterrence of hard-core cartel conduct.

1.5.2.3 Cost of incarceration

81. The cost of administering criminal penalties, such as jail terms, needs to be considered.

1.5.2.4 Costs of enforcement and administration

82. Criminal investigations may be more costly to undertake than civil investigations because of the higher standard of proof required and the rules of evidence that require better documentation of the chain of custody. The costs of criminal trials may be higher than those of civil court proceedings because criminal trials take longer, all else equal, as evidence cannot be admitted by way of written brief. Jury trials, if used, also increase costs over civil proceedings. The absence of a lay member in criminal trials may reduce costs. The magnitude of these costs is difficult to estimate and depends on the nature of the criminal regime.

1.5.3 Conclusions

83. There is a prima facie case for criminalisation[16]. As the exact level of costs and benefits will depend on the design of a criminal regime, the next section of the paper considers these design questions.

Questions for submitters

1. Do you consider cartels to be harmful?

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

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

[16] A discussion of the case for criminalisation of cartel behaviour is covered in *Criminalisation of Cartel Behaviour*, an occasional paper by David King, available at www.med.govt.nz.

Questions for submitters

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

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

6. Should New Zealand introduce criminal penalties for “hard-core” cartel conduct?

Chapter 2: Principles

84. As discussed above, the magnitude of costs and benefits depends on the exact design of the criminalisation regime. For that reason this section considers options for how it would be done.

85. The objective is to design an offence and penalty regime that deters hard-core cartels, while not deterring efficiency-enhancing cooperation arrangements. Any reform must also be consistent with: certainty; simplicity; fairness; proportionality; and reasonable enforcement, litigation and compliance costs.

86. The consideration of options will need to take into account different types of decision error:

- type 1: false positive (i.e. deterring welfare-enhancing conduct or over-reach);
- type 2: false negative (i.e. allowing welfare-reducing conduct or under-reach); and
- type 3: excessive uncertainty and costs for regulators and business.

87. There will be trade-offs between these principles and different types of decision error. it is important to understand the nature of such trade-offs and the following discussion reflects this.

Chapter 3: Behaviours

3.1 OECD definition of cartel behaviour

88. The OECD[17] defines a hard-core cartel as: "an anticompetitive agreement, anticompetitive concerted practice or anticompetitive arrangement by competitors to:

- fix prices,
- make rigged bids (collusive tenders),
- establish output restrictions or quotas, or
- share or divide markets by allocating customers, suppliers, territories, or lines of commerce".

89. The four main forms of hard-core cartel conduct occur on their own or in combination:

- **price fixing** is an anti-competitive agreement between competitors to coordinate pricing. Most commonly, price fixing will involve agreements of an actual or minimum price or schedule of prices. It may also relate to components of price, such as limiting discounts, discontinuing a free service or imposing agreed surcharges;
- **bid rigging** is a form of price fixing or market allocation where agreement is reached on which firms will win particular bids. It can involve bid rotation, bid suppression or making bids that are clearly going to be uncompetitive. Bid rigging is usually practised in markets where tender processes are commonly used for the acquisition of goods and services, such as government procurement and the construction industry;
- **output limitation agreements** or **output quotas** are anti-competitive agreements to cap the amount that will be supplied to a market; and
- **market allocation schemes** are anti-competitive agreements in which competitors divide markets among themselves. In such schemes, firms allocate specific customers or types of customer, product or territory among themselves.

90. The OECD recommendations emphasise that "the hard-core cartel category does not include agreements, concerted practices, or arrangements that are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies". The OECD recommends "introducing criminal sanctions in cartel cases in countries where it would be consistent with social and legal norms, which would enhance both deterrence and the effectiveness of leniency programmes".

[17] OECD *Recommendation of the Council Concerning Effective Action Against Hard Core Cartels* (adopted by the Council at its 921st Session on 25 March 1998 [C/M (98) 7/PROV]).

91. The OECD categories of cartel behaviour represent those categories where there is considerable international consensus on their pernicious effects. Some other categories of conduct are included in the hard-core cartel category in other jurisdictions. For example, in the US, group boycotts (exclusionary provisions in New Zealand) are condemned in cases involving horizontal agreements among direct competitors.

Question for Submitters

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

3.2 What behaviour are we attempting to criminalise?

92. The OECD specifies broad categories of serious cartel behaviour. These are derived from economic assessments of the harm caused by that behaviour. It is generally agreed that a hard-core price fixing cartel, which deliberately sets prices above the market clearing level and extracts significant rents from consumers with no efficiency gains, should be prohibited. Market allocation schemes eliminate all competition between competitors, not just price competition, so they are more harmful. Output limitation agreements have similar effects to price fixing agreements. Bid rigging is a form of price fixing or market allocation.

93. What is less clear cut is whether conduct at the margins of these cartel categories ought to be criminalised or not. To identify the boundaries of cartel behaviour we consider four marginal scenarios:

1. the minor cartelist;
2. the incompetent cartelist;
3. the unlucky cartelist; and
4. the naïve cartelist.

3.2.1 The minor cartelist

94. The minor cartelist is a cartelist who intends to form a cartel, but the nature of their business means that the scope of the harm that they cause is small. Consider two corner dairies who agree to fix prices. Assume that the market is limited to their geographical catchment because their customers are too lazy to travel any further. For ease of administration, the cartelists agree to fix prices on only 10 items. The cartel may be successful, but its economic impact is small because the turnover of affected goods is only $100,000 per annum.

95. Should cartel behaviour be criminalised if the volume of commerce affected is low? The general approach to this type of question is to criminalise regardless of the magnitude of the offending, but rely on prosecutorial discretion to not prosecute minor cases. The Australian prosecution guidelines[18] state that criminal prosecutions

[18] See MOU between the ACCC and DPP; revised ACCC immunity policy for cartel conduct as well as immunity policy interpretation guidelines; and Guidelines to the ACCC approach to cartel investigations, all available at www.accc.gov.au

are less likely to be brought against cartelists that affect less than AU$1 million of trade and where there are no other aggravating factors. A statutory threshold, rather than a prosecutorial guideline, creates incentives for potential defendants at the margin to try to game the law by exploiting the threshold.

96. A statutory threshold would contrast with the current Commerce Act prohibitions on practices that lessen competition. Those prohibitions do not specify any minimum level of commerce but require that the purpose, effect or likely effect of the conduct be to **substantially** lessen competition in a market.

3.2.2 The incompetent cartelist

97. The incompetent cartelist is a cartelist who enters into a cartel agreement fully intending that it will reduce competition between the parties to the agreement. The cartel does not succeed because the cartelists were too incompetent to set up a workable cartel. As an extreme example, consider two would-be cartelists who agree to fix prices. They, however, only have 35% market share. When they raise their prices, their competitors respond by cutting prices and rather than increasing profitability they lose further market share.

98. The common law recognised a defence of impossibility for conspiracy. For example, in the English case of *DPP v Nock*[19], a defendant was acquitted when he had agreed to attempt to produce the drug morphine from certain tablets. It was not chemically possible to derive the desired drug from the substance in the tablets. The New Zealand Courts did not follow *Nock* in *R v Sew Hoy*[20]. The Court of Appeal held that the making of the agreement itself was contrary to the public good, whether it proceeded further or not[21].

99. This situation is analogous to the crime of attempt. The forming of a cartel agreement is contrary to the public interest, whether or not it can succeed in achieving its object. The incompetent cartelist may succeed on later attempts. For these reasons, the behaviour of the incompetent cartelist should be subject to criminal liability.

3.2.3 The unlucky cartelist

100. The unlucky cartelist enters a cartel agreement but, through circumstances beyond their control, the cartel agreement cannot be successfully implemented. For example, changes in market conditions may mean that the cartel cannot be successfully implemented.

101. The relevant policy considerations here are the parallel to those that apply in the case of the incompetent cartelist.

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[19] [1978] AC 979.

[20] [1994] 1 NZLR 257; (1993) 10 CRNZ 581 (CA).

[21] Adams on Criminal Law CA 310.13.

3.2.4 The naïve cartelist

102. The naïve cartelist enters into a cartel without being aware that cartels are illegal: they may even inform others of the existence of their price fixing agreement. This is not uncommon. Groups of professionals and professional associations frequently fix prices while being unaware that this is illegal. Some go so far as to view price competition as a breach of professional ethics. Ignorance of the law is, however, not an excuse for any offence – this principle is set out in section 25 of the Crimes Act 1961.

103. Depending on how the mental element of the offence is defined, naïve cartelists may escape liability. The requirement of dishonesty for the UK cartel offence would allow naïve cartelists to deny liability on the basis that they did not know that their conduct was dishonest according to the standards of ordinary people. By contrast, the Canadian or Australian cartel offences may catch naïve cartelists.

104. Regardless of the motivations of the naïve cartelist, their behaviour still causes harm or is likely to do so. Given that one of the primary objectives of criminalisation is deterrence, there is no strong policy reason for excusing the behaviour of the naïve cartelist.

3.2.5 Conclusion

105. In all of the examples above, there is an agreement between competitors to form a cartel – only the effect or likely effect of that agreement differs. It should be noted that the section 27 prohibition on agreements that substantially lessen competition (the effect) prohibits an agreement that has the "**purpose, or has or is likely to have the effect**, of substantially lessening competition". Agreements with intended, likely or actual anti-competitive impacts are all subject to the prohibition. The level of actual harm caused is a consideration when determining penalties, but does not determine the legality of the conduct. If the law prohibited only actual anti-competitive harm, but not agreements or attempts to cause harm, would-be offenders could keep practising and refining their techniques, knowing that they run a risk of legal penalties only if they succeed.

3.3 What behaviour should not be criminalised?

106. The OECD recommendations emphasise that "the hard-core cartel category does not include agreements, concerted practices, or arrangements that are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies". This caveat is included because some behaviours associated with hard-core cartels (particularly price fixing and market allocation) are also associated with activities that reduce costs or enhance outputs. This type of activity is most commonly seen in joint ventures, franchises and networks.

3.3.1 Joint ventures

107. A joint venture is an association of persons formed to pursue a particular business objective together for mutual profit. The term "joint venture" does not have a settled legal meaning in New Zealand, reflecting the fact that this arrangement can take a wide variety of forms. Joint ventures between competitors are one of the trickier areas for competition law to negotiate. Joint ventures are increasingly popular and the forms they take are becoming more varied as a response to global competitive pressures.

108. Joint ventures between competitors sit somewhere on a spectrum between cooperation on specific activities such as research and development (R&D) and fully integrated mergers. They involve varying degrees of integration of the participants' operations. They often enhance efficiency but in some cases may be used as a cover for a cartel[22]. These efficiencies can come about through reducing risk, economies of scale, eliminating duplication of facilities, accessing complementary resources and regulating unique markets, such as sports leagues and copyright collection. Their effect on competition can vary from pro-competitive to neutral to anti-competitive. They can restrict competition through the suspension of rivalry between partners or by facilitating collusion between partners in areas outside the joint venture. They can be pro-competitive if they facilitate the market entry of a new entity that would not exist but for the collaboration. They also have pro-competitive effects if they facilitate the development of new products that would not otherwise be developed.

109. Genuine joint ventures do not deserve per se condemnation – they need to be assessed individually for their competitive effects. As a general principle, genuine joint ventures should be excluded from the scope of a cartel offence. They should, however, still be subject to the competition test in section 27.

110. Cartelists can seek to describe their collusion as a joint venture to try to cover up their activity and avoid per se condemnation. There are two main ways of doing this – one is to call the cartel a joint venture, being one that has no purpose other than cartel activity. These are relatively easily spotted because there is no integration of business functions or efficiency gains. The other way of disguising a cartel through a joint venture is to have a legitimate joint venture with some degree of integration of business functions, but to add restraints to the parties to the joint venture that effectively form a cartel. These restraints will be broader than necessary for the legitimate joint venture activity. This second approach can arise after the joint venture has been formed, as the joint venture facilitates information sharing (and coordination) beyond the scope of the joint venture.

[22] Cartels may price like a theoretical monopolist, but they do not achieve any efficiencies, as the production units remain the same. Monopolists, on the other hand, may achieve efficiencies owing to their greater economies of scale. Joint ventures achieve efficiencies because they have some merger-like aspects.

111. In order to function, a joint venture may need to set prices, which because of the cooperative nature of a joint venture, could be seen as a form of price fixing. The potentially controversial question is whether a pricing agreement (or other prima facie cartel behaviour) is central to the operation of a legitimate joint venture, or whether it is ancillary to the joint venture and deserving of condemnation if broader than reasonably necessary. This issue has come up in the US in the context of a joint venture between Shell and Texaco, which merged their refining and marketing activities on the west coast of the US into a joint venture called Equilon. The joint venture also priced the fuel that was sold through Shell's and Texaco's separately branded service stations. The legitimacy of the joint venture was uncontested. The Supreme Court ruled that while there "may be price fixing in a literal sense, it is not price fixing in the antitrust sense" because Shell and Texaco had ceased competing with each other in the sale of fuel upon the formation of the joint venture. "A joint venture, like any other firm, must have the discretion to determine the prices of the products that it sells, including the discretion to sell a product under two different brands at a single, unified price".[23] This judgment did not preclude analysis under the rule of reason – analogous to our section 27.

112. In our view, *Dagher* probably goes too far. We should not preclude questioning the necessity of a prima facie cartel measure. We need to inquire into whether it is reasonably related to the integration and reasonably necessary to achieve its pro-competitive benefits. If it is not reasonably related and necessary to the integration, it merits condemnation as a cartel. *Dagher* did not address the question of whether the pricing agreement was reasonably related to and necessary for the joint venture – it assumed that it was.

3.3.2 Franchises and dual distribution

113. Franchising is a form of licensing distribution arrangement. It can take a number of forms. For example, "product franchising" is where a distributor supplies the product of a manufacturer, often with the exclusive right to sell within a specific market (e.g. motor vehicles or petrol). Another type is a "manufacturing franchise" where an essential ingredient or technical information is all that is supplied, such as in the manufacturing of soft drinks. "Business format franchising" is a popular business method, providing a franchisee with a brand and business system to operate a branch business. "Franchising" does not have a settled legal definition in New Zealand.

114. Franchisors often offer territories to franchisees to ensure that franchisees do not compete with each other, but instead focus competitive effort on businesses outside the franchises. This elimination of intra-franchise competition has the hallmarks of a market allocation scheme. Franchises are generally vertical arrangements, so this behaviour within franchises is generally only subject to the disciplines of section 27. Franchise agreements are not necessarily anti-competitive – most of the competition comes from outside the franchise. Franchises can have pro-competitive effects if they can form a network that can compete with larger, integrated businesses. In defining the cartel offence, care will need to be taken to ensure that this vertical market division is not caught within the definition of a cartel.

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[23] *Texaco Inc v Dagher* 126 S.Ct. (2006).

115. As with almost any forum in which businesses interact, cartels can form in franchises. Within a franchise system, the franchisees may form a cartel agreement, either amongst themselves or with the assistance of the franchisor.

116. Some franchisors operate franchises at the same functional level as other franchisees (many franchises arise from a successful business franchising its business model). This means that there can be a horizontal dimension to their activity when they allocate territories. This horizontal dimension can bring them within the purview of cartel prohibitions, which are generally limited to competitors.

117. This situation is analogous to dual distribution. For example, a supplier may sell products to a distributor for resale in the market while also choosing to sell those products directly into the market. It is difficult to distinguish between the horizontal and vertical dimension in a dual-distribution system where the supplier competes for sales with its unaffiliated distributors. Such agreements can be pro-competitive and should not be condemned as cartels. An agreement between a single supplier and a single distributor is unlikely to raise any problems. However, where the agreement includes two or more suppliers or two or more unaffiliated distributors, there can be an agreement between the suppliers or unaffiliated distributors to restrain competition among themselves, such as by allocating markets or fixing prices.

118. Dual-distribution situations and franchises cannot be given blanket exemptions from the operation of the cartel offence, but must be able to engage in legitimate pro-competitive activity.

3.3.3 Networks

119. Network industries are those in which a product is useful because consumers use and interconnect with the same product in a "network". Traditional examples include telecommunications and transportation. A more recent example is electronic banking, which relies on a network that processes transactions to enable consumers to access their accounts through any ATM. A network industry is one in which each individual's demand for a product is positively related to the number of other consumers of the product. The larger the network, the more valuable the network is to individual users of the network. Large networks tend to be attractive to consumers and thus become larger. These network effects mean that cooperation is the norm.

120. Networks can be formed through franchises and joint ventures, but this is not always the case. They can be run by trade associations or independent bodies corporate. Companies often form joint ventures to create and operate networks that are essential to the functioning of the industry. In a network such as electronic banking, the network operator will set the price for transactions on the network, as a way to avoid every member of the network having to negotiate bilateral agreements with every other member of the network. This price fixing element does not justify condemnation as a cartel because there may be significant efficiency gains. The horizontal cooperation in networks can raise other competition concerns. Cooperation is essential to the functioning of the network and can create valuable efficiencies, but the network can also be used to exercise market power. Networks can create strong barriers to entry and can also be used to deny rivals access, thereby reducing their competitiveness. Genuine, efficiency-enhancing networks should be subject to competition scrutiny, but not per se condemnation as cartels.

121. Joint ventures, franchises and networks do sometimes engage in behaviour that on the face of it has the characteristics of a cartel, such as price fixing or market allocation. Genuine joint ventures, franchises and networks do not warrant criminal condemnation. They can, however, still lessen competition and should still be subject to civil penalties if they engage in anti-competitive behaviour. Unfortunately sophisticated cartels can also use joint ventures, franchises and networks as covers for their activities. Distinguishing between the genuine and the sham is critical – how this is done is discussed further in the section on exemptions and defences.

3.3.4 Activity that is critical for environmental or health and safety reasons

122. Some activity that has useful public benefits potentially falls within the categories of hard-core cartel activity.

123. A voluntary fishing quota scheme (a self-management scheme) would be considered an output restriction, even though it is critical to maintaining a sustainable fish stock[24].

124. Helicopter companies providing air rescue services may agree to divide up the country into territories to ensure a minimum level of coverage. All of the parties are free to provide additional services whenever they wish to do so. The division of a geographical territory would be classified as market allocation.

125. 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.

126. There is no intention to criminalise any of these types of scheme, as long as they are not being used as a front for a serious cartel.

3.3.5 Conclusion

127. These issues will be considered further in the context of the discussion on the definition of the offences and exceptions. Before considering specific possible definitions of the cartel offence, it is worth elaborating the concepts of per se rules and the rule of reason and considering the difference between general and specific law.

[24] The example is hypothetical. Most fish stock in New Zealand is managed through a government quota scheme. However, self-managed quotas do exist in other jurisdictions.

3.4 Broader questions

3.4.1 Per se or rule of reason?

128. Per se prohibitions prohibit certain types of conduct, without any assessment of the impact of that conduct on competition. Per se rules are form based. Section 30 of the Commerce Act is a per se prohibition because it deems certain types of agreement to substantially lessen competition. The justification for form-based rules is that certain practices almost always have such pernicious effects on competition and are so lacking in any redeeming virtue that they are presumed to be unlawful without any inquiry into their effects on competition. The US Supreme Court has described per se prohibited agreements as those that "have no single purpose except stifling of competition"; they are "manifestly anti-competitive" or "plainly anti-competitive". Cartels lack any redeeming virtue, although the level of harm can vary.

129. A well defined per se rule provides greater certainty and predictability for businesses. It also avoids the courts having to undertake detailed inquiries into the economic effects of a practice. This reduces the length of court proceedings and the costs of litigation. Per se prohibitions also maximise deterrence because of their straightforward nature[25].

130. The rule of reason involves a close examination of the effects of an agreement or conduct. This requires consideration of the intended, likely and actual impacts on competition in the market. Pro- and anti-competitive effects are weighed up to decide if an agreement is, on balance, anti-competitive. This generally requires an assessment of the affected market and testing the impacts of the agreement on that market.

131. "Rule of reason" is used as a generic term in this paper to refer to a balancing of pro- and anti-competitive effects. It is not used to refer to the specific rule of reason test in US antitrust law. Section 27 of the Commerce Act is a type of rule of reason approach, because agreements are only condemned if they could or do have the impact of "substantially lessening competition in a market". Section 27 does not enable the balancing of pro- and anti-competitive effects, if these effects occur in different markets. This means that section 27 is not, strictly speaking, a rule of reason. It is framed in a broad manner, although the authorisation process is intended to prevent over-reach.

132. Impact-based prohibitions can, by definition, never prohibit pro-competitive or competitively neutral conduct. They do not, however, create any "bright line" rules for businesses to be able to assess quickly if their conduct is illegal or not. Court proceedings under a rule of reason tend to be longer and more expensive than those under a per se rule, as they require detailed economic evidence.

133. The differences between per se prohibitions and the rule of reason are illustrated in the two set diagrams below (not to scale). Per se prohibitions can sometimes catch pro-competitive or competitively neutral conduct.

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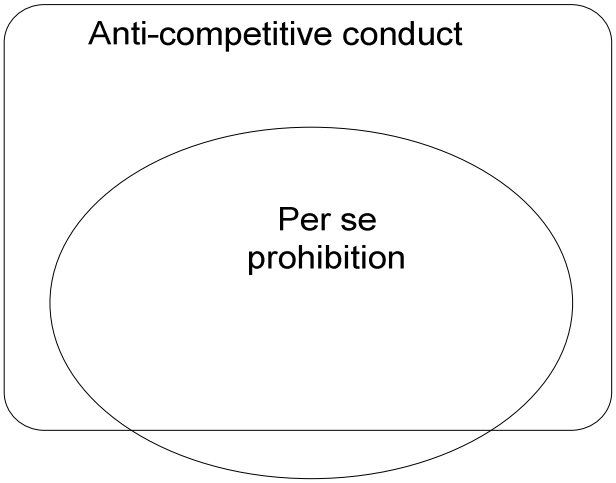
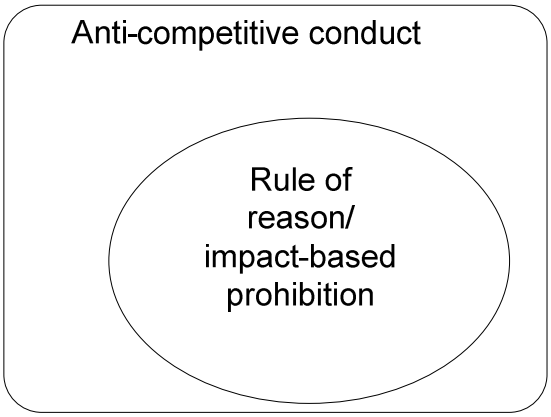
[25] Paul Scott 1999, *Expanding the Scope of Section 30 of the Commerce Act 1986 to Include Market Allocation*, Paper to the Tenth Annual Workshop of the Competition Law and Policy Institute of New Zealand, Vol 1, 30 July-1 August .





134. Per se prohibitions are generally limited by specific legislative exceptions or defences that reduce or eliminate the application of the prohibition to pro-competitive or competitively neutral conduct. Sometimes prosecutorial guidelines and discretion are also used to similar effect, although with less certainty in their application owing to their non-binding nature.

135. Under rule of reason analysis, there is often a de minimus threshold for illegality – for example, only that conduct that substantially lessens competition is prohibited. On the other hand, per se prohibitions do not have any such threshold. There can sometimes be a threshold in prosecutorial guidelines, such as not prosecuting offenders who affected less than a certain amount of commerce.

136. The common law countries that have criminalised hard-core cartels all have per se prohibitions. Canada has just abandoned a rule of reason in favour of a per se prohibition. This is because hard-core cartels are so likely to harm competition and to have no pro-competitive benefits that they warrant liability without a detailed inquiry into their actual competitive effects. A per se prohibition can express moral condemnation of cartel behaviour, because its moral nature is not assessed by balancing positive and negative effects. An effects-based prohibition introduces moral ambiguity into the condemnation because the condemnation lies not in the behaviour (which is fully within the control of the moral actor) but in consideration of net effects (which are not fully within the control of the moral actor).

137. A more pragmatic consideration is that a criminal offence subject to a competition test would require proving a "substantial lessening of competition" beyond reasonable doubt, instead of on the balance of probabilities. There are significant practical difficulties in proving economic arguments to this level of proof. If criminal trials were before a jury, there would also be large difficulties in making complex economic evidence accessible to a jury.

138. Having a criminal offence that is defined by a balancing of effects (pro- and anti-competitive) is unusual in common law jurisdictions.

139. Per se prohibitions minimise type 2 and 3 errors at some expense to type 1 error, which must be addressed through other means. Rule of reason minimises type 1 error at the cost of greater type 3 error.

140. While we leave this as an open question, the rest of the paper proceeds on the basis of a per se prohibition, in the interests of keeping the task manageable.

Question for submitters

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

3.4.2 Principle vs rule-based drafting

141. Some jurisdictions prefer black letter law. This allows for maximum certainty about what is and is not legal, but runs a greater risk of being either too narrow or too broad. Other jurisdictions take a more purposive approach. This can lead to uncertainty, particularly in novel situations, but can more easily avoid problems of under- or over-reach. It also enables the law to adapt to new situations without the need for legislative amendments. Small businesses often prefer black letter law/regulation as it gives them greater certainty, but this is less of an issue in this case, as small businesses are less likely to be criminally prosecuted, as they are less likely to be able to form cartels or have significant economic impacts if they do. We are not consulting on the general question of principle vs rule-based drafting but it can be raised as it relates to a specific issue.

Chapter 4: Developing a legal definition

142. The OECD definition of hard-core cartel conduct is not a legal definition. A number of attempts have been made to codify it into law. Given the variety of legal systems and approaches to the law, there is large variation in the way that different countries have criminalised cartel behaviour. The International Competition Network has attempted to outline the basic statutory elements that define a hard-core cartel. The three common components of a cartel are:

- an agreement;
- between competitors;
- to restrict competition.

143. There is no model cartel law, or model legal definition.

144. We outline three possible approaches to criminalising cartel conduct:

- create an offence based upon the existing civil prohibitions in the Commerce Act;
- adopt the Australian offence provisions; or
- take a greenfields approach and develop new offences based on first principles.

4.1 Option 1 Criminalising existing civil prohibitions in the Commerce Act

145. The approach under this option is to develop a basic model that criminalises the existing civil prohibition in the Commerce Act, in order to assess the advantages and disadvantages of this approach. By its nature, this option is conservative and involves the least degree of change. The greenfields option has more room for change and development.

146. Hard-core price fixing cartels are prohibited under the Commerce Act and subject to civil penalties. The prohibitions regarding hard-core conduct are set out in Part 2 of the 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. The main provisions relating to hard-core cartels are:

- **section 30**, which deems price fixing agreements between competitors to contravene section 27 (this is a per se rule). 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 the following practices from the application of section 30:
    - certain joint ventures;
    - recommended pricing by industry associations; and

- joint buying and promotion arrangements; and

- **sections 44 and 45**, which exempt certain practices from the whole of Part 2. These are:

  - practices between partners (s44(1)(a));
  - restraints of trade in service agreements (s44(1)(c));
  - provisions for the protection of goodwill in the sale of a business (s44(1)(d));
  - actions in compliance with Standards (s44(1)(e));
  - terms and conditions of employment (s44(1)(f));
  - export cartels (s44(1)(g));
  - actions in concert by users of goods or services against the suppliers (s44(1)(h));
  - agreements between interconnected bodies corporate (s44(1A));
  - carriage of goods by sea to or from New Zealand (s44(2)); and
  - transactions relating to intellectual property rights (s45).

147. The key difference between sections 27 and 30 is that the former focuses on the impact on competition, whilst the latter is a per se rule that focuses on the form of the conduct. That is, in section 27 proceedings, the courts will consider anti-competitive effects of the arrangement and any countervailing pro-competitive effects to determine if the net impact is a substantial lessening of competition. In contrast, in section 30 proceedings, the deeming provision means that it is not necessary for the court to consider the arrangement's effects on competition – price fixing is presumed to be anti-competitive.

148. It would be relatively straightforward, from a drafting perspective, to criminalise the conduct described in section 30. Section 30 refers back to section 27, so an offence provision would require some amalgamation of the two sections. The offence would also require a mental element. A possible offence, with highlighted wording indicating words not found in the original sections, is:

> *1. No person shall **intentionally** enter into a contract or arrangement or arrive at an understanding, containing a provision, **which they know** has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services, that are—*
>
> *(a) Supplied or acquired by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other; or*
>
> *(b) Resupplied by persons to whom the goods are supplied by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them in competition with each other.*

2. *No person shall **intentionally** give effect to a provision of a contract, arrangement, or understanding, **knowing** that **it** has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services, that are—*

   (a) Supplied or acquired by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other; or

   (b) Resupplied by persons to whom the goods are supplied by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them in competition with each other.

149. This raises a number of questions:

1. defining an appropriate mental element;
2. the types of prohibited conduct;
3. the relationship between the criminal and any civil prohibitions; and
4. whether sections 31-33 provide adequate exemptions from a cartel offence.

4.1.1 Defining the mental element

150. A criminal offence requires both a physical element (actus reus) and a mental element (mens rea). The civil prohibitions generally require only a physical element. If a mental element is not specified in an offence, the Courts will generally read one in.

151. There are two conduct elements of the offence that require a mental element:

- forming an agreement to fix prices; and
- implementing an agreement to fix prices.

152. Intention is generally required for inchoate liability[26]. This means that the mental element for "forming an agreement" should be intention, given the conspiracy-like nature of this offence (for further discussion on this approach, see the section on mental elements in the greenfields option). Given the deliberate nature of serious cartel conduct, intention should also be the appropriate mental element in relation to giving effect to the agreement.

153. The circumstances existing when a person acts also require a mental element. Knowledge of essential facts is most apt in relation to the circumstances. Knowledge that the agreement has the purpose or effect of fixing prices is probably the appropriate mental element for the circumstances of both offences.

[26] CA21.15 Adams on Criminal Law

4.1.2 Types of conduct covered

154. The OECD recommends criminalising four categories of conduct: price fixing, bid rigging, output restrictions and market allocation. Gault on Commercial Law[27] discusses the scope of the prohibition in section 30 by asserting that "if the effect or likely effect of the arrangement is to control or maintain price, it will be unlawful. Arrangements involving quotas on production or supply; market sharing either on a product, geographic, or customer basis; collusive tendering or bidding; and the use of a common basing point for the calculation of freight are examples of practices that may have the effect of controlling or maintaining price". There is, however, no case law referenced to support the broad sweep of the statement.

155. Section 30 obviously covers price fixing. It has also been used in a bid rigging case[28] and its Australian equivalent in the Trade Practices Act has been used in a number of bid rigging cases[29]. The issue of output restrictions has not come before the New Zealand Courts, but in Australia a case has been successfully brought for price fixing where an output restriction was likely to control price[30]. The economic interrelationship of quantity and price means that restrictions on quantity typically will have the effect or likely effect of fixing or controlling prices, although this interrelationship would still have to be specifically proved in court.

156. Is market allocation covered by section 30? There is one New Zealand case under section 30 involving a market segmentation and price fixing agreement. In *CC v Eli Lilly & Co (NZ) Ltd*[31], two executives agreed that Chemstock would not pro-actively sell Elanco animal remedies to the A and B customers. In return Elanco would either not sell to C and D customers at all or would do so only at the published price-list which would give Chemstock the necessary competitive edge. The penalty judgment records the defendant's acknowledgement "that the arrangement was likely to have the effect of fixing, controlling or maintaining prices although its main consequence would be to segment the market between Elanco and Chemstock".

157. The Australian case law on market allocation provides no guidance on this question. Market allocation schemes often involve an exclusionary provision as defined by section 4D of the Trade Practices Act – with the exclusionary provision targeted at the cartel's customers. The prohibition against exclusionary provisions under the Trade Practices Act does not require the target to be in competition with the perpetrator(s), as section 29 of the Commerce Act does.

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[27] CA 30.10.

[28] *CC v Roadmarkers Waikato (1981) Ltd* (HC Auckland, 1998, CL1/97, 25/6/98 Elias J).

[29] 1.45A.40 *Miller's Annotated Trade Practices Act*, 26th edition.

[30] *ACCC v The Tasmanian Salmonid Growers Association Ltd* [2003] FCA 788 (1 August 2003).

[31] HC Auckland, 1999, CL19/98, 30/4/99 Fisher J.

158. Paul Scott[32] argues that market allocation schemes are a form of price control. Price fixing agreements eliminate price competition, whereas market allocation schemes eliminate all competition, including that on price. This must lead to a breach of section 30 as it amounts to a controlling of price. The definition of "control" has been considered by the New Zealand Courts. Salmon J in *CC v Caltex NZ Ltd* (1999) 9 TCLR 305, said, at page 311: "Amongst the definitions of the word 'control' in the *Shorter Oxford English Dictionary* is the following: 'To exercise restraint or direction upon the free action of'." Without the market division agreement, prices would be set by the market through supply and demand. With the agreement, prices are set by the single firm in the market. This amounts to control of prices.

159. If Paul Scott's argument is accepted, market allocation falls within the scope of price fixing as defined by section 30. This is still an open question and it would be open to the Courts to take a different view. In each market allocation case, the effects on price would have to be proved, which would bring economic analysis into the evidence.

160. The cartel offence outlined above would require knowledge in relation to the elements of price fixing as defined by section 30. It would need to be proved that the defendant knew that the purpose, effect or likely effect of the provision was to fix, maintain or control prices. This could exclude some naïve cartelists who agree to allocate markets or control outputs for reasons other than to fix prices.

4.1.3 Relationship between civil and criminal prohibitions

161. There are two ways to manage the interface between the civil and the criminal prohibition. The first is to retain the existing section 30 and add a new criminal offence similar to section 30, as described above. This would mean that the physical elements of the civil and criminal offences would be the same. Alternatively, only the criminal offence based on section 30 would stand; section 30 as it currently exists would be repealed, and the civil regime for pursuing cartel conduct would rely on section 27.

162. Leaving section 30 unchanged and adding a criminal offence would lead to roughly parallel criminal and civil prohibitions. The Australian cartel legislation has parallel civil and criminal prohibitions. The wording of the physical elements is the same but there are still a number of differences between the two, including:

- the types and the maxima of the penalties that can be imposed;
- the mode of trial and the nature of the court's jurisdiction;
- the rules of evidence, the legal burden of proof and the need to prove the elements of an offence beyond reasonable doubt;
- the rules of procedure that apply, including the powers of investigation that are available;

[32] *Expanding the Scope of Section 30 of the Commerce Act 1986 to include Market Allocation*, paper to the Tenth Annual Workshop of the Competition Law and Policy Institute of New Zealand, Vol 1, 30 July-1 August 1999.

- the conventional obligations imposed on prosecutors, e.g. the obligation to make all the evidence, including exonerating evidence, available to the accused;

- the definition of the mental element;

- the application of general principles of criminal responsibility; and

- the exercise of prosecutorial discretion[33].

163. Providing for civil and criminal per se prohibitions against cartel conduct has the advantage of widening the range of possible enforcement responses to cartel conduct. It enables discretion to be exercised and criminal prosecutions brought only against the most egregious offenders. It also provides a fallback option if an investigation uncovers evidence that may be insufficient to establish criminal liability but sufficient to establish civil liability. It also provides scope for private civil actions. Private criminal prosecutions are theoretically possible, but highly unlikely as they would not lead directly to damages' awards.

164. With parallel prohibitions, targeting the most egregious type of cartel behaviour would rely on the discretion of the enforcement agency. In general, in other jurisdictions where there are parallel civil and criminal prohibitions, there are public guidelines issued by the enforcement agencies that set out how these agencies will exercise their discretion on whether a criminal or civil track is to be taken. There may be concerns that because guidelines do not bind enforcement agencies, there is the potential for the discretion to be exercised differently from that specified in the guidelines.

165. If the criminal offence is clearly defined and focuses only on the most egregious cartel behaviour, there is an argument that there is less of a need to have a parallel per se civil prohibition for the same conduct. The Canadian legislation does not have any per se civil prohibitions against cartel conduct. The potential advantage of this approach is that it would focus the criminal offence only on hard-core cartel behaviour.

166. The disadvantage of an exclusively criminal per se prohibition is that it could reduce the deterrence effect and/or be costly. There are likely to be some circumstances where price fixing or other cartel conduct occurs where it would be desirable to deter such behaviour but where criminal liability would appear a disproportionate response. For example, the minor cartelist may not have a significant actual or potential impact on competition in the market.

[33] See further Caron Beaton-Wells and Brent Fisse 2008, *Criminalising Serious Cartel Conduct: Issues of Law and Policy* 36 *ABLR* 166 at 170.

167. Given that in the majority of cases, price fixing and other hard-core cartel conduct is unlikely to have pro-competitive effects, it would be desirable to avoid requiring courts to undertake detailed competition analyses of the effects of such a practice. Not all investigations will uncover evidence good enough to support a criminal prosecution, but the evidence may be adequate for civil proceedings – those situations may have no action taken if they also require proof of anti-competitive effect under section 27. Evidence may establish a corporate civil infringement but be insufficient for individual criminal liability.

168. The offence outlined above does not have any thresholds or other constraints to ensure that it only targets the most egregious behaviour. For this reason, it would be preferable, under this option, to retain section 30 as a per se civil prohibition to allow for the exercise of prosecutorial discretion.

4.1.4 Sections 31-33

169. Sections 31-33 (in existing or modified form) should apply to both the civil and the criminal prohibitions. In addition to the exceptions provided by sections 31-33, the authorisation process can be used to protect agreements that do not fall within the scope of sections 31-33.

4.1.4.1 Joint venture pricing

170. Section 31 of the Commerce Act provides an exemption for joint venture pricing. Section 31(1) defines a joint venture very 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 restriction of proportionate supply for unincorporated joint ventures is appropriate for some mining and manufacturing situations but is ill-suited to most other sectors. Section 31 has been criticised for chilling pro-competitive activity and leading to a favouring of incorporated joint ventures, even though they may have other disadvantages for the business[34]. It is not a model to follow in defining a joint venture exemption or defence.

171. The overkill of section 31 was acknowledged in Australia when the equivalent Trade Practices Act provision was amended in 2006, on the recommendation of the Dawson report, and replaced by a new joint venture defence (the joint venture defence relating to price fixing has been repealed by the new cartel offences). The joint venture defence under section 76C (exclusionary provisions) requires the defence to establish that the provision:

    i. is for the purposes of a joint venture; and

    ii. does not have the purpose, and does not have and is not likely to have the effect, of substantially lessening competition in any market.

172. For the purposes of this discussion, the short-lived Australian joint venture defence for price fixing is introduced as proof of a problem, rather than a possible solution.

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[34] Alan Lear 2005, *Joint Ventures: Treatment under New Zealand, United States and European Competition Law*, 11 NZBLQ 187.

173. A first-principles joint venture exemption would define a joint venture in economic terms, requiring a significant economic integration of functions. It might also require proof of actual or potential efficiency gains. A joint venture exemption should also include a requirement that the alleged cartel elements are reasonably necessary for the operation of the joint venture, to exclude sham joint ventures. It may be necessary to place an evidentiary, but not persuasive, burden of proof on the defendant as they would be best placed to produce the required evidence.

174. Joint venture exemptions and other defences are discussed further in the greenfields option.

4.1.4.2 Agreements of more than 50 people

175. Section 32 exempts agreements of more than 50 people from section 30. This is in place as a means for trade associations to make price recommendations. This exemption has little economic justification. There is a possibility that it does no harm because of the difficulties of running a cartel with 50 members. However, cartels with a relatively large number of members have been identified in some cases in Europe and Japan. Trade associations can also cover multiple markets. A cartel of two or three participants could operate in a particular market under the cloak of a trade association agreement with more than 50 parties.

176. The OECD has also specifically recommended the repeal of section 32[35].

4.1.4.3 Joint buying

177. Section 33 protects joint buying arrangements from per se liability for price fixing. To avoid over-reach of the cartel offence (type 1 error), this exemption should probably be extended to the cartel offence, as joint buying can have beneficial effects if the savings achieved through joint buying are passed on to consumers. “Buyer cartels” are best examined under section 27 as the effects of a “buyer cartel” are not unambiguously bad.

4.1.4.4 Pros and cons

178. Criminalising the existing civil prohibition on price fixing, as outlined above, would have a number of advantages. It would give businesses certainty that if their conduct does not breach the existing law, they will not breach the new criminal provisions. The language and concepts are familiar and there is existing case law (both New Zealand and Australian) to support the amendments. Liberalising the joint venture exemption could potentially stimulate more pro-competitive activity.

179. The disadvantage of this approach is that there is still some uncertainty over whether the prohibition on controlling price includes market allocation schemes and this would introduce type 2 error (under-reach). It will also be much harder to prove to a criminal standard price-related purpose, effect or likely effect for output limitations and market allocation schemes.

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[35] OECD, *Product Market Competition and Economic Performance in New Zealand*, Economics Department Working Papers No. 437 By Annabelle Mourougane and Michael Wise ECO/WKP(2005)24.

180. While the existing case law would be relevant when interpreting and applying the elements of the new offence, statutory interpretation in the criminal context is heavily influenced by the NZBORA. For example, the word “likely” may take on a higher threshold in the criminal context.

181. The scheme outlined above would also suffer from over-reach (type 1 error) as franchises and networks not structured as joint ventures could be subject to criminal penalties. This could be rectified by introducing further exemptions or defences – possibilities are outlined in relation to the greenfields option.

4.2 Option 2 Adopting the Australian approach

182. Criminalisation of cartels in New Zealand will fulfil the SEM outcome of ensuring that similar conduct in both jurisdictions incurs similar penalties. Adoption of the Australian legislation is a somewhat different question.

183. The Australian legislation contains both cartel offences and a new set of parallel civil per se prohibitions. The new offences and civil per se prohibitions address four types of anti-competitive behaviour: price fixing, output restriction, market allocation and bid rigging. These types of cartel behaviour are defined in terms of the core concept of a “cartel provision”. It is an offence (subject to proof of the fault/mental elements referred to below) or a civil per se violation to make a contract, arrangement or understanding that contains a cartel provision or to give effect to a cartel provision contained in a contract, arrangement or understanding.

184. The only difference between the elements of the offences and those of the civil prohibitions is that the former require the proof of certain mental (fault) elements, namely intention to make a contract or arrangement or arrive at an understanding, or to give effect to a cartel provision and knowledge or belief that the cartel provision is contained in a contract, arrangement or understanding.

185. There are several exceptions, the majority of which replicate pre-existing exemptions from the civil prohibitions in the Trade Practices Act. Exemption may be obtained for provisions in contracts, arrangements or understandings on a case-by-case basis through the longstanding authorisation process in Part VII of the Trade Practices Act. In addition, in the case of price fixing, there is an exception in relation to the prices of goods or services to be collectively acquired or for the joint advertising of prices for the re-supply of goods or services collectively acquired.

186. Exceptions also aim to prevent overlap between the various prohibitions under the Trade Practices Act. For example, if there is an agreement that involves a vertical exclusive dealing or resale price maintenance provision, there are exceptions that exclude the application of the per se cartel prohibitions (the conduct is subject to the prohibitions specific to such restraints). The same applies to provisions for the purchase of shares or assets, which are subject to the general merger and acquisition prohibition under section 50.

187. The main exception to the cartel offences and new civil prohibitions is for joint venture activity. The joint venture exception to the cartel offence and the joint venture exception to the civil per se cartel prohibitions are limited to a cartel provision contained in a contract that relates to the joint production and supply of goods or services[36]. The joint venture exceptions do not apply to cartel provisions contained in an arrangement or understanding. The new joint venture provisions have been criticised[37].

188. The legislative prohibition (but not the joint venture exceptions) is set out in the appendix. Different drafting styles mean that the Australian legislation would not be adopted verbatim in New Zealand; it would require some adaptations to suit the style and format of the Commerce Act.

189. The Australian Criminal Code prescribes the way that criminal offences are formulated in legislation. The Code is relatively restrictive. In the New Zealand context, we may be able to make different choices about how we criminalise because we are not as tightly constrained by a criminal code.

190. The main driver for adopting the Australian cartel law would be harmonisation. The Memorandum of Understanding between the Governments of New Zealand and Australia on Coordination of Business Law acknowledges that the further coordination of significant areas of business law can facilitate deeper economic ties. The governments recognise that coordination is multifaceted and does not necessarily mean the adoption of identical laws, but rather finding a way to deal with any differences so they do not create barriers to trade and investment.

191. Ideally, Australian and New Zealand business law should converge on global best practice. It is doubtful that there is any exemplary international model at this stage that could be directly imported into New Zealand statute. There would be benefits in tailoring a regime for New Zealand.

192. There are significant harmonisation benefits in New Zealand criminalising cartel behaviour. Criminalisation would ensure that trans-Tasman cartels faced similar penalties in both jurisdictions, in accordance with the SEM Outcomes Framework. Criminalisation would also facilitate aspects of the enforcement process such as extradition, and ensure that Australian cartelists could not hide out in New Zealand. Whether there are significant benefits from adopting the same law is another question.

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[36] Description adapted from Caron Beaton-Wells *Australia's Criminalization of Cartels: Should it be Contagious* paper to the 4th ASCOLA Conference: More Common Ground for International Law? Washington 16-17 June 2009.

[37] See e.g. Fisse 2009, "The Contract Requirement for the Joint Venture Exceptions under ss 44ZZRO and 44ZZRP of the Trade Practices Act", 17 *Competition & Consumer Law Journal* 43.

193. The advantage of adopting the Australian approach is that it would reduce compliance costs for trans-Tasman businesses that have to comply with competition law in both jurisdictions. Vetting for compliance would only need to be done against one set of laws. The Commerce Act differs significantly from the Trade Practices Act in other areas of competition law, and to gain significant compliance cost reductions from harmonisation, we would need to harmonise more than just the cartel provisions. There would be greater development of the case law if we could rely on Australian judgments as well as domestic ones, given the generally greater volume of litigation in Australia.

194. The disadvantages of the Australian legislation have been widely aired. Some of the critiques of specific issues are considered further in relation to the greenfields option. Adopting the Australian legislation would mean that we cannot address any of those critiques in our own legislation. If we were to follow the Australian law we would also need to adopt subsequent amendments to the cartel provisions and these could happen frequently – the Trade Practices Act is amended more often than the Commerce Act.

195. In competition law, the strictest regulator tends to set the de facto rules for multinational companies. Trans-Tasman businesses will seek to comply with whichever regulator's rules are stricter. If the legislation is stricter on one side of the ditch, having more liberal legislation in the other jurisdiction may have little practical effect for Trans-Tasman businesses. However, the Commerce Act does apply to more than just trans-Tasman businesses. We need to consider the effects on domestic businesses as well.

4.3 Option 3 The greenfields approach

196. The greenfields approach would repeal sections 30-34 and replace them with a new civil and criminal regime. Each possible element of the regime is discussed below and presented as an option. A "Starter for 10" has also been developed. It is intended as an initial proposition, a starting point, that can be modified. All the elements making up the "Starter for 10" are open for debate and discussion. The purpose of the "Starter for 10" is to provide an overview of a regime that can be compared with the Australian law and a criminalised version of the current section 30.

4.3.1 The physical element of the offence

197. Despite a common law tradition, there is large variation in the way that the US, the UK, Australia and Canada have specified the physical elements of their cartel offences. At one end of the spectrum, the US uses 31 words (and substantial case law), the Canadians 66, the UK about 770 and the Australians 1600 words (see the appendix for the text of the different statutes). The US is a slight outlier because of the heavy reliance on case law and extensive administrative as well as judicial interpretation of section 1 of the Sherman Act over more than a century. Given the considerable variation in drafting styles, each law is reduced to its simplest conceptual components below. This simplification glosses over different uses of language and drafting styles.

198. The US offence is in the form of:

A conspiracy/to restrain trade or commerce.

The Canadian:

An agreement or conspiracy/with a competitor/to engage in cartel behaviour

The UK:

An agreement/with a competitor/to agree or implement agreements/which if operating as intended/are cartel behaviour.

The Australian:

An agreement/with a competitor/to engage in cartel behaviour; or

Implementing/an agreement/to engage in cartel behaviour.

199. The purpose of developing the greenfields approach is to decide on the essential elements of the cartel offence, rather than focus on statutory language.

4.3.1.1 Conspiracy or agreement

200. The origins of most modern competition legislation appear to be in early (late 19th century) Canadian statutes and the US Sherman Act. As these were criminal statutes they generally made it an offence to conspire to fix prices. In newer statutes (such as those of the UK, Australia and New Zealand) the concept of conspiracy is retained but the offence is generally formulated without using the word "conspiracy". This is illustrated by *Trade Practices Commission v Allied Mills Industries Pty Ltd*[88]. In that case certain anti-competitive arrangements or understandings were alleged, together with conspiracies to enter into such arrangements or understandings. Sheppard J held that it was not appropriate to allege an anti-competitive arrangement or understanding and a conspiracy to enter such an arrangement or understanding where the particulars provided showed that the underlying agreement alleged to constitute the conspiracy was the same as that alleged to constitute the arrangement or understanding. Put another way, it is not appropriate to charge conspiracies that are themselves proscribed arrangements or understandings.

201. In New Zealand criminal law, conspiracy has been codified in section 310 of the Crimes Act. This codification means that the case law has developed almost entirely around conspiracies to commit offences. Some of the case law has developed from conspiracies to import drugs into New Zealand. This case law covers "ring", "chain" and "wheel" conspiracies, where there is one global agreement, even if not every conspirator has been in contact with every other conspirator. The conspirators are treated as parties to a common design and therefore a party to the agreement or conspiracy. Conspiracy may be useful for dealing with cartel facilitators such as Peter Whittle in the US/UK marine hose cartel. Whittle was an independent consultant who was paid to run the cartel. He received information on upcoming tenders and would then decide who would get the job and how much they would bid for it.

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[38] *Trade Practices Commission v Allied Mills Industries Pty Ltd [No 5]* 32 ALR 570; 48 FLR 102 (FC).

202. The question that remains is whether the modern New Zealand doctrine of conspiracy is suited to application in competition law and if it should be used instead of or in addition to the existing Commerce Act formulation of agreements as "contracts, arrangements and understandings".

4.3.1.2 Contracts, arrangements and understandings

203. The discussion in this paper uses the term "agreements" generically. In New Zealand, as in Australia, the terms "contract", "arrangement" and "understanding" are used in the legislation. Each of these concepts requires that there be two or more parties. The Australian and New Zealand Courts have tended to treat the three concepts as distinct, although they have recognised that arrangements and understandings are closely related. The term "contract" has its normal common law meaning. "Arrangements" and "understandings" are terms that describe something less than a formal contract.

204. While an understanding involves even less formality than an arrangement, the case law indicates that the Courts are likely to insist that the essential elements of an arrangement must also be present in an understanding. 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. In the case of an understanding, however, the Courts are more likely to relax the standards for showing that the above requirements are met[39].

205. Regardless of the exact boundary of "understanding" (and Australian case law may have diverged from New Zealand's), the limits of an understanding, in the cartel context, will be set by the mental element requiring intent. At the boundaries of an understanding, such as where an expectation has arisen without explicit commitment, it will be very difficult to prove intent.

4.3.1.3 With a competitor

206. Most international cartel legislation tries to ensure that it is only applied to agreements between competitors (or people who, but for the agreement, would be competitors). This is intended to ensure that the offence covers horizontal conduct rather than vertical conduct (between entities in different parts of the supply chain). This is sensible because vertical arrangements can be pro-competitive and, without an exclusion, common business practices, such as franchise agreements, could be criminalised. In section 30 and the Australian cartel legislation, only two or more of the parties to the agreement need to be competitors or likely competitors. This type of provision may not go far enough in ensuring that only horizontal conduct is included in the scope of the offence[40].

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[39] Descriptions paraphrased from *Gault on Commercial Law* 27.07

[40] See Brent Fisse 2009 "Unjustified per se Criminal and Civil Liability under the Trade Practices Act 1974 (Cth) for Supply Agreements between Competitors", in UNSW *Law Journal* Vol 32(1).

207. A possible refinement would be to ensure that the alleged principal offenders are competitors at all levels of the supply, production or distribution chain to which the cartel provision relates. This means that the cartel provisions would not apply where the alleged principal offenders do not compete at the level of an input supply contract containing the alleged cartel provision, but only in a downstream market. This would be the case even if the likely effect of the input agreement is to control the price of goods or services in a downstream market where they do compete. This would exclude some network operations, such as credit card interchange fee agreements, from the scope of the cartel prohibitions[41].

208. Another way of further refining the horizontal dimension would be to exclude liability for cartel provisions where the relevant provision in an agreement between competitors does not have the purpose or likely effect of substantially lessening competition **between those competitors**.[42] This would require a limited form of competition analysis, but without the need for a full-blown market definition. However, the element of substantial lessening requires more economic evidence than the current requirement simply to identify if two parties are or would be in competition with each other.

209. In the US, restraints imposed by agreement between competitors have been denominated as horizontal restraints and those imposed by agreement between firms at different levels of distribution as vertical restraints. The characterisation of a restraint as horizontal or vertical depends solely on the parties' relationship, not on its purpose or effect.

210. Dual distribution (where a manufacturer directly distributes some of its product, but sells some through independent distributors) and franchising situations, where the franchisor operates some franchises, would not be exempted from the cartel offence by the requirement for horizontal competition.

211. The agreement need not be exclusively between competitors – there may be some third parties involved, such as trade associations. From a purist standpoint, these third parties should only be subject to accessory liability. This is not a major issue in the context of a cartel offence given the mental elements required for liability.

212. Instead of requiring horizontality in the parties to the agreement, it may be preferable to put the horizontal element into the conduct. So for example, instead of "an agreement, between competitors, to fix prices", we would have "an agreement, to fix prices between competitors". This option is dependent on how the other elements of the physical defence are defined and may have slightly different consequences.

4.3.1.4 To engage in cartel behaviour

213. "To engage in cartel behaviour" is used as shorthand for whichever categories of hard-core cartel behaviour are included in the criminal prohibition. The possible categories are price fixing, market allocation, output restriction and bid rigging. A discussion on their scope and inclusion or exclusion is outlined below.

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[41] Brent Fisse 2008, *Defining the Australian Cartel Offences: Disaster Recovery*, Competition Law Conference Sydney, 24 May 2008.

[42] Brent Fisse 2009, "Unjustified per se Criminal and Civil Liability under the Trade Practices Act 1974 (Cth) for Supply Agreements between Competitors" in UNSW *Law Journal* Vol 32(1).

4.3.1.5 Implementing a cartel agreement

214. The Canadian cartel offence does not appear to prohibit the implementation of a cartel agreement. The UK and Australian statutes do. The Canadians have a civil prohibition against implementing agreements. The Australian statute allows the prosecution of people who implement a cartel agreement that was formed before the criminalisation provisions came into effect. The Commerce Act 1986 has similar provisions in section 27 prohibiting the implementation of anti-competitive agreements formed before the commencement of the Act.

215. It is desirable to have a separate offence for implementing agreements because, for a long-lived cartel, the formation of the agreement may be outside the limitation periods for prosecution, whereas its continuous implementation is not. Implementation can cover situations where the parties to an agreement change over time or additional parties join at a later date.

216. Allowing prosecutions for implementing cartel agreements formed before the law is changed provides a stronger incentive for cartels to disband when criminal provisions come into effect. It also prevents a flurry of cartel agreements before the legislation comes into effect, safe in the knowledge that they are only subject to civil penalties.

217. To maintain consistency with the Commerce Act, the critical physical elements for the criminal offences in New Zealand are probably:

- forming 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.

Summary – "Starter for 10": Physical elements

- Forming an agreement (contract, arrangement or understanding) or conspiring/with a competitor/to engage in cartel behaviour; or
- Implementing an agreement/ with a competitor/to engage in cartel behaviour

Questions for submitters

9. What should the physical elements of the cartel offence be?
10. Should conspiracy be brought into the offence?
11. Should there be a competition element, and if so, how should it apply?
12. Should there be a separate offence of implementing a cartel agreement?

4.3.2 The mental element of the cartel offence

218. The principal distinction between civil prohibitions and criminal offences is that criminal offences generally require a mental element or state of mind, sometimes termed "mens rea". Requiring a mental element provides an opportunity to distinguish hard-core cartel conduct from less egregious violations of competition law. Outlined below are the different approaches that have been taken to defining the mental element of a cartel offence:

***UK*:**

"**Dishonestly agrees**" with one or more other persons to make or implement a cartel agreement

US:

An offence requires proof of: (1) the existence of a per se illegal conspiracy; (2) that the defendant **knowingly entered into the conspiracy**; and (3) that the conspiracy affected interstate or foreign trade and commerce

Australia:

The Australian offence requires **intent** to enter into the agreement or give effect to it; and **knowledge or belief** that the agreement contains a cartel provision.

219. There are essentially two approaches to defining the mental element for a cartel offence: the descriptive approach, which imposes some additional mental element or type of knowledge that is more specific to cartel offences; and the basic approach, which requires the basic criminal mens rea elements of "knowledge" or "intent" in relation to the physical elements of the offence.

4.3.2.1 Descriptive approach

220. The UK cartel legislation requires dishonesty. The early Australian legislative proposal included an "intention to dishonestly obtain a gain", which was intended as a touchstone of serious harm or serious culpability. Dishonesty is the mental element required for theft and its application to cartels probably developed from the analogy between cartel activity and theft. The meaning of "dishonesty" is slightly different between New Zealand, UK and Australian criminal laws.

221. Requiring dishonesty as an element of a cartel offence has been strongly criticised[43]. The UK and Australian definition of dishonesty requires "knowledge that the conduct was dishonest according to the standards of ordinary people". It is a subjective test, in that there is no objective measure of "the standards of ordinary people". It could allow cartelists to deny liability and be acquitted on the basis of mistake of law and subjective beliefs about the morality of their conduct. The "standards of ordinary people" limb of the element of dishonesty is an undefined and indefinable idea that introduces high levels of uncertainty.

[43] See for example Brent Fisse 2007,, "The Cartel Offence: Dishonesty?" 35 *ABLR* 235.

222. In the New Zealand legislation, "dishonestly", in relation to acts or omissions, means done or omitted without a belief that there was express or implied consent to, or authority for, the act or omission from a person entitled to give consent or authority. Attention is focused entirely on the state of mind of the defendant. Absence of consent or authority is probably not relevant to defining cartel offences.

223. Another approach would be to include a fraudulent element in the definition of the offence. Cartels can be considered similar in nature to the crime of obtaining by deception or causing loss by deception (section 240 of the Crimes Act)[44]. The secret nature of cartels means that consumers are deceived into believing that the price they are paying is set by the market, rather than a cartel. Section 240 of the Crimes Act defines deception as requiring either a false representation or an omission to disclose a material fact, with intent to deceive, where there is a duty to disclose it. While cartels are illegal, there is no specific duty on the participants to reveal their existence. Misrepresentation in its ordinary sense connotes the making of a positive assertion. On that basis, silence would not be seen as making a representation. However, a failure to correct a mistaken belief has been held to be in itself a false representation[45]. While there may conceptually be an element of fraud in a cartel, it may be a stretch to define the average cartel as fraudulent[46].

224. A descriptive approach could bring in a bright line that clearly separates hard-core cartel conduct from other anti-competitive behaviour. Brent Fisse has suggested, in the Australian context, the additional mental element of an intent by competitors to lessen competition between them. This doesn't require a market assessment under a substantial lessening of competition test, but may lead to some economic evidence being brought into play.

225. Conceptually, this is like reversing an ancillary restraints defence (discussed further in the section below on defences) to become part of the offence. The ancillary restraints defence has two limbs:

    (i) the restraint is ancillary to a broader, legitimate agreement; and

    (ii) it is directly related to, and necessary for giving effect to, the objective of that broader agreement.

226. In running an ancillary restraints defence, the defendant essentially argues: "we did not have a primary anti-competitive purpose, instead we had a broader legitimate purpose in entering the agreement; any anti-competitive elements of the agreement are necessary for giving effect to the broader legitimate agreement".

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[44] See the discussion on the moral nature of cartel conduct in the pros and cons section.

[45] Adams CA240.13.

[46] *Norris v Judgments – Government of the United States of America and others* [2008] UKHL 16.

227. Proving "intent by competitors to reduce competition between each other" could be difficult. It could possibly be inferred from an agreement to fix prices/allocate markets/reduce outputs, as long as the alleged cartel conduct was the dominant purpose of the agreement, but this is a rather circular definition that does not necessarily add much. Proving intent to reduce competition between competitors will bring some economic evidence into play, although not as much as if one were required to prove a substantial lessening of competition in a market. You would need to prove that the parties are in competition with each other, and that they intended to reduce that competition.

228. Proving "intent to reduce competition between the parties" could also partially undermine the per se nature of the prohibition. While the concern becomes competition between the parties, which is easier to prove than competition in a market, per se illegal agreements are presumed to be anti-competitive without regard to their actual effects. The US courts have equated intent to participate in such an agreement with intent to restrain trade unreasonably. To require intent to go further and envision actual anti-competitive results (even just between competitors) could reopen the questions of reasonableness that the per se rule is designed to avoid.

229. The descriptive approach is superficially appealing for defining the offence and avoiding over-reach. The decision on the use of the descriptive approach is dependent on the defences and the way in which the defences and the civil per se offence are defined. These issues are discussed further below.

4.3.2.2 Basic approach

230. In this approach, we adopt the standard approach to defining the mental element of a criminal offence: identify the physical elements then assign the appropriate standard mental elements to them. For a cartel offence there are a few physical elements of the offences that require mental elements:

- forming an agreement to engage in cartel behaviour; and
- implementing an agreement to engage in cartel behaviour.

231. There are the conduct elements of "forming an agreement" and "implementing an agreement" and the circumstance element of "an agreement to engage in cartel behaviour".

232. Intention is generally required for inchoate liability[47]. This means that the mental element for "forming an agreement" should be intention, given the conspiracy-like nature of this offence (see the discussion above on the physical element). Given the deliberate nature of cartel conduct, intention should also be the appropriate mental element in relation to the implementation of the agreement.

[47] CA21.15 Adams on Criminal Law.

233. 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 probably the appropriate mental element for the circumstances of both offences. This knowledge about the agreement is knowledge of the matrix of facts that can be drawn on to establish that the agreement is one to engage in cartel behaviour. It is not knowledge that the matrix of facts can be legally characterised as cartel behaviour.

Summary – "Starter for 10": Basic approach

- **Intent** to form an agreement **knowing** that the agreement is one to engage in cartel behaviour; and
- **Intent** to implement an agreement **knowing** that the agreement is one to engage in cartel behaviour.

Question for submitters

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

4.3.3 Categories of the cartel offence

234. 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.

235. There are at least two possible approaches:

(i) define the offence by reference to its effect on price; and

(ii) define the offence by reference to the specific behaviours.

236. The first approach is outlined more fully in the section above on criminalising the existing civil prohibitions. This may require a separate prohibition on market allocation schemes, depending on opinions on whether or not they have the effect of controlling price. If the prohibition is defined entirely by effect on price, it has the advantage of excluding some arrangements that may appear to be output restrictions or market allocation schemes, such as an after hours' doctors' roster, which do not have an effect on price. The mental elements of a criminal offence may have some impact on the meanings of purpose and effect in this context, which could scupper the effectiveness of this approach. A subjective view of effects may exclude agreements that have an objective effect on price, if the person in question does not understand the relationship between price and quantity.

237. The second approach specifically targets the actions, rather than the effect on price. Price fixing would be defined as direct price fixing rather than by reference to effects on prices.

238. Output restriction schemes have an effect on price but there may be some difficulties in proving that they directly fix prices. This means that output restrictions would require a separate prohibition. This should include not only reductions in output but also agreements to maintain or not increase the supply of a product. The prohibition should also cover agreements that prevent output.

239. Market allocation schemes would need to have a separate prohibition as they do not directly fix price.

240. Bid rigging generally involves direct price fixing and/or market allocation. There may, however, be sophisticated ways of bid rigging without either direct price fixing or market allocation. Imagine a scheme where an agreement is struck between competing bidders that everyone bids competitively but whoever wins the bid will compensate the losers by a set amount. This situation arose in *ACCC v CC (NSW) Pty Ltd (No8)*[48]. The Court held that a special fee payable by the successful tenderer to unsuccessful tenderers in relation to construction tenders was likely to have the effect of controlling the price, in that the successful tenderer was likely to pay the fees out of the proceeds of the job and to take them into account in calculating its tender price.

241. A bid rigging prohibition also needs to take into account potentially pro-competitive behaviour. For example, vendors with complementary assets can either form consortia to bid or offer each other mutual discounts for the purposes of separate tenders. These sorts of arrangement may be covered by a joint venture exemption. If the purchaser is made aware of any arrangements between bidders, there is no bid rigging.

242. There is little experience to date in New Zealand or Australia of direct prohibitions on output restrictions or market allocation. The Australians have taken a hybrid approach in defining their criminal offence. Price fixing continues to be defined by the purpose, effect or likely effect of fixing, controlling or maintaining prices. This fixing, controlling or maintaining of price can be direct or indirect. Provisions, which have the purpose of directly or indirectly restricting output, rigging bids or allocating markets, are also prohibited.

Question for submitters

14. Which of the OECD categories of hard-core cartel (price fixing, market allocation, output restriction and bid rigging) should be explicitly covered by a cartel offence? Should they be included directly or only indirectly by reference to effects on price? *("Starter for 10": All four categories. No reference to effects on price (even for price fixing).)*

[48] [1999] FCA 954.

4.3.4 Exemptions, exceptions and defences

243. To avoid over-reach, the actual prohibition can be framed very narrowly or exceptions and defences can be used to define the scope of the offence. Exceptions and defences are critical if we take a basic approach to the mental elements of the offence. The UK statute has no exceptions or defences to the criminal cartel offence, as the requirement of dishonesty is intended to preclude any legitimate activity being caught. This approach risks under-reach rather than over-reach. As with the definition of the elements of the offence, exceptions and defences are subject to different types of error; they can be too narrow, too broad or too impractical.

4.3.4.1 Existing exceptions

244. The Commerce Act contains a number of exceptions to Part 2 (sections 43-46). These are:

(i) practices authorised by statute (s43);

(ii) practices between partners (s44(1)(a));

(iii) restraints of trade in service agreements (s44(1)(c));

(iv) provisions for the protection of goodwill in the sale of a business (s44(1)(d));

(v) actions in compliance with Standards (s44(1)(e));

(vi) terms and conditions of employment (s44(1)(f));

(vii) export cartels (s44(1)(g));

(viii) actions in concert by users of goods or services against the suppliers (s44(1)(h));

(ix) agreements between interconnected bodies corporate (s44(1A));

(x) carriage of goods by sea to or from New Zealand (s44(2));

(xi) transactions relating to intellectual property rights (s45); and

(xii) the acquisition or disposition of business assets or shares (s46).

245. The exceptions have not been reviewed for some time and they perhaps should not all be uncritically applied to the cartel offence (or continue to apply to Part 2). For example, shipping exemptions have been reviewed in other jurisdictions and the international trend is to move away from such exemptions. The OECD found a lack of convincing evidence that the practice of price fixing and freight rate discussions offered net benefits to shippers[49]. The report recommended that OECD governments review these types of exemption.

246. The global trend towards stronger prohibitions on cartels and the imposition of greater penalties may make protections for export cartels redundant. It does not matter whether they are legal or not in New Zealand, if they are illegal in the export market.

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[49] OECD 2002, *Competition Policy in Liner Shipping*, www.oecd.org/dataoecd/13/46/2553902.pdf.

247. We have not had the opportunity to consider in depth any of the section 44 or 45 exceptions, or exemptions from the Commerce Act in other legislation. We are, however, seeking views on whether there are any exceptions or exemptions that should be repealed or at least not applied to the cartel offence.

Question for submitters

15. Are there any existing exceptions to Part 2 that should not be applied to the cartel offence (or more broadly)? Are there any exemptions from the Commerce Act in other legislation that should not be applied to the cartel offence? *("Starter for 10": Include all existing exceptions to Part 2.)*

4.3.4.2 Authorisations

248. Part 5 of the Commerce Act enables the Commerce Commission to grant authorisations for restrictive trade practices, if a practice will result in a benefit to the public that would outweigh the lessening in competition that would result from the practice.

249. Authorisations are no solution for problems of over-reach. Over-reach chills practices that are not anti-competitive. Authorisation is a mechanism for allowing anti-competitive practices that have overriding public benefits. Authorisation is an avenue for addressing unforeseen situations that require anti-competitive practices in order to achieve public benefits, without the need for specific legislative exemptions. Authorisations allow a case-by-case assessment of the transaction to determine its competitive impacts. It can be difficult to define class or block exemptions in legislation exhaustively. In practice, applications for authorisation are few and the probability of a successful application is low[50].

250. The authorisation process has a "lessening competition" jurisdictional threshold. Practices that do not lessen competition cannot currently be authorised, even if they fall within the scope of a per se prohibition.

251. In the criminal law, an offence should be defined as narrowly as possible, to avoid the need for exceptions and defences. Specific defences should be provided to cover activity that could have been authorised but for which no authorisation was sought. If this does not occur, conduct will be punished on the basis of a failure to seek authorisation, rather than the intrinsic nature of the conduct.

1.5.3.1 Ex ante certainty

252. When a law is changed, there follows a period of uncertainty as to how it will be applied by an enforcement agency and how it will be interpreted by the Courts. This uncertainty generally reduces over time. In areas that are infrequently litigated, the uncertainty can linger for a considerable period. This uncertainty can have a chilling effect on commercial activity, particularly if the stakes are high. With criminal sanctions it is important to maximise the predictability of the application of the law.

[50] Of the 60 applications since 1986, around 10 have been approved or partially approved – the other applications were either outside the Commission's jurisdiction, refused or withdrawn.

253. There are different ways to promote predictability in cartel criminalisation. The US has the advantage of a considerable body of ever-expanding case law. The underlying cartel provisions in statute have remained unchanged for more than a 100 years. The US Department of Justice has built up a track record of predictability in its application of the law. Other jurisdictions do not have these same advantages.

254. One common way of promoting predictability is through the issuance of guidelines. Guidelines can vary in the level of detail and specific guidance that they offer[51].

255. Predictability can also be promoted through the publishing of legal opinions or enforcement decisions. The Canadian Competition Bureau provides legally binding written opinions to businesses on whether proposed business plans and practices would raise concerns under the competition legislation. Opinions are published – either in full or in a form that protects the disclosure of confidential information. In the year before the new cartel offence comes into effect, the fee for opinions on the new cartels offence is waived.

256. Two mechanisms for promoting greater ex-ante predictability are developed below. These are public notification and clearances; both are mechanisms for advanced disclosure or clearance.

Public notification

257. One of the hallmarks of a classic cartel is secrecy. Criminalisation is intended to deter cartel formation through greater penalties and lead to improved detection through altering the incentives to apply for leniency. Secrecy may be an indicator of whether or not an agreement deserves criminal prosecution.

258. Consider a legislative scheme where public notification exempts the parties to the agreement from criminal prosecution. The specific provisions of an agreement would have to be notified, and notification would have to occur as soon as the possible cartel agreement was formed. The parties could still be subject to civil penalties.

259. Who would publicly notify their schemes? The hard-core cartelist is gambling on avoiding detection and is unlikely to notify because, if they do, they are unlikely to be able to implement their agreement. They are also better off to seek leniency as this can protect them from civil penalties as well. Those who think they may be caught within the scope of a criminal prohibition but who do not regard their behaviour as a cartel are likely to use public notification. Joint venturers, network businesses and the like could use notification to ensure that they are not criminally prosecuted. A notification system of this type may go some way towards reducing over-reach.

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[51] See the Canadian Competitor Collaboration guidelines, which run to 61 pages and provide detailed information on how the Competition Bureau will approach different scenarios. www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02987.html. The ACCC has produced a 12-page set of guidelines on its approach to cartel investigations. www.accc.gov.au/content/item.phtml?itemId=882220&nodeId=cd1644c035c1d07db8c9ce05b09e21fd&fn=Guideline%20-%20ACCC%20approach%20to%20cartel%20investigations.pdf.

260. A notification scheme would need to be administratively simple while revealing enough information for a reasonable assessment to be made if there is possible cartel activity. It could create a flood of notifications, with disputes about adequacy of notification and concerns about the three year limitation on filing of civil proceedings. The notification scheme would also need to be designed so as not to interfere with the operation of the leniency programme. Cartels may be able to hide in plain view if there is a sufficient volume of notifications. It does also potentially excuse criminal conduct for the brazen – a notification scheme could be considered unprincipled for this reason.

261. While notification would not impose any obligation on the Commerce Commission to investigate, considerable resources may still be diverted into investigating notified agreements.

Clearances

262. Clearances are not available for anti-competitive practices, but are used for mergers and acquisitions. Clearances can be costly and administratively burdensome but are justified because acquisitions and mergers are not easily reversed. A solely ex post regime would create considerable uncertainty and impose exceedingly high costs if transactions had to be unwound.

263. Clearance processes have been considered for restrictive trade practices 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 Commerce Commission could be viewed as an inefficient use of public resources. There are implications for the effectiveness of the Commerce Commission in devoting time to assessing clearance applications. Clearances in the trade practices area would need to be time bound as changing market conditions affect assessments of the competition effects of a proposal.

264. The sharp distinction between restrictive trade practices and business acquisitions ignores the spectrum of commercial practices such as joint ventures. These can have many of the characteristics of a merger, including costly reversibility, without being classified as acquisitions.

265. A clearance regime for long-term contracts could provide greater certainty for business and ensure that anti-competitive effects were minimised. The benefit of clearance over authorisation is that it would not have a "lessening competition" threshold, so agreements that did not lessen competition but potentially fell within the scope of the cartel offence could be cleared. Limiting clearance to long-term contracts would minimise the volume of applications to the Commerce Commission.

Questions for submitters

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

17. Should there be a notification scheme, which provides for immunity from criminal prosecution? *("Starter for 10": Yes.)*

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

19.	Should there be a clearance regime for other potentially restrictive trade practices? *("Starter for 10": Clearance regime for long-term contracts.)*

4.3.4.4 Exceptions and defences

266. The terms "exception" and "defence" are used interchangeably in this section. In reality, it is unlikely that a prosecutor will seek to take a prosecution under a cartel provision if the agreement falls squarely within the scope of an exception or defence. They will only undertake prosecutions in cases where they believe the defendants are relying on a defence as a cover for a cartel or if they do not believe they clearly fall within an exception. The distinction between a defence and an exception is important in determining how and when the issue is brought into play in proceedings. At this stage, we are considering the nature and scope of exceptions and defences. The choice between exception and defence will be considered at a later stage.

267. There are two possible ways of structuring the defence or exception. One is to introduce principle-based defences that would cover most situations; the other is to have specific defences that list the types of acceptable conduct.

4.3.4.5 Principle-based defences

Competition defence

268. A competition defence could be raised if an agreement does not substantially lessen competition. By definition, a competition test will not create any over-reach problems. It does, however, introduce type 3 problems because a competition test can create uncertainty for businesses in determining whether or not an agreement substantially lessens competition.

269. A competition defence also brings competition analysis back into the definition of an offence. If raised by the defence, the persuasive burden of proof would still be on the prosecution to prove that it does substantially lessen competition. This would create strong incentives for the defendant to always raise it, regardless of the merits of their case, because of the difficulties of proving a lessening of competition to a criminal standard of proof. Even in the civil context, a competition defence to a per se offence is problematic because it undermines the usefulness of per se condemnation.

270. A joint venture may substantially lessen competition, not because of any cartel-like activity (such as setting the price of the jointly produced output), but because of the intrinsic nature of the particular joint venture (such as reducing the number of competitors in a market). If this defence were introduced, the joint venture could be subject to criminal sanctions, even though other joint ventures with similar effects would only be subject to civil penalties. For these reasons a competition test is undesirable as a defence to a cartel charge.

Defence of ancillary restraint

271. 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. Most cases in which joint ventures are challenged under section 1 of the Sherman Act involve challenges to these collateral restraints, rather than the joint venture itself. When evaluating collateral restraints, Courts distinguish between naked restraints – those lacking any redeeming virtue – and ancillary restraints – those that are an important part of some arrangement that has potentially redeeming virtues. The former are condemned per se whereas the latter are subject to the rule of reason.

272. Characterisation has become a critical issue in the US, particularly since the Supreme Court has held that practices involving the "core" activities of a legitimate joint venture may not be attacked under the ancillary restraints doctrine[52].

273. The Canadians have included the ancillary restraint defence in their cartel legislation (see the appendix for exact wording). It is a defence if an agreement would otherwise contravene the prohibition on cartels if:

(i) it is ancillary to a broader or separate agreement that includes the same parties and does not itself constitute a cartel; and

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

274. US trials have the flexibility to consider both per se and rule of reason approaches within the same proceeding. The first limb of the ancillary restraints defence poses the question of whether the broader agreement is legitimate or not. In the US courts, this can involve a "quick look" competition test to determine if the broader agreement is not a cartel, but nevertheless substantially lessens competition. If this is so, the case then proceeds on a rule of reason approach. As the Canadians have separate civil and criminal prohibitions (as we must), judges cannot decide at trial through a "quick look" competition test which mode of analysis is most appropriate. For this reason, the first limb of the defence is narrowed to just a question about whether the broader agreement is itself a cartel. This means that joint venture agreements that substantially lessen competition because of the nature of their structures or activities (not cartel activities) escape criminal condemnation, as they should, but separate legal proceedings are required to establish a substantial lessening of competition. This does create some tricky issues for those making prosecution decisions.

275. The ancillary restraints defence is not limited to joint venture situations – it covers any type of agreement. It could protect franchises and network businesses. The exact scope of the ancillary restraints test depends on where the line is drawn between the "core" of the activity and the "ancillary parts" – see the discussion above in the section on joint ventures. It does not protect the restraint from a competition test, merely per se condemnation. It will not chill legitimate pro-competitive activity and allows firms to undertake relatively simple assessments to see if they come within its scope.

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[52] ABA section of Antitrust Law, *Antitrust Law Developments* (6th ed. 2007) pp 460-470.

276. The ancillary restraints doctrine cannot be used to address cartel-like agreements formed for environmental or health and safety reasons.

277. Over the years, a number of arguments have been advanced, mainly in the US courts, to attempt to defend cartel behaviour. These include that the cartel:

- price is reasonable, fair or similar to that set by a competitive market (it is impossible for the judiciary to determine if a price is reasonable or not);
- is necessary to prevent ruinous or cutthroat competition (competition is meant to reallocate resources away from inefficient producers);
- enables an orderly retirement of excess production capacity (cartels tend to slow down rather than enhance necessary change);
- monopoly profits fund socially desirable innovation or R&D (but are a very inefficient way of funding these things; R&D tends to produce its own monopoly rewards through intellectual property protection);
- enables the maintenance of large inventories to prevent shortages (well functioning markets are better able to match supply and demand than cartels); and
- creates higher-quality products and prevents dangerous ones reaching the public (regulation can achieve these outcomes more efficiently)53.

278. It is possible that some of these types of argument could be advanced under an ancillary restraints defence. It is unlikely, however, that they would succeed as they are covers for a cartel and excuses for reductions in competition.

Legitimate primary intention

279. Drawing on the ancillary restraints doctrine, Caron Beaton-Wells and Brent Fisse have suggested the possibility of a defence of legitimate primary intention:

> "It is a defence if the person establishes that the cartel provision is intended primarily:
>
> (a) to increase the output of goods or services, to reduce their cost, to improve their quality or to achieve the use of environmentally sustainable resources;
>
> (b) to prevent a serious risk to a person's life or the health or safety of the public or a section of the public or to remedy serious physical harm occasioned to a person or serious damage to property; or
>
> (c) to prevent a serious risk to the environment or to remedy serious harm occasioned to the environment"[54].

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[53] Paul Scott 1999, "Price Fixing and the Doctrine of Ancillary Restraints", *Canterbury Law Review*, Vol 7.

[54] Caron Beaton-Wells and Brent Fisse 2008, *The Australian Criminal Cartel Regime: A Regime for New Zealand?*, paper for CLPINZ, August.

280. This defence may require some modification. Increasing the output of goods or services is not unambiguously good. In two-sided platforms/markets it can lead to greater market dominance owing to network effects. Increases in the variety of goods or services available in a market are a good thing, and should be included as this would cover the situation where a joint venture begins producing a good that would not otherwise be available.

281. A defence of legitimate primary intention would offer the advantage of explicitly spelling out the legitimate broader purpose, and foreclosing possible reliance on the excuses outlined above. It would also cover all the situations discussed in the first section that should not be criminalised. The defence lacks the second limb of the ancillary restraints test requiring the restraint to be no broader than reasonably necessary to achieve the legitimate goal. The second limb of the ancillary restraints defence could be incorporated as an additional safeguard to ensure that the restraint is no broader than necessary.

Efficiency defence

282. The standard operations of franchises, networks and joint ventures should escape criminal condemnation because of their potential efficiencies. A possible way of removing legitimate franchise agreements, joint ventures and networks from the scope of the cartel offence is to introduce an efficiency defence. The franchise, network or joint venture would have to show that its operation leads to non-trivial efficiency gains. This could be problematic if a genuine efficiency-improving joint venture had ancillary restraints that formed a cartel between its parent companies. The efficiency defence would also need a requirement that the restraints be no broader than necessary to achieve the efficiencies.

283. An efficiency defence is probably necessary if the offence is defined in terms of its effect on price. An efficiency defence would be quite complex and involve economic evidence and expertise of a type that, in a civil context, would require the presence of a lay member to assist the judiciary.

4.3.4.6 Specific exceptions or defences

Joint ventures

284. A specific joint venture exception defence requires a definition of a joint venture.

285. In the US, the threshold for assessing the legality of a joint venture is whether it involves sufficient integration of the economic resources of the parties to escape per se condemnation as an illegal cartel. The crucial factor in determining this is the actual substance of the joint venture. The Supreme Court has held that simply characterising an agreement among competitors as a joint venture will not save it from per se liability where the only purpose and effect of the agreement is to suppress competition. The lower courts and enforcement agencies have found so-called joint venture arrangements to be per se unlawful where there was no meaningful integration and the arrangements served merely as devices to fix prices or allocate customers. Where joint ventures involve the integration of the parties'

productive assets so that they potentially increase efficiency and enable them to compete more effectively, the arrangement is analysed under the rule of reason[55].

286. The existing New Zealand provisions for joint ventures (section 31) are covered in the discussion of Option 1 above.

287. The Australian criminal cartel provisions provide an exception for joint ventures where the agreement is for the purposes of a joint venture, the joint venture is for the production or supply of goods or services, and the alleged cartel provision is contained in a contract. This is a tighter definition of a joint venture than that in section 31. The requirement for a contract is also stricter than in section 31.

288. There were a number of arguments and critiques of the Australian joint venture provisions – some submitters to the Australian Senate on the Bill argued that the definition was too narrow (it exempted too few activities from criminal sanction) and others argued that it was too broad (it exempted too much). On the broadness front, Brent Fisse[56] argued that the joint venture defence allows for "ultra-light" joint ventures to be formed, which are a cloak for cartel activity because the joint venture exception is available where there is some minor integration of business functions, but the dominant purpose of the parties is to evade the application of the per se prohibitions against cartel conduct. On the narrowness front, submitters argued that the requirement of a contract potentially excludes arrangements or understandings that are preliminary to the formation of the contract. The production or supply condition excludes joint ventures for the acquisition of goods or services.

289. Obviously there is a balance to be struck in designing a joint venture defence. It would need to capture cartels that are dressed up as joint ventures while ensuring that legitimate business activity is not discouraged or penalised.

290. A first-principles joint venture exemption would define a joint venture in economic terms, requiring a significant economic integration of activities. It might also require proof of actual or potential efficiency gains. A joint venture exemption should also include a requirement that the cartel provision in question be reasonably necessary to achieve the commercial objectives of the joint venture.

Franchises and networks

291. Networks and franchises are relatively simple concepts but could be quite difficult to define clearly in legislation. One definitional difficulty is that it would be easier to structure sham franchises and networks than sham joint ventures. The integration of functions lies at the heart of the concept of a joint venture, whereas this is not the case with networks and franchises. Networks and franchises are better covered by a principle-based exception.

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[55] ABA section of Antitrust Law, *Antitrust Law Developments* (6th ed. 2007) pp 435-437.

[56] See submission by Brent Fisse to Senate Economics Committee Inquiry into the Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008, 20 January 2009, www.aph.gov.au/senate/Committee/economics_ctte/tpa_cartels_09/submissions/sub05.pdf.

Joint buying

292. Section 33 exempts joint buying arrangements from per se liability. To avoid over-reach of the cartel offence, this exemption should probably be extended to the cartel offence, as joint buying can have beneficial effects if the savings achieved through joint buying are passed on to consumers. "Buyer cartels" are best examined under section 27 as the effects of a "buyer cartel" can be pro-competitive.

Agreements of more than 50 people

293. Section 32 of the Commerce Act currently exempts agreements of more than 50 people from section 30. The issues around this exemption are explored more fully in the section above on criminalising section 30. There is no good reason for this exemption to exist.

4.3.4.7 Burden of proof

294. Defences and exceptions will need to place an evidential burden of proof on the accused as they will be best placed to produce evidence of the defence. There is unlikely to be any strong reason to reverse the persuasive burden of proof, particularly given the presumption of innocence in the NZBORA.

4.3.5 Relationship with civil penalties

295. There is a discussion of the relationship between civil and criminal penalties in the section on creating a criminal offence from section 30.

296. In the greenfields approach, section 30 would need to be repealed. If it were left as is, the scope of conduct covered by the per se civil prohibition would be narrower than the conduct covered by the criminal prohibition; amongst other reasons, because of the narrowness of the joint venture exemption in section 31. The criminal prohibition should be the same as, or narrower than, the civil prohibition.

297. There is still a need for some form of civil per se prohibition. This would cover situations where evidence cannot be gathered to a criminal standard, enable private enforcement and enable prosecutorial discretion to be exercised for cartel cases with small effects.

298. The wordings of the physical elements of the civil and the criminal prohibitions could largely mirror each other. There may be some divergence in the interpretation through the operation of the NZBORA. It is possible to broaden the scope of the civil prohibition with a broader effect-type test, which would be inappropriate for a criminal prohibition.

299. The defences and exceptions could be the same. There is a possibility of introducing competition defences into a civil prohibition, but this would largely undermine the effectiveness of a per se prohibition. The defences and exceptions for the civil prohibition may be narrower in scope (i.e. excusing less conduct), providing greater incentive for parties to seek authorisation.

"Starter for 10": defences and exemptions

- A hybridised defence of legitimate primary intention will apply to the cartel offence.
- A specific joint venture defence would apply, based on an economic definition of a joint venture.
- There should be no exemption based on the number of parties to the agreement. There should be an exemption for joint buying arrangements.
- The accused relying on any defence would have an evidentiary but not persuasive burden of proof.

Questions for submitters

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

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

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

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

24. Should the defences and exceptions for the new civil prohibition be the same as those for the criminal offence? *(Note: "Starter for 10": New civil prohibition mirrors physical elements of new criminal offence with same defences and exceptions.)*

25. Which of the three approaches (adaptation of section 30/adopting Australian legislation/greenfields approach) outlined above should be adopted?

Chapter 5: Corporations/Individuals

300. Hard-core cartels are already prohibited civilly and those found liable (individuals and corporations) are subject to pecuniary penalties. One of the main drivers behind criminalisation is the increased deterrent impact of a jail sentence in comparison with that of a monetary penalty. Obviously, corporations cannot be imprisoned. New Zealand already has corporate criminal liability in many other areas of the law. As a general rule, corporations can commit any offence (with limited exceptions such as bigamy).

301. Price fixing and other forms of serious cartel conduct are rarely the product of insular individual choice, but are typically related to organisational pressures and failures of organisational control. The corporation is generally also the main beneficiary of a cartel.

302. There may well be an increased stigma and stronger adverse publicity for a company in being convicted of a cartel offence, rather than having a civil judgment against it. Additionally, there may be practical advantages in being able to bring simultaneous criminal proceedings against a body corporate and an individual instead of having to bring separate civil proceedings against a corporation.

303. There can be other disincentives for corporations if conviction means that they are excluded from public procurement processes or if investment funds use criminal convictions as a proxy measure for mismanagement.

304. There would be reduced incentives to prosecute a body corporate, to a higher standard of proof, if the civil pecuniary penalties and criminal fines were set at the same level.

305. If corporations were not criminally liable, there might be an incentive for them to try to distance themselves from guilty individuals, in the hope of scapegoating those individuals and avoiding or minimising adverse corporate publicity.

306. Section 90 of the Commerce Act already attributes the actions and states of mind of directors, servants and agents to the body corporate. It is an open question whether the effect of this section is to impose vicarious liability on the corporation or if it is only the attribution of actions (which then carry liability)[57]. In either case, this is a type of strict liability because there would be no defence for the corporation if it took reasonable steps to prevent anti-competitive behaviour. Presumably though, this would be a mitigating factor in sentencing.

Question for submitters
26. Should corporations be criminally liable for cartel offences? *("Starter for 10": Yes.)*

[57] *Giltrap City Ltd v CC* [2004] 1 NZLR 608; (2003) 10 TCLR 831; 7 NZBLC 104,009 (CA).

Chapter 6: Impacts of criminalisation on investigation, prosecution and sentencing of cartel cases

307. The purpose of this section is to describe the key differences between the criminal and the civil laws that would have an impact on cartel cases. Unless a specific legislative exception is made, standard criminal law will apply to the cartel offence. This section includes a discussion of some key policy issues, where there may be a case for a variation from the generic criminal provisions.

6.1 Accessory liability or parties to the offence

308. On its face, the accessory liability provisions in the Commerce Act are very similar or identical to the party provisions contained in the Crimes Act. In particular, the language of section 80 of the Commerce Act provides for accessory liability by aiding, abetting, counselling or procuring a contravention of the Act. These are classic descriptors of criminal law party liability.

309. However, section 80(e) appears to go further than criminal party liability by imposing liability on those who have been "in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by any other person of a provision of the Act". This appears to cover conduct involving less active participation than actually aiding, abetting or counselling the contravention of the act.

310. The Crimes Act provisions imposing secondary liability are well understood and well settled. To attract liability under the more commonly used party provisions, there must be proof of help or encouragement in fact and an intention to help or encourage. The intention element comprises two distinct mental elements:

- knowledge of the essential matters that constitute the offence committed by the principal party; and
- an intention or purpose to help or encourage the principal party to do the acts that constitute the offence.

311. Whilst the accessory provisions in the Commerce Act and the parties provisions in the Crimes Act use similar language, there is more flexibility in the interpretation of "accessory" under the Commerce Act. There will be variations in the degree of intent an accessory needs to have, depending upon the nature of the contravention alleged.

312. It is appropriate that the parties to a criminal offence are a more narrowly defined group than those who face civil liability. There is no need for any provisions specific to the cartel offence in this area.

6.1.1 Attempt

313. The Crimes Act has separate provisions for attempt. It is a crime, under section 311, to attempt to commit any offence.

6.2 Investigations

6.2.1 Self-incrimination

314. The Commerce Commission's current investigatory powers allow the Commission to interview people compulsorily (section 98c), require the furnishing of information or production of documents (sections 98a, b) and search under a warrant (section 98A). No one may refuse to appear before, or provide any information or documents to, the Commission on the basis that it may incriminate them. However, statements made to the Commission in answer to its questions shall not be used against the person who made them in criminal proceedings or proceedings for pecuniary penalties, except in the case of perjury and offences under section 103.

315. In the criminal context, the Serious Fraud Office and Securities Commission have similar powers to the Commerce Commission to interview compulsorily and require the furnishing of information or documents. Self-incrimination is also no excuse for not answering questions. In the fraud context, self-incriminatory statements can only be used in evidence against that person in a prosecution where the person gives evidence inconsistent with the statement. In the securities legislation, self-incriminatory statements can be used in any proceeding in respect of the falsity of the person's testimony.

316. Section 23(4) of the NZBORA 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). Any modification to this right would need to be considered for compliance with the NZBORA. This entails an assessment of whether the restriction can be justified in a free and democratic society.

317. Where there is no specific enactment relating to self-incrimination, the "default" provisions of the Evidence Act 2006 apply. The privilege against self-incrimination, as contained within sections 60 and 63 of the Evidence Act, only applies to oral testimony. This was confirmed by the Supreme Court in *Cropp v Judicial Committees*[58]. The Evidence Act states that the privilege against self-incrimination does not apply to bodies corporate. The privilege does not apply to documents already in existence. Nor can it be raised by a defendant in a criminal proceeding when giving evidence about the matter for which the defendant is being tried. The privilege only applies to protect the forced disclosure of incriminating information. It does not affect the admissibility of information once disclosed.

318 There may be a need for an amendment to the Commerce Act, so that self-incriminating statements can be used in evidence against that person in a criminal prosecution, if they give other evidence inconsistent with their statement or if the defence proffers evidence, possibly through other witnesses, or cross-examines prosecution witnesses on a basis that is inconsistent with the person's original statement. It may also be desirable to clarify the Commerce Act to ensure that the extent of the privilege against self-incrimination is consistent with the Evidence Act.

[58] [2008] 3 NZLR 774 at paragraph 471.

Questions for submitters

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

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

6.2.2 Search powers

319. If passed, the Search and Surveillance Bill will enable the Commerce Commission to seek the assistance of the Commissioner of Police in the use of Police investigatory powers. This may include production and examination orders (although provision is made for those orders in the Commerce Act), and even surveillance device warrants. Surveillance device warrants involve the interception of private conversations and, under the new Bill, it is possible to obtain a surveillance device warrant in all criminal cases where a search warrant could be obtained. To obtain the assistance of the Police, the Commerce Commission would have to provide all relevant materials to the Police, so that the Police can form the requisite belief/suspicion to apply for the relevant order.

6.2.3 Use of evidence in civil and/or criminal proceedings

320. At the early stages of an investigation, it may not be apparent whether or not the alleged behaviour should be prosecuted on a criminal or civil track. This makes a difference because the mode of collection can affect the admissibility of evidence. As discussed above, the use of compulsory powers to obtain statements in civil proceedings is commonplace. However, many of those very same provisions render that evidence inadmissible in criminal proceedings. Equally, not all evidence gathered through the use of criminal procedures can be used in civil proceedings. For instance, information gathered through the use of surveillance or interception warrants may only be used in the prosecution of serious crime. The critical issue in determining admissibility is the extent and purpose of the power that has been used to gather the evidence.

321. Civil information gathering powers will usually have specific exceptions, and if they do not, the NZBORA will potentially modify their effects. Fair trial rights, rights to silence or privileges against self-incrimination may be invoked.

6.2.4 Obstruction

322. 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 for contravention is $10,000 for individuals and $30,000 for bodies corporate. Other obstruction offence provisions in legislation are set out in the table below:

Legislation	**Offence**	**Maximum Penalty**
Reserve Bank Act 1989	Destroying, altering or concealing records	Individual: 18 months' imprisonment or a fine of $200,000 Body corporate: a fine of $2,000,000
Takeovers Act 1993	Misleading the Panel	A fine of $300,000 If continuing, a further fine of $10,000 for every day during which the offence is committed.
Search and Surveillance Bill	Failing to comply with examination or production order	Individual: one year's imprisonment Body corporate: a fine of $40,000
Securities Act 1978	Similar to Commerce Act	A fine of $300,000 If continuing, a further fine of $10,000 for every day during which the offence is committed.
Trustee Companies Management Act 1975	Destroying or altering records, or misleading Board	Two years' imprisonment or a fine of $5,000
Serious Fraud Office Act 1990	Destroying or altering records	Two years' imprisonment or a fine of $50,000

323. The comparison above indicates that the current level of fines for obstruction offences in the Commerce Act is inadequate. Consideration should be given to increasing the level of fines, possibly to bring them in line with the Securities Act 1978.

324. The most serious offences of obstruction are defined in the Crimes Act (false statement, fabricating evidence, conspiring to defeat justice).

Question for submitters

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

6.3 Prosecutions

325. Cartel offences will be indictable offences tried in the High Court, just as current civil proceedings are brought in the High Court.

326. The roles of Crown Law and investigating agencies are set out in the Crown Law Prosecution Guidelines[59]. Any person may institute a prosecution for an offence against the general criminal law. Every prosecution is commenced by way of an information laid under the provisions of the Summary Proceedings Act 1957, and the person bringing the prosecution is known as the "informant". In practice almost all prosecutions for offences against the criminal law are brought by the Police; most of the remainder are brought by regulatory agencies and the residual are private prosecutions.

327. The initial decision to prosecute lies with the Police or the Crown agency responsible for administering the legislation. The Police or agency may consult the Solicitor-General or a Crown Solicitor for advice as to whether a prosecution is well founded. The Solicitor-General or Crown Solicitor never makes the initial decision to prosecute. Their role is only to advise. In making a decision to prosecute there are two primary considerations: evidential sufficiency and the public interest. The Commerce Commission would be best placed to make the initial decision to prosecute. This would mean that there is no risk to the effectiveness of leniency agreements through the decisions of an independent prosecutor.

328. In the case of prosecutions brought by Crown agencies for offences triable only on indictment, the informant ceases to be the prosecutor from the point at which the accused is committed for trial. At that point, the prosecution becomes a "Crown" matter and only the Attorney-General, Solicitor-General or Crown Solicitor may lay an indictment. The Crown Solicitor almost invariably presents the indictment. In exercising that power, they act independently of the Police or other investigating authority, the Commission in this case, and are not subject to its instructions.

[59] www.crownlaw.govt.nz/uploads/ProsecutionGuidelines.pdf.

6.3.1 Prosecutors Panel

329. The Serious Fraud Office has a Serious Fraud Prosecutors Panel. In deciding to investigate and prosecute a suspected offender, the Director of the Serious Fraud Office acts and operates independently. When the Director has determined that a prosecution should commence, the actual prosecution is carried out by a senior barrister in private practice. This is a legislative requirement. The Solicitor-General, in consultation with the Director of the Serious Fraud Office, appoints these barristers to the Prosecution Panel. The Director determines which member of the Panel should prosecute any particular case. The Panel members are independent of the Serious Fraud Office and the intention is that they bring an objective approach and judgement to the prosecution. Indictments are laid in the name of the Solicitor-General, although the prosecution continues to be managed by the Serious Fraud Office. Serious Fraud Office prosecutions on indictment are supervised by the Crown Law Office in much the same way as those of the Crown Solicitors. In conducting a Serious Fraud Office prosecution on indictment, these Panel members are required to follow Crown Law Office protocols in their conduct of the prosecution.

Question for submitters

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

6.4 Trials

6.4.1 Jury trials

330. Trial by jury is a longstanding feature of the criminal law and is protected by section 24 of the NZBORA. There are limitations on this right. It has most recently been constrained by section 361D of the Crimes Act. This section confers on the Court the power to deny an accused their normal right to jury trial on the basis that the jurors would not be able to perform their duties effectively given the length and complexity of the trial. An order under this section can only be made for the trial of offences punishable by less than 14 years' imprisonment. The trial must be expected to last for more than 20 sitting days.

331. Competition law is difficult for the average member of the public to understand. Even judges can struggle with economic evidence – this is recognised in the Commerce Act by provision for lay members to sit with judges in more complex cases. To some extent, more technical elements of competition law are excluded from the cartel offence by making it a per se offence. Nonetheless, even relatively simple price fixing conspiracies are likely to be complex in comparison with most other crimes. It is likely that most cartel trials would meet the "complex" requirement of section 361D.

332. Civil price fixing proceedings can be quite lengthy. Criminal trials can take longer as there is no requirement for evidence to be admitted by way of written brief. For this reason, the majority of cartel trials are likely to take longer than 20 days and so will meet the "long" requirement of section 361D.

333. Given that the majority of cartel trials will be judge only by virtue of section 361D, should specific provision be made to ensure that all cartel trials will be judge only? This would require an explicit limitation on the right to a jury trial.

334. Section 24(e) of the NZBORA specifically provides that everyone charged with an offence has the right to the benefit of a trial by jury when the penalty for the offence is or includes imprisonment for more than three months. Any modification to this right would need to be considered for compliance with the NZBORA. This involves an assessment of whether the restriction can be justified in a free and democratic society.

335. The right to a jury trial is an ancient one and was seen as an important check against state power. In the more than 300 years since the Star Chamber, other social and legal developments have meant that juries do not necessarily provide more of a check against state power than judges. Jury trials are also seen as a means of introducing community norms and values into court proceedings. They provide opportunities for citizens to validate laws by applying them in specific trials. Alexis de Tocqueville claimed that jury trials educate citizens about self-government. Jury trials are also seen as possibly giving a fairer hearing to a party who is not part of the establishment than representatives of the state would.

336. Juries are criticised for delivering more inconsistent results than judges, particularly in highly emotional cases where juries may be tempted to convict on the basis of personal feelings rather than rational assessments of the evidence.

337. Turning to the specifics of cartel trials, the best data comes from the US. Throughout the federal criminal justice system, in the period 1996-2006, 83% of criminal defendants pleaded guilty, without going to trial; this included 87% of fraud defendants and 84% of cartel defendants. The differences between contested cartel trials and other criminal trials are stark. The US Department of Justice succeeded in convicting 77% of criminal defendants at trial and nearly 80% of fraud defendants. This figure dropped to 49% for cartel defendants. While the sample of cartel trials in this 10-year period is small (n=45) it is still large enough for the difference in conviction rates to be statistically significant[60].

338. There are a number of possible reasons why the conviction rate at trial is so much lower for cartels. The first is that the corporation tends to support the individual through the litigation process, as the company is exposed to significant liabilities from a guilty conviction. This gives the defendant significant resources and this undoubtedly has an effect. The second is that juries may view cartel offences as less contemptible than other crimes. “Fraud” and “embezzlement” connote greedy criminals, whereas “price fixing” or “bid rigging” does not. There can be legitimate-sounding explanations for cartel behaviour, while it is very difficult to put forward a non-criminal explanation for fraudulent behaviour. For example, competitor meetings can be justified by the need to develop industry standards. It can also be difficult for juries to understand the harm caused by cartels, as opposed to a fraud. The third reason is that the defendants are often sympathetic; they are not directly enriched by their cartel activity. They can justify their actions as an attempt to protect jobs. If the companies for which they work are seen as reputable and substantial employers, it can be difficult to secure convictions. The fourth possible reason is that the

[60] F. Joseph Warin, David P. Burns and John W.F. Chesley 2006, *To Plead or Not to Plead? Reviewing a Decade of Criminal Antitrust Trials*, www.antitrustsource.com, July.

government also relies on witnesses who have been granted amnesty, which brings issues of fair play into the minds of a jury[61].

339. There are a number of ways that defence counsel can manipulate the natural emotional responses of a jury to secure acquittals in cartel trials, even in the face of strong evidence of guilt. This factor, combined with the technical nature of offending, means that more just outcomes might be achieved if all cartel trials were conducted by judges alone.

Question for submitters

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

6.4.2 Procedures

340. There are a number of differences between civil and criminal trials. They have different rules of evidence, different rules for discovery/disclosure, interlocutory applications versus pre-trial applications and a higher standard of proof for criminal trials. There are also differing rules of procedure. Criminal trials are commenced by the laying of an information, followed by a committal process then trial. Civil proceedings begin with a Statement of Claim and a Notice of Proceedings. All of these processes have their own special rules to determine the admissibility of evidence and procedure.

341. Cartel offences will be prosecuted using all the criminal procedural rules. At this stage, there does not appear to be a strong need for hybrid procedural rules. Hybrid rules would also create significant uncertainty. Future criminal justice reforms may also streamline the criminal process.

6.5 Other criminal statutes

342. Criminalising cartel offences brings a number of other criminal statutes and agreements into play. These include: the Criminal Proceeds (Recovery) Act 2009, the Extradition Act 1999, the Mutual Assistance in Criminal Matters Act 1992 and criminal assistance treaties.

6.5.1 Criminal Proceeds (Recovery) Act 2009

343. In December 2009 the Criminal Proceeds (Recovery) Act commences. That Act introduces a civil forfeiture order regime that provides for the restraint and forfeiture of property derived as a result of a significant criminal activity without the need for a conviction. Applications for civil forfeiture orders under the Act are triggered by "significant criminal activity", which is an offence punishable by a maximum term of imprisonment of five years or more, or offending that is said to have derived benefits of $30,000 or more. Actions under the Criminal Proceeds (Recovery) Act can only be brought by the Police. There is no requirement for the Police to bring an action; it is entirely discretionary.

[61] Warin et al.

6.5.2 International cooperation

344. The Mutual Assistance in Criminal Matters Act enables the execution of search warrants in comparable jurisdictions if the offence carries a term of imprisonment of two years or more. New Zealand is also a signatory to the United Nations Convention Against Transnational Organised Crime. The cartel offence, if punishable by imprisonment of more than four years, would be covered by the Convention. The Convention enables a basis for extradition and mutual assistance in countries where there may be no bilateral treaties in existence. The Extradition Act would apply to an offence punishable by imprisonment of 12 months or more.

6.6 Penalties

6.6.1 Imprisonment

345. The OECD has looked into the question of whether there are criteria to determine the length of prison term that most cost effectively serves the goals of deterrence and increased detection.

346. Some have suggested that the optimal prison term should be relatively short, in particular because after a short time the marginal cost to society of additional prison time might exceed the gains from additional deterrence. This view is based on the assumption that even short prison sentences are viewed by business executives as extremely undesirable and costly, and that the stigma and reputational losses would exist for any non-trivial time in jail.

347. It is probably more important that the potential defendant knows with some certainty that they are likely to be sentenced to jail rather than knowing that long sentences could be imposed. This suggests that even short sentences can be an effective deterrent, provided there is a credible threat that they actually will be imposed.

348. On the other hand, there is a case for longer statutory maximum sentences. Having a longer statutory maximum sends a signal to prosecutors and courts that cartels should be considered a serious criminal violation. With a shorter statutory maximum, courts might be more inclined to let defendants off the hook and impose an alternative sentence instead.

349. Both the US and Canada have recently revised their maximum sentences, with an increase from three to 10 years in the US and a rise from five to 14 years in Canada. The UK has a maximum sentence of five years and Australia's is 10. Different sentencing practices mean that a comparison with international jurisdictions is not very helpful. More relevant is a consideration of the maximum sentences for similar or analogous offences in New Zealand:

Tax offences:	Five years
Insider trading:	Five years
Market manipulation or deception:	Five years
False statement in financial report:	Five years
Money laundering:	Seven years

Dishonestly using a document:	Seven years
Obtaining by deception:	Seven years
False statement by promoter:	Ten years

350. An indicative comparison suggests that a maximum sentence of between five and seven years is probably appropriate.

Question for submitters

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

6.6.2 Fines

351. The first part of the discussion document includes a discussion on optimal pecuniary penalties for individuals. The maximum fine and maximum pecuniary penalty for an individual should be set at the same level. This is currently $500,000, although the discussion document suggests raising it to $5 million.

352. The maximum pecuniary penalty should be no higher than the maximum fine. To enable appropriate fines to be set for bodies corporate, the maxima for fines should be the same as those for pecuniary penalties:

the greater of—

$10,000,000; or

either—

if it can be readily ascertained and if the Court is satisfied that the contravention occurred in the course of producing a commercial gain, 3 times the value of any commercial gain resulting from the contravention; or

if the commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

353. It may also be possible to specify that the criminal fine can be no lower than the civil pecuniary penalty.

Question for submitters

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

6.6.3 Other penalties

354. The Sentencing Act 2002 allows for penalties other than imprisonment and fines to be imposed in appropriate circumstances. These are home detention, community detention, intensive supervision, supervision, community work and reparation. In some situations, these penalties may be imposed in combination with each other or with a fine.

355. The difficulties in identifying the specific victim of a cartel and assessing the level of damage that they have suffered directly (or passed on to others) would make it exceedingly difficult to impose a sentence or order of reparation. For that reason, sentences of reparation should be expressly excluded for the cartel offence. The civil damages regime under section 82 of the Commerce Act is a more appropriate means for victims to obtain compensation. A criminal conviction would stand as proof of conduct in the marketplace; a damages action would focus on the degree of harm suffered by the victim and the appropriate compensation for the loss or damage.

356. The Commerce Act has provisions for the imposition of orders excluding certain people from the management of a body corporate. This discussion document also canvasses the option of enabling the Court to impose an adverse publicity order. Given the nature of cartel offending, judges should have the discretion in sentencing to impose these civil orders, as part of the sentence, as long as they are imposed in accordance with the purposes and principles of sentencing set out in the Sentencing Act.

Question for submitters

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

6.7 Interaction between civil and criminal prohibitions

357. Double jeopardy is a legal principle that prevents somebody being tried twice for a crime on the same set of facts. Something like double jeopardy would occur if somebody were tried criminally and had a proceeding against them for civil pecuniary penalties on the basis of the same cartel behaviour. Civil pecuniary penalties have a punitive element. As a general principle, it should not be possible to have proceedings for civil pecuniary penalties against somebody who has been convicted for the same actions. It should be possible to bring criminal proceedings against someone, even if proceedings have been commenced for civil pecuniary penalties for the same actions. Civil proceedings should be stayed when criminal proceedings are started, based on the same actions.

6.8 Jurisdiction

358. Section 4(1) of Commerce Act extends jurisdiction "to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand".

359. Cartels are often global in nature. The agreement to form a cartel can be made in the proverbial smoke-filled room anywhere in the world. The relevant factor for deciding on jurisdiction is where the harm or potential harm occurs. Without strong rules on jurisdiction, cartels can escape the reach of the law if parent companies that are not New Zealand resident form a cartel agreement to affect a New Zealand market.

360. The conspiracy provisions of the Crimes Act (section 310) allow for the prosecution of conspiracies formed outside New Zealand. The position of the Commerce Act on this point is unclear – we await the decision of the Supreme Court on this question[62]. Regardless of the Supreme Court decision, the jurisdictional rules applying to conspiracies should apply to a cartel offence.

Question for submitters

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

[62] *Poynter v The Commerce Commission* SC 32/2009.

Chapter 7: Appendix – definitions in common law jurisdictions

United States

Section 1 of the Sherman Antitrust Act 1890 provides that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal". The statute provides no guidance on whether a particular violation should be pursued criminally or civilly.

The Department of Justice charges on the basis of *United States v United Stated Gypsum Co*[63] that "intent is a necessary element of a criminal antitrust violation" and may not be presumed as a matter of law. "Action undertaken with knowledge of its probable consequences and having the requisite anti-competitive effects can be a sufficient predicate for a finding of criminal liability under the antitrust laws. Where carefully planned and calculated conduct is being scrutinized in the context of a criminal prosecution, the perpetrator's knowledge of the anticipated consequences is a sufficient predicate for a finding of criminal intent."

Criminal prosecutions are generally only used for cases that involve allegations of per se violations of section 1. When a per se violation is charged, the requisite criminal intent may be established by proving the defendant knowingly agreed to participate in the alleged conspiracy.

To establish a prima facie case, the Government needs to only show: (1) the existence of a per se illegal conspiracy; (2) that the defendant knowingly entered into the conspiracy; and (3) that the conspiracy affected interstate or foreign trade and commerce. Criminal prosecution is only used if the DoJ believes there has been a clear and purposeful violation, so criminal indictments are unlikely where the state of the law is unclear, there are novel issues of law or fact, there is confusion caused by prior prosecutorial action, or there is clear evidence the defendants did not appreciate the consequences of their actions[64].

[63] 438 US 422 (1978).

[64] ABA section of Antitrust Law, *Antitrust Law Developments* (6th ed. 2007) pp 733-737.

Canada

Section 45(1) of the Competition Act provides that:

(1) Every person commits an offence who, with a competitor of that person with respect to a product, conspires, agrees or arranges

(a) to fix, maintain, increase or control the price for the supply of the product;

(b) to allocate sales, territories, customers or markets for the production or supply of the product; or

(c) to fix, maintain, control, prevent, lessen or eliminate the production or supply of the product.

(2) Every person who commits an offence under subsection (1) is guilty of an indictable offence and liable on conviction to imprisonment for a term not exceeding 14 years or to a fine not exceeding $25 million, or to both.

(3) In a prosecution under subsection (1), the court may infer the existence of a conspiracy, agreement or arrangement from circumstantial evidence, with or without direct evidence of communication between or among the alleged parties to it, but, for greater certainty, the conspiracy, agreement or arrangement must be proved beyond a reasonable doubt.

(4) 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.

(5) No person shall be convicted of an offence under subsection (1) in respect of a conspiracy, agreement or arrangement that relates only to the export of products from Canada, unless the conspiracy, agreement or arrangement

(a) has resulted in or is likely to result in a reduction or limitation of the real value of exports of a product;

(b) has restricted or is likely to restrict any person from entering into or expanding the business of exporting products from Canada; or

(c) is in respect only of the supply of services that facilitate the export of products from Canada.

(6) Subsection (1) does not apply if the conspiracy, agreement or arrangement

(a) is entered into only by companies each of which is, in respect of every one of the others, an affiliate; or

(b) is between federal financial institutions and is described in subsection 49(1).

United Kingdom

Section 188 of the Enterprise Act 2002 sets out the cartel offence:

(1) An individual is guilty of an offence if he dishonestly agrees with one or more other persons to make or implement, or to cause to be made or implemented, arrangements of the following kind relating to at least two undertakings (A and B).

(2) The arrangements must be ones which, if operating as the parties to the agreement intend, would—

(a) directly or indirectly fix a price for the supply by A in the United Kingdom (otherwise than to B) of a product or service,

(b) limit or prevent supply by A in the United Kingdom of a product or service,

(c) limit or prevent production by A in the United Kingdom of a product,

(d) divide between A and B the supply in the United Kingdom of a product or service to a customer or customers,

(e) divide between A and B customers for the supply in the United Kingdom of a product or service, or

(f) be bid-rigging arrangements.

(3) Unless subsection (2)(d), (e) or (f) applies, the arrangements must also be ones which, if operating as the parties to the agreement intend, would—

(a) directly or indirectly fix a price for the supply by B in the United Kingdom (otherwise than to A) of a product or service,

(b) limit or prevent supply by B in the United Kingdom of a product or service, or

(c) limit or prevent production by B in the United Kingdom of a product.

(4) In subsections (2)(a) to (d) and (3), references to supply or production are to supply or production in the appropriate circumstances (for which see section 189).

(5) "Bid-rigging arrangements" are arrangements under which, in response to a request for bids for the supply of a product or service in the United Kingdom, or for the production of a product in the United Kingdom—

(a) A but not B may make a bid, or

(b) A and B may each make a bid but, in one case or both, only a bid arrived at in accordance with the arrangements.

(6) But arrangements are not bid-rigging arrangements if, under them, the person requesting bids would be informed of them at or before the time when a bid is made.

(7) "Undertaking" has the same meaning as in Part 1 of the 1998 Act.

Section 189 Cartel offence: supplementary

(1) For section 188(2)(a), the appropriate circumstances are that A's supply of the product or service would be at a level in the supply chain at which the product or service would at the same time be supplied by B in the United Kingdom.

(2) For section 188(2)(b), the appropriate circumstances are that A's supply of the product or service would be at a level in the supply chain—

(a) at which the product or service would at the same time be supplied by B in the United Kingdom, or

(b) at which supply by B in the United Kingdom of the product or service would be limited or prevented by the arrangements.

(3) For section 188(2)(c), the appropriate circumstances are that A's production of the product would be at a level in the production chain—

(a) at which the product would at the same time be produced by B in the United Kingdom, or

(b) at which production by B in the United Kingdom of the product would be limited or prevented by the arrangements.

(4) For section 188(2)(d), the appropriate circumstances are that A's supply of the product or service would be at the same level in the supply chain as B's.

(5) For section 188(3)(a), the appropriate circumstances are that B's supply of the product or service would be at a level in the supply chain at which the product or service would at the same time be supplied by A in the United Kingdom.

(6) For section 188(3)(b), the appropriate circumstances are that B's supply of the product or service would be at a level in the supply chain—

(a) at which the product or service would at the same time be supplied by A in the United Kingdom, or

(b) at which supply by A in the United Kingdom of the product or service would be limited or prevented by the arrangements.

(7) For section 188(3)(c), the appropriate circumstances are that B's production of the product would be at a level in the production chain—

(a) at which the product would at the same time be produced by A in the United Kingdom, or

(b) at which production by A in the United Kingdom of the product would be limited or prevented by the arrangements.

Australia

Section 44ZZRF of the Trade Practices Act 1974:

(1) A corporation commits an offence if:

(a) the corporation makes a contract or arrangement, or arrives at an understanding; and

(b) the contract, arrangement or understanding contains a cartel provision.

(2) The fault element for paragraph 1(b) is knowledge or belief.

Section 44ZZRG:

(1) A corporation commits an offence if:

(a) a contract, arrangement or understanding contains a cartel provision; and

(b) the corporation gives effect to the cartel provision.

(2) The fault element for paragraph 1(a) is knowledge or belief.

(3) Paragraph (1)(a) applies to contracts or arrangements made, or understandings arrived at, before, at or after the commencement of this section.

44ZZRD defines a cartel provision

(1) For the purposes of this Act, a provision of a contract, arrangement or understanding is a ***cartel provision*** if:

(a) either of the following conditions is satisfied in relation to the provision:

(i) the purpose/effect condition set out in subsection (2);

(ii) the purpose condition set out in subsection (3); and

(b) the competition condition set out in subsection (4) is satisfied in relation to the provision.

Purpose/effect condition

(2) The purpose/effect condition is satisfied if the provision has the purpose, or has or is likely to have the effect, of directly or indirectly:

(a) fixing, controlling or maintaining; or

(b) providing for the fixing, controlling or maintaining of;
the price for, or a discount, allowance, rebate or credit in relation to:

(c) goods or services supplied, or likely to be supplied, by any or all of the parties to the contract, arrangement or understanding; or

(d) goods or services acquired, or likely to be acquired, by any or all of the parties to the contract, arrangement or understanding; or

(e) goods or services re-supplied, or likely to be re-supplied, by persons or classes of persons to whom those goods or services were supplied by any or all of the parties to the contract, arrangement or understanding; or

(f) goods or services likely to be re-supplied by persons or classes of persons to whom those goods or services are likely to be supplied by any or all of the parties to the contract, arrangement or understanding.

Purpose condition

(3) The purpose condition is satisfied if the provision has the purpose of directly or indirectly:

(a) preventing, restricting or limiting:

(i) the production, or likely production, of goods by any or all of the parties to the contract, arrangement or understanding; or

(ii) the capacity, or likely capacity, of any or all of the parties to the contract, arrangement or understanding to supply services; or

(iii) the supply, or likely supply, of goods or services to persons or classes of persons by any or all of the parties to the contract, arrangement or understanding; or

(b) allocating between any or all of the parties to the contract, arrangement or understanding:

(i) the persons or classes of persons who have acquired, or who are likely to acquire, goods or services from any or all of the parties to the contract, arrangement or understanding; or

(ii) the persons or classes of persons who have supplied, or who are likely to supply, goods or services to any or all of the parties to the contract, arrangement or understanding; or

(iii) the geographical areas in which goods or services are supplied, or likely to be supplied, by any or all of the parties to the contract, arrangement or understanding; or

(iv) the geographical areas in which goods or services are acquired, or likely to be acquired, by any or all of the parties to the contract, arrangement or understanding; or

(c) ensuring that in the event of a request for bids in relation to the supply or acquisition of goods or services:

(i) one or more parties to the contract, arrangement or understanding bid, but one or more other parties do not; or

(ii) 2 or more parties to the contract, arrangement or understanding bid, but at least 2 of them do so on the basis that one of those bids is more likely to be successful than the others; or

(iii) 2 or more parties to the contract, arrangement or understanding bid, but not all of those parties proceed with their bids until the suspension or finalisation of the request for bids process; or

(iv) 2 or more parties to the contract, arrangement or understanding bid and proceed with their bids, but at least 2 of them proceed with their bids on the basis that one of those bids is more likely to be successful than the others; or

(v) 2 or more parties to the contract, arrangement or understanding bid, but a material component of at least one of those bids is worked out in accordance with the contract, arrangement or understanding.

Competition condition

(4) The competition condition is satisfied if at least 2 of the parties to the contract, arrangement or understanding:

(a) are or are likely to be; or

(b) but for any contract, arrangement or understanding, would be or would be likely to be; in competition with each other in relation to:

(c) if paragraph (2)(c) or (3)(b) applies in relation to a supply, or likely supply, of goods or services—the supply of those goods or services; or

(d) if paragraph (2)(d) or (3)(b) applies in relation to an acquisition, or likely acquisition, of goods or services—the acquisition of those goods or services; or

(e) if paragraph (2)(e) or (f) applies in relation to a re-supply, or likely re-supply, of goods or services—the supply of those goods or services to that re-supplier; or

(f) if subparagraph (3)(a)(i) applies in relation to preventing, restricting or limiting the production, or likely production, of goods—the production of those goods; or

(g) if subparagraph (3)(a)(ii) applies in relation to preventing, restricting or limiting the capacity, or likely capacity, to supply services—the supply of those services; or

(h) if subparagraph (3)(a)(iii) applies in relation to preventing, restricting or limiting the supply, or likely supply, of goods or services—the supply of those goods or services; or

(i) if paragraph (3)(c) applies in relation to a supply of goods or services—the supply of those goods or services; or

(j) if paragraph (3)(c) applies in relation to an acquisition of goods or services—the acquisition of those goods or services.

Immaterial whether identities of persons can be ascertained

(5) It is immaterial whether the identities of the persons referred to in paragraph (2)(e) or (f) or subparagraph (3)(a)(iii), (b)(i) or (ii) can be ascertained.

Recommending prices etc.

(6) For the purposes of this Division, a provision of a contract, arrangement or understanding is not taken:

(a) to have the purpose mentioned in subsection (2); or

(b) to have, or be likely to have, the effect mentioned in subsection (2);

by reason only that it recommends, or provides for the recommending of, a price, discount, allowance, rebate or credit.

Immaterial whether particular circumstances or particular conditions

(7) It is immaterial whether:

(a) for the purposes of subsection (2), subparagraph (3)(a)(iii) and paragraphs (3)(b) and (c)—a supply or acquisition happens, or a likely supply or likely acquisition is to happen, in particular circumstances or on particular conditions; and

(b) for the purposes of subparagraph (3)(a)(i)—the production happens, or the likely production is to happen, in particular circumstances or on particular conditions; and

(c) for the purposes of subparagraph (3)(a)(ii)—the capacity exists, or the likely capacity is to exist, in particular circumstances or on particular conditions.

Considering related provisions—purpose/effect condition

(8) For the purposes of this Division, a provision of a contract, arrangement or understanding is taken to have the purpose, or to have or be likely to have the effect, mentioned in subsection (2) if the provision, when considered together with any or all of the following provisions:

(a) the other provisions of the contract, arrangement or understanding;

(b) the provisions of another contract, arrangement or understanding, if the parties to that other contract, arrangement or understanding consist of or include at least one of the parties to the first-mentioned contract, arrangement or understanding; has that purpose, or has or is likely to have that effect.

Considering related provisions—purpose condition

(9) For the purposes of this Division, a provision of a contract, arrangement or understanding is taken to have the purpose mentioned in a paragraph of subsection (3) if the provision, when considered together with any or all of the following provisions:

(a) the other provisions of the contract, arrangement or understanding;

(b) the provisions of another contract, arrangement or understanding, if the parties to that other contract, arrangement or understanding consist of or include at least one of the parties to the first-mentioned contract, arrangement or understanding; has that purpose.

Purpose/effect of a provision

(10) For the purposes of this Division, a provision of a contract, arrangement or understanding is not to be taken not to have the purpose, or not to have or to be likely to have the effect, mentioned in subsection (2) by reason only of:

(a) the form of the provision; or

(b) the form of the contract, arrangement or understanding; or

(c) any description given to the provision, or to the contract, arrangement or understanding, by the parties.

Purpose of a provision

(11) For the purposes of this Division, a provision of a contract, arrangement or understanding is not to be taken not to have the purpose mentioned in a paragraph of subsection (3) by reason only of:

(a) the form of the provision; or

(b) the form of the contract, arrangement or understanding; or

(c) any description given to the provision, or to the contract, arrangement or understanding, by the parties.