

PRICE FIXERS DOING TIME? NEW ZEALAND SET TO JOIN THE TREND OF CRIMINALISING CARTEL BEHAVIOUR

March 2010

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New Zealand is revisiting the debate of whether to criminalise hard core cartel behaviour. In some ways, this is not at all surprising – the pressure to consider criminalisation for price fixing, bid rigging and other cartel conduct has intensified since Australia introduced potential criminal sentences last year. It also partly reflects an international regulatory trend to pursue individual directors and managers, not just corporations.

A change could have significant impact on the effectiveness of the Commerce Commission's role in tackling cartels, and on the cost to business of this legislation. That cost includes the cost of responding to an investigation, and to overall economic welfare in possibly losing some legitimate business enterprise.

The question remains: has there been adequate analysis of the justifications for criminalisation in the New Zealand context, and of the procedural and practical implications?

Civil penalties - a policy about-turn?

The discussion paper issued by the Ministry of Economic Development on "Cartel Criminalisation" gives the impression that it is highly likely that cartel conduct will be made a criminal offence in 2010 or 2011.

Currently, cartels are illegal and punishable by potentially large 'pecuniary penalties' which, while not technically criminal fines, at least have 'quasi-criminal elements' and significant reputational issues attached.

It might seem that the paper moves swiftly to consider details of 'how we might criminalise', without detailed analysis of the assumption that current penalties are inadequate or sub-optimal and that criminalisation will achieve the stated policy aims. That analysis is crucial if the goal is more than simply to follow international trends.

It also seems to have been largely forgotten that, despite a Ministry of Commerce consultation process some ten years ago suggesting that there may be a case for criminal penalties, the 2001 amendments to the Commerce Act did not introduce criminal penalties. Instead, Parliament chose to lift the maximum civil penalties. The amendment also sought to deter individuals from engaging in cartel conduct by:

- directing imposition of pecuniary penalty against an offending individual, unless there is good reason not to;
- forbidding companies from indemnifying directors, employees or agents for breach of the price fixing provisions; and
- providing for management bans for up to 5 years.

Since 2001, the highest penalty for price fixing has been \$2.85 million, against Koppers Arch in the wood treatment chemicals market and the highest individual penalty has been \$65,000 in the same proceedings. Both were well short of the maximum penalty, which is for corporations, the greater of NZ\$10 million, or 3 times the relevant commercial gain, or 10% of turnover (potentially, group turnover), and for individuals \$500,000.

If criminality was not considered necessary back in 2001, what has changed in

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New Zealand in less than a decade? It seems the main changes are offshore:

- Some of our key trading partners have criminalised in recent years, including Australia, the UK, Ireland, Japan and Korea. They join the long-standing criminal jurisdictions of the US and Canada. The OECD advocates criminalisation as 'best practice' because imprisonment and loss of liberty are seen as a far greater deterrent than financial penalties and reputational damage. The MED raises concerns that New Zealand could be seen as a 'soft touch' if we do not follow suit.
- Australia's criminalisation of cartels has elevated this topic into one of business law harmonisation, as part of the commitments made to push towards a Single Economic Market between the Tasman neighbours.

These changes appear to be the real impetus for the law reform, rather than any demonstrable inadequacies in the current levels of detection and deterrence in New Zealand.

Acknowledgment of more complex issues

If cartels are to be criminalised, a number of complex issues affecting the goal (enhanced deterrence) will need to be considered, and the Commission's enforcement role could become harder to fulfil.

One of the most significant issues will be how proceedings will be brought against members of overseas cartels that affect New Zealand. Service of a criminal summons overseas is a complex issue; while it has recently been considered by our courts in a cartel case, that was in the limited context of trans-Tasman service of (non-criminal) documents. Also, even the United States has only recently obtained extradition orders for the first time, for an alleged member of a cartel resident in the UK. Overseas enforcement will need to be carefully considered, otherwise there is a risk that criminalisation practically will only impact on local (or possibly Australian) members of a cartel, who may not be the key instigators. If so, will the identified objective of deterrence be met?

A second significant issue is that the threat of imprisonment will only be a stronger deterrent than the current regime if it is a credible threat. Criminal proceedings will require a higher standard of proof and raise new issues under the New Zealand Bill of Rights Act. If it ends up being too hard to secure criminal convictions, the threat of them will not prove to be a real deterrent. Consideration will also need to be given to how proceedings against individuals seeking imprisonment will be coordinated with other proceedings, especially if dual civil and criminal regimes are put in place.

In a small economy such as New Zealand's these issues need to be carefully analysed at a policy level rather than just when considering what specific wording to use in the Act.

Risk of over-reaching into legitimate business endeavours

Another very important consideration is the balance between deterrence of illegal behaviour and over-reaching laws that deter ordinary commercial and entrepreneurial behaviour.

Few people contest that hard core cartels are detrimental to efficient market functions and should be deterred and punished. International experience shows that the main problem with deterrence using fear of punishment, particularly jail sanctions, is the difficulty in defining offences in a way that

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does not over-reach and lead to positive economic activity being curtailed. That can easily happen if managers are uncertain about the boundaries of the law and are nervous of potential criminal repercussions.

A subsidiary problem is that, in recent years, the Commerce Commission has labelled some investigations as 'price fixing' or 'cartel behaviour' when the conduct could be viewed as ordinary joint venture behaviour or industry solutions that are sensible and economic-efficiency enhancing. Examples include:

- Joint bids for government services contracts where the collaboration between suppliers is transparent and disclosed to the buyer.
- Restraints that are ancillary to a legitimate unincorporated joint venture, but which struggle to fit clearly within the narrow exemption offered by section 31 of the Commerce Act.

Some of these incidents rely on an aggressive interpretation of the current price fixing provisions, and lack the essential element of covert behaviour or secretive intent. It is hard to say this type of borderline conduct should be categorised as 'theft' or 'fraud upon the consumer'.

The MED acknowledges that the exemptions and defences in the Act will need to be revised and clarified if the conduct is criminalised. In our view, if criminalisation does proceed, it will be critical that the exemptions and defences be improved so businesses know, as far as possible, exactly where they stand when considering what could well be legitimate joint conduct and when developing compliance programs for employees.

Policy framework options put forward by the MED

A substantial portion of the paper is devoted to discussion of three main options for how a criminal provision would be framed. However, each of these raise distinct issues:

- Using the existing Commerce Act provisions and turning them into criminal provisions. One problem is that the current law is far from clear about where the exact boundaries lie, and too much commercial activity could be caught.
- Adopt wholesale the Australian legislative provisions – but while this takes 'harmonisation' to its logical endpoint, there is no promise the Australian law is ideal, particularly with our different economic conditions, and it has yet to be tested by any prosecution being taken.
- Drafting a new criminal greenfields provision for New Zealand. This is a more difficult path, but may produce the best policy setting for our small, remote and trade-dependent economy.

MED consultation - submissions to be made by 31 March 2010

The lengthy Government discussion papers are available here:
<http://www.med.govt.nz/upload/70683/Cartel-Criminalisation.pdf>
http://www.med.govt.nz/templates/ContentTopicSummary_42449.aspx

This law reform would be a significant step-change in New Zealand's competition law. It could have wide ranging consequences for Commission investigations and for those who are the subject of Commission scrutiny. It is important that businesses and industry associations participate in the discussion. Public submissions can be made until 31 March 2010. Wilson Harle is currently taking part in informal workshops with the MED on the issues arising, and we would be happy to discuss any relevant points.

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